

# Being Tax Savvy



Many Australians delay taking control of their finances because they don't have the time, they find it too daunting or they may just not know where to start. The reality is though the sooner you take charge the sooner you can start working towards achieving better results, especially in the long term.

To assist you in this process CPA Australia has developed *30 Ways to Build Your Wealth* - a series of five fact sheets to get you on the path to good money management. This fact sheet provides helpful tips on being tax savvy. The other fact sheets cover creating good money habits; spending money to make money; becoming financially literate; and maximising your entitlements - all of which can be downloaded at [www.cpaaustralia.com.au/links?30wayskit](http://www.cpaaustralia.com.au/links?30wayskit)

While the information highlights some factors to consider and how these may impact your finances, it does not replace the need for ongoing financial planning advice that is tailored to your specific needs.

## 1. Salary sacrifice

*Salary sacrificing provides an opportunity for employees to pay for expenses from pre-tax dollars. For most employees, the opportunities are quite limited. However for some (such as nurses) there can be wider scope to salary sacrifice.*

The main benefit of salary sacrificing is that rather than an employee paying their expenses from their take home or post-tax salary and wages, they may be able to have some of these expenses paid from their pre-tax salary by their employer. This effectively reduces the employees assessable income and therefore the amount of income tax payable.

However, there are very few expenses that normal employees can salary sacrifice with real benefits as most incur fringe benefits tax (FBT). This tax is paid by the employer, but is then passed on to the employee, effectively negating the tax benefit that would otherwise have been gained. The most common item that does not incur FBT, and is therefore beneficial to package is a superannuation contribution, but cars and laptop computers can also be packaged with some benefits.

Additional exemptions to fringe benefits are available to certain employees. There are many more salary sacrifice opportunities if you work for state hospitals and other attached medical facilities, charities, public and benevolent institutions or are an employee of a rebatable employer.

When considering salary packaging you need to ensure that you actually need the benefit you are packaging so that you are left with enough money to fund your lifestyle and that there is an overall benefit to you. There are also other considerations, such as the implications if you are receiving social security entitlements, or any lump sum payments you might have to make (e.g. on a novated lease), if you terminate your employment.

You should seek professional advice if considering this strategy. You will also need to check with your employer as to what you can do and the extent that you can package as each employer has its own policies.

## 2. Getting rid of non tax-deductible debt / clearing debt

*Debt is a necessary part of life – and not all debt is necessarily bad, particularly if the debt is used to buy an asset that appreciates in value.*

Most people carry some level of debt during their working life, be it home loans, car loans or credit card debt. Repaying the debt can take up a large portion of people's disposable income, so managing debt becomes a critical component of managing your personal finances. However debt can also be used in your favour.

Firstly, very few people would be able to afford to purchase a home without taking out some form of loan. Home mortgage debt accounts for the largest proportion of household debt in Australia, but most people are comfortable with this as they believe the value of the home will increase over time.

On the other hand, more Australians have taken advantage of readily available credit to take one or more credit cards. This is far more dangerous debt as the interest payable is often two or more times higher than for home mortgage debt and the purchases are usually consumable items – not assets which have the potential to increase in value.

However, just as people use debt to finance the purchase of the home, people can also borrow to invest in a range of assets such as investment property or shares. The advantage of borrowing to invest is that if the return on the asset exceeds the cost of borrowing then you can grow wealth more quickly. The interest payable on investment loans is also normally tax-deductible.

So first get rid of the consumer debt. This includes credit cards, store cards and car loans. Next, focus on clearing your non tax-deductible home loan debt and then if necessary, clear the debt on your investment portfolio.

### 3. Buy insurance via superannuation

*Provided you are able to meet any estate planning needs, there can be real savings to buying insurance through your superannuation as the premiums are paid from your contributions, which have normally been taxed at a lower rate than if they had been paid from salary and wages.*

Insurance, be it life insurance, total and permanent disability (TPD) or even income protection can often be purchased through your superannuation fund. And under the new choice rules for super, your employer's chosen super fund has to offer a minimum level of cover. There are estate planning needs that should be taken into account first, as you have less control over where your funds go if your insurance is part of a superannuation policy so there are implications for your Reasonable Benefit Limit (RBL) and possible tax liabilities for the recipients. You should determine all these aspects before pursuing this cost-effective insurance strategy. A financial adviser can help you evaluate whether buying insurance via superannuation will meet your needs.

However, if it is appropriate for you to have insurance through a superannuation fund, there can be significant savings in premiums as a result. Insurance premiums are also tax deductible to super funds and some super policies offer group life policies which may result in a better rate for the insurance cover. However, even if the premium is exactly the same, the fact that it is paid from superannuation contributions (which have been taxed at 15 per cent), compared with after-tax salary and wages (which may have been taxed at up to 48.5 per cent), can result in significant savings.

### 4. Superannuation splitting

*One of the tax breaks offered to superannuation is that you normally get a portion of your contributions back tax free when you retire. New rules from 2006 double the potential benefits to families. The new rules mean that contributions can be directed to ensure both spouses are able to take advantage of this tax-free threshold for lump sum payments.*

The new rules mean that, at the end of each financial year, you can choose to split the contributions that have been made into your super during the year and transfer that portion into your spouse's super. This includes the superannuation guarantee your employer puts in and any contributions you make with salary sacrifice or with after-tax savings. As a result, you can grow super benefits for both of you so that both of you can maximise the tax concessions when some/all of the benefits are drawn out as lump sums. It also ensures that each partner can have super benefits under their own control.

There are further tax breaks in super up to limits called the Reasonable Benefit Limit (RBL). If super is in two accounts, you will effectively have super that can be measured against both spouses' RBLs instead of just one spouse's and each will be able to decide how they want to take their own benefits.

#### Legal Notice

Copyright CPA Australia 2006. All rights reserved. Without limiting the rights under copyright reserved herein, no part of these materials may be reproduced or utilised in any form or by any means, electronic or mechanical, including photocopying, recording or by information storage or retrieval system, without prior written permission from CPA Australia.

CPA Australia has used reasonable care and skill in compiling the content of this material. However, CPA Australia makes no warranty as to the accuracy or completeness of any information herein. This material is intended to be a guide only and no part is intended to be advice, whether legal or professional. You should not act solely on the basis of the information contained in this material as parts may be generalised and may apply differently to different people and circumstances. Further, as laws change frequently, all users are advised to undertake their own research or to seek professional advice to keep abreast of any reforms or development in the law.

To the extent permitted by applicable law, CPA Australia, its employees and agents, exclude all liability for any loss or damage claims and expenses including but not limited to legal costs, indirect, special or consequential loss or damage (including but not limited to, negligence) arising out of the information in this material. Where any law prohibits the exclusion of such liability, CPA Australia limits its liability to the resupply of the information.

### 5. Contribute to super

*Contributing to super is one of the most tax-effective ways to save for your future.*

When you contribute to super, the earnings are taxed up to a maximum rate of only 15 per cent and the tax on capital gains is at a maximum of 10 per cent. In comparison, the earnings of investments outside super are taxed at the investor's marginal tax rate, which could be as high as 48.5 per cent (including the Medicare levy).

If you're looking to save from your after-tax income, an investment in super will grow more quickly than the same investment outside super due to the lower tax, plus there's no extra tax paid on the benefit when you retire.

If you're able to contribute to your super from your pre-tax salary, sometimes called salary sacrifice, there may even be greater tax savings as you are no longer paying income tax on that part of your salary. Your super contribution will be taxed at 15 per cent but then the 15 per cent tax on the earnings may still be considerably less than the tax on other investments.

The only drawback is that your super is locked away until retirement but if you've got the money to put away, super is a very efficient way to save.

### 6. Using the correct tax and investment structure

*Ensuring you have the correct tax and investment structures can make a difference to your bottom line, as long as your choice of structure is made for the right reasons.*

Choosing the correct tax and investment structure is always an important decision, however it is more commonly an issue for small-business owners and the self employed, especially when setting up a business, rather than for the average family.

There are many things that must be considered when deciding what is the best tax and investment structure in your situation. While reducing your tax is always a factor, it can never be the sole reason for entering into a transaction due to the anti-avoidance tax provisions which prohibit transactions/schemes being made solely on the basis of tax.

It is important to note that if you establish multiple structures that there may be implications for your affairs. Seeking the advice of a professional financial adviser is recommended to ensure you make a well-informed decision.

**To locate a CPA Financial Planning Specialist who can assist you with your financial planning needs, visit <http://www.cpaaustralia.com.au/links?findafp>**

*Note: Information is current as at 1 May 2006.*