2022 TAX PLANNING GUIDE

Strategies to minimise tax

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A NOTE FROM OUR DIRECTOR

At Day One Advisory we believe that proper tax planning is essential for all businesses. After all, who wants to pay more tax than they need to!

Tax planning is about more than reducing your tax bill though. It's a time to reflect on the performance of the business and to plan the next stages of growth.

We're glad that you're interested in tax planning and we hope that this guide is useful and gives you some great insights.

Day One Advisory is an accounting and advisory firm for small businesses. Our goal is to help business owners achieve the outcomes that are important to them by providing expert advice and exceptional support.

We pride ourselves on the relationships we build and the way we care about our clients.

If there is anything you need, please don't hesitate to reach out.

Matt Byrne

Director of Day One Advisory

INTRODUCTION

What is tax planning

Tax planning is the process of forecasting your tax liabilities and implementing strategies to minimise tax. Tax planning involves:

- Forecasting the accounting profit or loss for the business for the financial year.
- Estimating tax adjustments.
- Implementing strategies to minimise tax liabilities and planning for how the income for the year will be taxed.
- Estimating the tax liabilities and outlining the due dates for lodgements and payments.

Beyond that, tax planning is also a fantastic time of the year to take a step back from the detailed operational side of the business and review your financial performance and future plans. It's also a perfect time for you to consider your personal financial goals and make sure you're on track to achieve them.

Why is tax planning important

Tax is a cost for all businesses and is often a significant portion of turnover. Despite that, it's often not given the same amount of consideration as other major costs such as rent or wages.

Without proper planning it's easy to fall behind on your obligations and build up a debt with the ATO.

Accurately forecasting your tax liabilities will give you the opportunity to factor the cost into your cash flow.

At Day One Advisory, we complete tax planning in April/May each year for tax liabilities that are due in May or June of the following year so that gives our clients 12 months to plan and budget. As a result, we're very happy to say that the vast majority of our clients don't have tax debts and most have the savings available to pay their bills before they fall due.

As you'll see below, most strategies that are available to minimise your tax liability are time sensitive. Without proper tax planning, you could miss out on significant tax savings.

How a tax planning process should work

There are a few key steps to get the most out of the tax planning process:

- The first step is gathering the relevant information from you, the business owner. You're the closest to the operations of the business and tax planning can't be completed without your input.
- That information is used to review the most appropriate strategy for your business, estimate the tax liabilities and prepare the tax plan.
- Once the tax plan is completed, you should receive a copy with a detailed commentary. We send a video commentary with each tax planning report to help our clients interpret the report.
- After you've had some time to process, it's then time to have a meeting with your advisor to discuss any questions.
- Following the meeting, any action items should be clearly outlined so they can be actioned by the relevant date.

An introduction to tax deductions

Before we get stuck into the details of the tax planning strategies below, we wanted to firstly note that a lot of these are aimed at reducing your taxable income by creating additional tax deductions.

A tax deduction reduces the taxable income that you pay tax on rather than being a tax credit or offset.

To explain that with an example, let's assume your business has a taxable income of $100k before any of the below strategies are implemented. If you didn't make any changes, the tax on that $100k would be $25k assuming your small business is operated through a company.

If, as a result of undertaking tax planning you identified additional tax deductions of $50k, your taxable income would be reduced to $50k (the original $100k less $50k of additional deductions) which, assuming the same 25% tax rate, would result in tax payable of $12.5k.

As you can see from this example, the additional tax deduction of $50k has resulted in a $12.5k tax saving in that year and not $50k.

OUR TOP STRATEGIES TO MINIMISE YOUR TAX LIABILITY

Bring forward expenses

A simple way to reduce your tax liability is to bring forward expenses into the current financial year. If you have an expense that is due in July or August, bringing this forward into the current financial year can give you a timing benefit.

When we refer to bringing forward expenses, we're talking about expenses that you would ordinarily be incurring anyway. A trap that business owners often fall into is going out and spending money just to get a tax deduction. While it sounds counterintuitive, it could be cheaper to pay the tax.

Let's take an example to illustrate that point so you don't think we're crazy. Let's assume you've got taxable income of $100k for this financial year and to reduce this you decide to spend $10k on a new asset that the business doesn't need.

While this $10k asset may result in a reduction in your tax liability of $2.5k, you're still out of pocket $7.5k ($10k cost less $2.5k tax saving). If you hadn't bought the asset you would pay the $2.5k tax. In this example, the asset cost you $7.5k while the tax would have cost $2.5k so it would have been cheaper to pay the tax.

The point we're making here is, don't spend money just for a tax deduction. There has to be a commercial reason for you to do this otherwise, it might be better in the long run to just pay the tax.

Contribute additional super

You may be able to make additional voluntary contributions into your super fund and claim a tax deduction. Super contributions are taxed at 15% so if your personal tax rate is above that, there is a tax saving to be had. For example, let's assume your tax rate is 30% and you contribute $10,000 to your super fund. You will receive a deduction for $10,000 which is a tax saving of $3,000 for you.

Your super fund will receive the $10,000 and pay $1,500 tax so the overall saving is $1,500 in this example.

The total super contributions you can claim a deduction for each year is $27,500 which includes any contributions made by an employer. As such, it's important to review all super contributions made during the year to avoid going over that cap. There is some paperwork required and a few other considerations that are beyond the scope of this paper so it's important to seek appropriate advice before making a contribution.

Pay super for employees

By paying your employees' June quarter super before 30 June (ordinarily due 28 July) you can bring forward the tax deduction into this financial year. However, it's important to keep in mind that super is only deductible when it's received by your employees' super funds so you need to leave plenty of time for the payment to be processed.

The major super clearing houses usually publish a final cut-off date that is around the middle of June so keep an eye out for that date and if you want to bring forward the deduction.

Keep a logbook

Most businesses we work with own a car that is used by the business owner for private purposes at least some of the time. Where there is private use, the business is providing a fringe benefit and may be liable for an additional tax called Fringe Benefits Tax (FBT).

To avoid costly FBT, most small business owners will reimburse the business for the private portion by making a 'contribution' to the business. This contribution is often a paper transaction only and it's likely that your accountant has been processing this in the background.

The contribution is treated as income of the business and therefore increases the business's taxable income for the year.

If you don't keep a logbook, the contribution amount is calculated as broadly 20% of the purchase price of the car. If you've bought a car for $50k, that's extra income for the business each year of $10k.

However, if you use your car a lot for work, you could reduce the contribution down to the actual private portion thereby reducing your taxable income for the year.

At the very least having a logbook lets you choose between the logbook method or the 20% to get the best outcome.

Consider your business structure

The structure you operate your business from is a choice that is often made and implemented when you first start out in business. Fast forward to today and your business could be in a completely different position than what it was on day one. The structure you operate your business from should evolve and adapt just like your business.

Tax planning is a perfect time to review your structure and consider if it is still appropriate for your business, the income you earn and your personal financial and family situation. For example, trusts are widely used for family businesses but if your business is making significant profits or you're thinking about bringing on some outside investment, a company may be a more appropriate structure to operate the business through.

If you do change your structure, it's vital to consider the tax implications of this as a change in structure would constitute a sale for tax purposes resulting in a taxable gain. There are options to manage this but they can be complicated so you should seek advice.

Immediate write off of assets

The ability to write off the cost of a new asset has been a feature for a number of years now so this shouldn't be anything new to those that have been in business for a while.

Currently, you can claim a deduction for the cost of depreciating assets that are ready and available for use before 30 June. This isn't a tax credit but rather the bringing forward of a deduction that would ordinarily be available over a number of years.

To illustrate the benefit, let's take an example. Assume your business has a taxable profit of $100k before the accelerated depreciation deductions. If you traded through a company you would pay $25k tax on that profit.

However, let's also assume you bought an asset before 30 June that cost $50k. You'd get a deduction under the accelerated depreciation rules of $50k reducing the profit to $50k. The tax payable on that $50k profit would be $12.5k so the deduction for the purchase of the asset saved $12.5k in tax for the year.

The current rules are scheduled to finish at the end of the 2023 financial year so will still be available until next year.

Write off bad debts

Business owners are generally very aware of who owes them money and how long it's been outstanding for. Despite that, you may be carrying invoices where the prospect of payment is unlikely and so it might be time to write that invoice off as a bad debt. After all, you don't want to be paying tax on income you're never going to receive.

Small business CGT concessions

If you're a small business for tax purposes you can get access to some very generous tax concessions when you sell your business. In some cases, these concessions can reduce the gain you make to nil.

While the concessions are aimed at small businesses, they are horribly complicated and it can take years of planning to be eligible. Even if a sale isn't in your 5-year plan, it's important to keep these concessions in the back of your mind otherwise you might not look at this until it's too late.

Review your trust distribution strategy

Most small businesses we work with include a discretionary trust in their structure in one way or another. That could be the operating entity, the shareholder in the trading company or an investment entity. Discretionary trusts are a great option that provides flexibility for small business owners to tax the income they make in a way that works for them while still sticking to the rules.

Because of that flexibility, the controllers of the trust need to make some decisions each year about who the income of the trust will be distributed to. This distribution strategy is a key part of any tax planning as it directly impacts the amount of tax that will be paid.

The key point for business owners to know is that if the decision regarding distributions isn't made, the undistributed income could be taxed at 47% which may be a costly mistake. As a result, it's vital that you have executed a distribution minute before 30 June and keep that on file.

Loss carry back for companies

The loss carry back rules apply to companies for a limited time. This allows companies that have a loss in the current year to 'carry it back' to a previous year when they were profitable and get a refund of the tax they paid in that previous year (subject to satisfying the rules of course).

These rules may be useful where you've claimed a large deduction for some equipment purchased before 30 June that has put you into a loss position.

The loss carry back rules provide a more immediate cash benefit than carrying forward the loss to a future year so this strategy is worthy of your consideration if you operate a company and have a loss this year.

Tax consolidation for groups

This strategy only applies to those that have multiple companies in their group that are under common ownership. If that's you then read on because this can be a very helpful strategy.

It is common for each entity in the group to have a different tax position each year and in some instances you could have one company with a profit and another with a loss. Rather than pay tax in one company while the other has to carry forward a loss, you could consolidate the companies for tax purposes and offset the losses against the profit.

When a group is consolidated for tax purposes it is treated as a single entity and so all the group income and expenses are combined when calculating the taxable income for the year.

Tax consolidation is a complex process so best to seek appropriate advice to see if this is an option for you.

Don’t forget your personal deductions

While this guide has been aimed mainly at businesses, it’s also important that you consider the deduction that may be available to you personally. Some of the key deductions are:

- Work from home deductions. This includes the current shortcut method where you can claim 80c for every hour you work from home.
- Donations to Deductible Gift Recipients
- Fees to prepare your prior year tax return
- Income protection insurance premiums you paid personally (not those paid by your super fund)
- Work related use of your personal motor vehicle and other travel costs

FORECASTING TAX LIABILITIES

Once you've worked through the available strategies and planned out how the income of the business will be taxed, the next step is to forecast the timing of the tax payments so you can factor this into your cash flow.

For most small businesses, the annual tax return will need to be lodged by 15 May of the following year and the tax paid either by that date or 5 June. If you're doing tax planning early enough, that will give you 12 or more months to budget for the payment.

In addition to any tax liabilities arising on lodgement of the tax return, businesses and business owners also pay income tax via the PAYG instalment system.

PAYG instalments are a pre-payment of that year's tax liability. For example, if you receive a PAYG instalment for the quarter ended 30 September 2022, that PAYG instalment applies against the tax liability for the 2023 financial year.

Once you lodge a tax return with a tax liability, the ATO should automatically add you to the PAYG instalment system and will require you to pay your tax by instalments going forward.

For businesses that have just started trading in 2022 or whose first year with a tax bill was 2022, you're likely to receive your first PAYG instalment for the June quarter 2023 following lodgement of your tax return.

The issue that arises is that the first PAYG instalment will be payable not long after you've paid the tax liability from the 2022 year and this can cause some cash flow issues if you weren't aware the payment was coming.

As part of the tax planning process it's vitally important that you map out the tax payments from both the lodgement of tax returns but also the PAYG instalments that may arise.

OTHER CONSIDERATIONS

Long term consequences might out way current year savings

It can be very tempting to focus only on the short-term cashflow implications of your tax planning strategies. However, proper tax planning should consider tax over the lifecycle of the business so that overall, you pay the least amount of tax.

For example, utilising a bucket company is a great way to reduce current year tax because you get access to a flat tax rate as low as 25% in some instances. However, if proper planning isn't undertaken and the strategy isn't executed correctly, it could

As you can see, the bucket company strategy may be great for the current year, but it could be very costly down the line so it's important that you understand the impact of any strategies on the future of the business.

Don't wait to prepare your tax return

A common way for business owners to defer their tax liability is to complete their tax return at the last minute.

However, deferring the preparation of your tax return also means you won't know your final tax liability until the date the payment is due which can cause some major cash flow issues if the tax liability is more than you had planned.

The better option is to complete your tax return as early as possible and defer lodgement until closer to the due date. This locks in the final tax liability without bringing forward the payment date so you stay informed and can build the liability into your forecasts.

Questions?
Book a call with the team on our website.

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