

## TAX PLANNING

### What is tax planning?

Tax planning is a generic term that embraces all the ways in which taxpayers plan to reduce their tax liabilities without engaging in tax evasion, including using different structures.

### Choice of structure (see page 2)

The major entities that would be used to carry on a business or hold income producing assets are sole traders, a company, a trust, unit trust or partnership. The choice of entity is linked, to some extent, with the choice of the financing to be used for the acquisition of assets. For example, only a company can issue shares.

The choice of entity will usually involve a number of non-tax as well as tax considerations.

Some of the non-tax matters to consider include:

- Limited/unlimited/joint and several liability of the owners;
- Formation costs;
- Registration and annual return requirements;

Some of the tax issues to consider include:

- Rate of tax;
- Flow through of losses;
- Flexibility of income splitting and return to owners;
- Capital gains consequences;
- Method of financing, debt, equity and salability;

The following example demonstrates an effective tax planning by using mortgages and flexible structures for investments, **the result - \$40,600 tax saving!**

Before			After		
Taxpayer	Taxable income	Tax @ 30 Jun 07	Taxpayer	Taxable income	Tax @ 30 Jun 07
John Smith (Investment income)	\$180,000	\$64,050	John Smith	\$75,000	\$18,975
Linda Smith (Spouse)	\$150,000	\$50,100	Linda Smith	\$75,000	\$18,975
Tim Smith (14)	NIL	NIL	Tim Smith (14)	\$1,334	NIL
			Smiths Pty Ltd (Private company)	\$118,666	\$35,600
			The Smith's Family Trust (Investment income \$180,000)	NIL (\$180,000 less \$60,000, \$120,000 distributed)	NIL
			Mortgage (Interest paid \$60,000)	N/A, deducted	N/A
<b>Total</b>	<b>\$330,000</b>	<b>\$114,150</b>		<b>\$270,000</b>	<b>\$73,550</b>

	<b>BUSINESS STRUCTURES</b>			
<b>ISSUES</b>	<b>Sole Traders</b>	<b>Partnerships*</b>	<b>Trusts^</b>	<b>Companies</b>
<b>Client Understandability</b>	High	Medium	Low	Low/medium
<b>Set up cost</b>	Low	Low	Medium	Medium/high
<b>Record keeping requirements</b>	Yes, onerous substantiation provisions	Yes, onerous substantiation provisions	Yes, but substantiation provisions do not apply	Yes, but substantiation provisions do not apply
<b>Liability for debts</b>	Owner personally liable	Partners are jointly/severally liable	The Trustee may be liable	Limited to company
<b>Income streaming</b>	No	No	Yes, usually	Yes
<b>Can sue and be sued</b>	Yes	No, but all partners together can	No, but Trustee can	Yes
<b>Franking credits</b>	No	No	No	Yes
<b>Tax rates#</b>	Marginal, highest at 46.50%	Marginal, highest at 46.50%	NIL, beneficiaries at marginal rate	30%
<b>Legal relationship between members</b>	Income Tax Assessment Act 1997	Partnership agreement, Partnership Act 1958	Trust Deed, Income Tax Assessment Act 1997	Constitution, Corporations Act 2001
<b>Utilization of losses</b>	Against other income subject to non commercial loss provisions	Against other income subject to non commercial loss provisions	Against future trust income	Against future company income
<b>Capital gains tax on sale of assets</b>	Payable by owner at marginal rate – discounts might apply	Payable by partners at marginal rate – discounts might apply	Payable by beneficiaries at marginal rate – discounts might apply	Payable by company at 30% - discounts do not apply
<b>Distribution of CGT indexation amounts and/or other CGT exemptions</b>	N/A	No distribution required, automatic distribution to partners	Subject to the Trust Deed, these amounts may be tax free	Distribution is a dividend, limited flow through of CGT exemptions
<b>CGT rollover relief</b>	To a company	To a company	To a company	To a company

\* Note: This column applies to partnerships other than limited partnerships. A limited partnership is taxed as an entity at the company tax rate.

^ Note: This column refers to discretionary trusts. The beneficiaries in unit trusts are the unit holders.

#: Note: The tax rates are as at 30 June 2007

*AJML GROUP PTY LTD and related entities*

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