

## June 2008 Newsletter

### 7 Tips on How to Reduce Your Tax Bill

With 30 June 2008 fast approaching, it is time to look at some things you can consider doing today, to minimise your end of year tax bill (or boost the refund if you're one of the lucky ones). I will discuss some things you can do which will assist in the current tax year and I also touch on some tax planning opportunities, which you may take advantage of in the future. Whilst I am a Chartered Accountant and I am qualified to discuss these topics, you should seek your own specific tax and financial advice, to ensure these ideas are appropriate to implement.

1. **Now: Bring forward as many expenses as possible** – given the personal marginal rate tax cuts coming into effect in the 2009 financial year, you are better off to try and bring forward as many tax deductible expenses in this financial year, as you will obtain a marginally larger tax benefit (as tax rates are higher this year compared to next financial year). Therefore, make sure you pay any due expenses before 30 June. In addition, try and identify any fees you can pay in advance such as membership fees, annual subscriptions, insurances, etc.
2. **Now: Pre-pay interest in advance** – one of the largest tax deductible expenses you can bring forward is pre-paying 12 months interest in advance on any investment loans. Most financial institutions offer borrowers' interest in advance products. These fixed rate products allow borrowers to pay 12 months worth of interest in advance (i.e. interest which would cover most of the 2009 financial year), which therefore allows them to claim the full deduction for this interest in the 2008 financial year. This is particularly useful if you expect your taxable income to be lower next year. Of course, with marginal tax rates reducing next year, there is a marginal benefit to most people from prepaying this year.
3. **Now: Get your paperwork in order** – this is the bane of most people's life... paperwork! However, it's a necessary evil and the fact of the matter is, if you are missing any receipts or paperwork, now is the best time to follow it up and request replacements (not in 6 months when you are scrapping paperwork together for your tax accountant). Also, make sure your file notes are up to date. If there is anything that's a bit non-standard (i.e. bank error, etc.), make sure you have a file note explaining what happened.
4. **Now: document redraw** – the ATO treats each separate redraw as a separate loan and will assess the purpose the redrawn monies were used for, to determine if a tax deduction is allowable. Therefore, it's important that you use redraw carefully. It is even more important that you retain clear file notes documenting the purpose of each redraw and where the funds went (i.e. a clear audit trail).

That way, if you are ever audited (say in a few years time), you'll have a clear picture of what you did and why. [Note: redraw is when you withdraw any extra repayments from your loan account (therefore increasing the loan balance) and use these funds for another purpose.]

5. **Future: Interest only offset** – an interest only offset is exactly as the name describes. It is a standard interest only loan with an offset account attached. Setting up an interest only offset provides you with the flexibility to alter the level of gearing (i.e. percentage of purchase price borrowed) throughout the ownership life. For example, if you purchase an investment property for \$500,000, the total cost including stamp duties might be \$530,000. If you had \$300,000 of cash to contribute to this purchase, you might traditionally only borrow \$230,000 (i.e. \$530k - \$300k). What most people don't realise is that they can't go back later and increase the loan to get their cash back and claim a deduction for the interest on the higher loan amount. You crystallise the maximum tax deductible loan (i.e. \$230k in this case) when you actually purchase the property. However, a better alternative is to borrow the full cost at \$530,000 and deposit your cash in a linked offset account. Interest is still only charged on the net balance (i.e. loan for \$530k less balance of the offset being \$300k), so it doesn't cost you any extra. However, you can withdraw and deposit cash to/from the offset at your leisure, thereby altering the net balance. As the loan balance of \$530,000 is persevered (i.e. it never changes), you can continue to claim a deduction for all the interest charged in respect of the net balance. Essentially, you are setting up the maximum tax deductible loan when you purchase the property. This product is perfect for people who purchase an owner-occupier property, but expect to rent the property out sometime into the future, as it allows people to minimise interest costs while occupying the property, without impacting their ability to claim the maximum tax deduction if the property is ever rented out.



6. **Future: Manage cash flow through interest capitalisation** – interest capitalising means that you don't actually pay the interest charged and that it's just added to the loan balance (in the same way interest is added to your credit card balance if you don't repay it in full). Allowing interest to capitalise on an investment loan can be a good tax planning strategy, as it allows borrowers to divert all their income to reduce non-deductible debts first (before paying interest on

deductible loans). Mathematically, it allows a borrower to convert non-deductible debt into being deductible. However, this strategy comes with a strong warning. Interest capitalisation strategies should never be used to lower monthly repayments. You should still maintain the same dollar value of repayments, but direct all these repayments into your non-deductible loan. Interest capitalisation strategies can be abused by pretending that debt is more affordable than it really is. Clearly, this is a very risky and often ill-conceived strategy. It is important these loans are structured by an experienced professional to ensure compliance with the relevant private tax rulings.

7. **Future: Consider alternative ownership structures** – the most common ownership structure is to purchase property in joint names (called ‘joint tenants’). However, there are many other ownership structures that warrant consideration. For example, assigning a fixed percentage of ownership of a property can be a better solution (called ‘tenants-in-common’) from a tax and estate planning perspective. The percentage can be apportioned according to the split of taxable income between two parties to maximise the tax benefits (e.g. husband owns 70% and wife 30%). Another benefit of owning property as ‘tenants-in-common’ occurs if one of the parties passes away. If property is owned as ‘joint tenants’ and one party dies, the remaining party assumes 100% ownership of the asset. However, if you own property as ‘tenants-in-common’, the percentage of the property owned by the deceased person is passed into their estate. This may be more important where two parties purchase a property outside of a marriage or de facto relationship (as a form of asset protection).

Other methods of owning property can include a company or trust. There are three main types of trusts, being unit, discretionary (or family) and hybrid discretionary. Unit trusts provide beneficiaries with a fixed entitlement (income or capital or both). A discretionary trust gives the trustee the sole discretion (per the trust deed) as to how the income is distributed to beneficiaries. A hybrid trust is a combination of unit and discretionary. A hybrid trust can be structured so that an investor can still personally benefit from the negative gearing benefits of investing in property.

Of course, you should seek advice from a suitably experienced accountant or solicitor when determining the best ownership structure, as there are many personal considerations which I have not addressed.

These are just a few of the available tax planning opportunities associated with debt planning. The way you structure your borrowings today can have a significant impact on your tax position tomorrow, so always make sure you are well advised.

## Is the RBA out of touch?

Recently, there has been much debate about the merits of the Reserve Bank of Australia (RBA) adjusting interest rates to manage inflation within its target band of 2% and 3%. The first criticism came from Columbia University professor, Joseph Stiglitz, a winner of the Nobel prize for economics in 2001, and a former chief economist of the World Bank. Joseph’s main point was that we are facing ‘imported inflation’, as global food and energy prices are pushing up prices here in Australia. “To think that there is anything Australia can do to dampen global food inflation or global energy inflation is absolutely absurd”, Joseph said.

Former RBA governor Bernie Fraser agrees that the inflation targeting needs a rethink. He feels that the inflation target of 2% to 3% may need to be reviewed upwards, as the things that are causing higher inflation (like higher oil prices) may be structural rather than seasonal or cyclical increases.

I think we have seen anecdotal evidence that consumers are spending less (April retail sales were down sharply) and borrowing less, so the rate hikes seem to be working. It is therefore fair to question if further rate hikes are really necessary.

## Wealth Advisory survey - \$500 donated

Thank you to everyone who completed our recent Wealth Advisory customer survey. The information we received was very useful and is helping us greatly with shaping the Wealth Advisory service we will be launching in the coming months. We received 280 responses. We committed to donating one dollar to charity for each survey we received. However, we decided to donate the higher amount of **\$500 to the Cerebral Palsy Foundation**. Thank you again to all those people who took the time to respond.

### Our Best Rates

Basic variable	8.46%
Offset (> \$700k)	8.66% (0.80% ongoing disc.)
Offset (> \$1 million)	8.59% (0.85% ongoing disc.)
Offset (> \$1.35 million)	8.54% (0.90% ongoing disc.)
3 years fixed	8.79%
5 years fixed	8.89%
10 Years	8.95%

Rates current as at 29/5/08 and are subject to change without notice. Standard lenders terms and conditions apply.

### Investment Property Seminar - 17 June

Our next joint investment property seminar co-hosted with Wakelin Property Advisory will be held on Tuesday 17 June at 6:30pm. Call Wakelin on (03) 9859 9595 to book (Melbourne only). You will receive a free copy of **Streets Ahead** by Richard and Monique Wakelin and **Smart Borrowers Handbook** by Stuart Wemyss with every registration.