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YOUR KNOWLEDGE

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Why is my tax refund so small?

The tax refund many Australians expect has dramatically reduced. We show you why.

There is a psychology to tax refunds that successive Governments have been reticent to tamper with. As a nation, Australia relies heavily on personal and corporate income tax, with personal income tax including taxes on capital gains representing 40% of revenue compared to the OECD average of 24%. For the amount we pay, we expect a reward.

The reward is in the form of tax deductions that reduce the amount of net income assessed for tax purposes and tax offsets that reduce the tax payable, generating a refund for some. Plus, refunds have a positive impact on tax compliance.

As part of the previous Government's efforts to flatten out the progressive individual income tax system, a time-limited low and middle income tax offset was introduced. The lifespan of the offset was extended twice, partly as a stimulus measure in response to COVID-19. The offset delivered up to $1,080 from 2018-19 to 2020-21, and up to $1,500 in 2021-22 for those earning up to $126,000. This was a significant boost for many people each tax time and bolstered the tax returns of millions of Australians. For many, the end of this offset has meant their tax refund has reduced dramatically compared to previous years.

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Do we pay more tax than other nations?

It depends on how you look at the statistics. Australia relies heavily on income tax, collecting 40% of tax revenue from personal income. That makes Australia the fourth highest taxing nation for personal tax in the OECD – but we were second highest in 2019 if it makes you feel better. But, if you are looking at take home pay there is a separate measure for that. The *employee tax on labour income* looks at our take home pay once tax is taken out and benefits have been added back in. This shows the take home pay of an average single worker is 77% of their gross wage compared to the OCED average of 75.4%. For the average worker with a family (one married earner with 2 children), once tax and family benefits are taken into account, the Australian take home pay average is 84.1% compared to the OECD average of 85.9%. All of this means Australia is a high taxing nation but returns much in the form of means tested benefits.

Australia also does not have social security contributions like other nations. These contributions represent an average of 27% of the total tax take for OECD nations.

Due to the fact Australia has a progressive tax system, the pain of taxation is felt more by higher income earners. The top 11.6% of Australian income earners contribute 55.3% of the tax revenue from personal income tax.

With the final round of legislated income tax cuts due to commence on 1 July 2024, this should reduce the overall dependence on personal income tax relative to corporate and other taxes.

So, do we personally pay more tax than other nations? If you are a high-income earner the answer is likely to be yes. If not, the answer is no.

As Benjamin Disraeli reportedly said, "…lies, damn lies, and statistics". It's all how you read it.

Is a second job worth it?

In an Uber the other day, the driver revealed he had become a driver to pay for his second mortgage. He invested in property but with interest rates spiking, the only way he could hold onto the property was to earn additional income. His "day job" starts early and ends at 3pm at which time he heads off to start driving.

He is not alone. The latest stats from the Australian Bureau of Statistics reveal the number of workers holding multiple jobs has increased by 2.1% since December 2022 – in total, Australia has 947,300 people holding multiple jobs or 6.6% of the working population.

The reason why people take on second jobs is varied. For some, it is to manage increasing costs, for others it is to start up a new venture but with the security of a regular income stream from their primary occupation.

Is it worth it?

From a tax perspective, Australia has a progressive income tax system – the more you earn the more tax you pay and access to social benefits tapers off. It's important when looking at a second job to understand your overall position. How much you are likely to earn, your costs of generating income and what this income level will mean.

The trap for many picking up a 'gig economy' second job is they are often independent contractors. That is, you are responsible for managing your tax affairs. All Uber drivers for example, are required to hold an ABN and be registered for GST. There is a compliance cost to this and from a cashflow perspective, 1/11th of the fee collected needs to be remitted to the ATO once a quarter. It's important to quarantine both the GST owing and income tax to ensure you have the cashflow to pay the tax when it is due. The upside is you can claim expenses related to your second job.

If you are taking on a second job, ensure your tax-free threshold applies to your highest paying job from a PAYG withholding perspective -End-

Succession: what does it take to hand your business to the next generation?

What is the end game for your business? Succession is not just a topic for a TV series or billionaire families, it's about successfully transitioning your business and maximising its capital value for you, the owners.

When it comes to generational succession of a family business, there are a few important aspects:

- succession of the business
- succession of the ownership of the business
- succession planning/pathway
- moving from a business family to an investment family

For generational succession to succeed, even if that succession is the sale of the business and the management of the sale proceeds for the benefit of the family, communication is essential. Where generational succession fails, it is often because succession has not been formalised until a catalyst event or retirement planning requires it.

A concept of 'legacy' is not enough. Successful succession occurs when the guiding principles of governance, family rules, aligning values, dispute resolution, succession and estate planning are managed well before discontent tears it apart.

Generational succession usually involves the transfer of an interest in a business to another generation of a family (usually younger). It is often a family in business rather than simply a family business.

> **"One-third of Australian family businesses expect that the next generation will become the majority shareholders within five years time. Yet only 25% of Australian family businesses have a robust, documented and communicated succession plan in place."**
> *PWC Family Business Survey*

The options for how a movement of an interest may occur are many and varied. Usually the focus is on the transfer of some or all of the equity held in the business over a period or at a defined point in time and the payment of some form of consideration for the equity transferred. Alternatively, a part of the equity transfer may ultimately be dealt with through the estate.

Generational succession comes with its own set of issues that need to be dealt with:

Capability and willingness of the next generation

A realistic assessment of whether the business can continue successfully after the transition. In some cases, the older generation will pursue generational succession either as a means of keeping the business in the family, perpetuating their legacy, or to provide a stable business future for the next generation. While reasonable objectives, they only work where there is capability and willingness. Communication of expectations is essential.

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Capital transfer

Consider the capital requirements of the exiting generation. To what extent do you need to extract capital from the business at the time of the transition? The higher the level of capital needed, the greater the pressure on the business and the equity stakeholders.

In many cases, the incoming generation will not have sufficient capital to buy-out the exiting generation. This will require the vendors to maintain a continuing investment in the business or for the business to take on an increased level of debt. Either scenario needs to be assessed for its sustainability at a business and shareholder level. In some scenarios the exiting owners will transition their ownership on an agreed timeframe.

Managing remuneration

In many small and medium businesses, the owners arrange their remuneration from the business to meet their needs rather than being reasonable compensation for the roles undertaken. This can result in the business either paying too much or too little. Under generational succession, there should be an increased level of formality around compensation. Compensation should be matched to roles, and where performance incentives exist, these should be clearly structured.

Who has operational management and control?

Transition of control is often a sensitive area. It is essential to establish and agree in advance how operating and management control will be maintained and transitioned. This is important not only for the generational stakeholders but also for the business. Often the exiting business owners have a firm view on how the business should be run. Uncertainty in the management and decision making of the business can lead to confusion or a vacuum - either will have an adverse impact. Tensions often arise because:

- The incoming generation want freedom of decision making and the ability to put their imprint on the business.
- Without operating control, they feel they have management in name only.
- The exiting generation believe their experience is necessary to the business and entitles them to a continued say.
- A perception that capital investment should equate to ultimate operating control.
- An uncertainty by either or both generations about the extent of their ongoing roles.

Agreeing transition of control in advance, on an agreed timeframe, can significantly reduce tensions.

Transition timeframes and expectations

Generational succession is often a process rather than an event. The extended timeframe for the transition requires active management to ensure there are mutual expectations and to avoid the process being derailed by frustration.

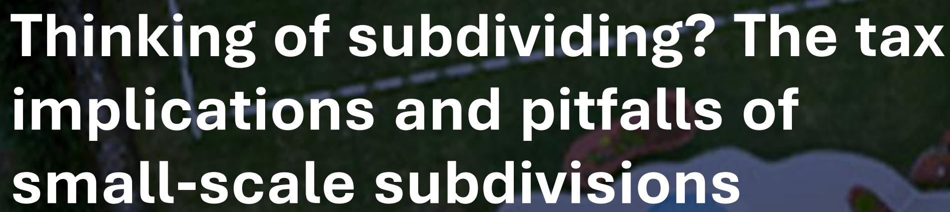
The established generation may have identified they want to scale down their business involvement and bring on other family members to succeed them. This does not necessarily mean they want to withdraw completely. An extended transition period is not uncommon and can often assist the business in managing the change. This can also work well in managing income and capital withdrawal requirements.

The need for greater formality and management structure

A danger for many SMEs is the blurring of the boundaries between the role of the Board, shareholders, and management. With generational succession this can become even more pronounced. Formality in these structures is important, with clear definitions of the roles and clarification of the expectations. For example, who should be a director and what is their role?

For some, the role of the family is managed by a family constitution – an agreed set of rules. For others there will be an external advisory group that advises the family to ensure the required independent expertise is brought to bear.

Successfully managing generational change is a process we can help you navigate. Talk to CVW Accounting about how we can help you to structure an effective transition path.



You've got a block of land that's perfect for a subdivision. The details have all been worked out with Council, the builders, and the bank. But one important aspect has been left out - the tax implications.

Many small-scale developers often assume their tax exposure is minimal – but this is not always the case and the tax treatment of a subdivision project can significantly impact on cashflow and the financial viability of the project.

New guidance from the Australian Taxation Office (ATO) walks through the tax impact of small-scale subdivision projects. We look at some of the leading issues:

Tax treatment of the subdivision

Subdividing land

The tax treatment of even a small subdivision can become complex very quickly and tax applies according to the circumstances. You cannot simply assume that because it's a small development, any profit from the eventual sale will be taxed as a capital gain and qualify for CGT concessions.

In general, if you own a property personally, it has been held and used for private purposes over an extended period. Then you subdivide it and sell the newly created block, then capital gains tax is likely to apply to any gain you make. The gain is recognised from the point you first acquired the land, although you will ned to apportion the amount paid for the property between the subdivided lots. If you are subdividing a property that contains your home – the main residence exemption will not generally be available if you sell a subdivided block separately from the block containing your home, even if the land has only ever been used for private purposes in connection with your home.

If a property is initially owned jointly but the property is subdivided and the lots split between the owners, then this will normally trigger upfront tax implications even though the land hasn't been sold to an unrelated party yet. Arrangements like this (referred to as partitioning) can be complex to deal with from a tax perspective.

Developing a property

But what happens if you develop the land? It's not uncommon for people to decide to subdivide and develop their block by building a house or duplex and then selling the new dwelling.

When someone develops a property with the intention of selling the finished product at a profit in the short term, there is a risk this will be taxed as income rather than under the capital gains tax rules. This limits the availability of CGT concessions (such as the 50% CGT discount) and will often expose the owners to GST liabilities as well. This can be the case even for one-off property developments.

Let's look at an example. Claude purchased his home on 1 July 2001 for $300,000. In July 2020, Claude began investigating the idea of subdividing his block and building a new house, then selling it. A registered valuers report on the subdivision says the original house and land is now worth $360,000,

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and the subdivided lot is worth $240,000 (the valuation is an important step before commencement to prevent any debates with the ATO). Claude decides to go ahead and build a dwelling on the newly subdivided block and takes out a loan of $400,000 for the development. He intends to pay off the loan as soon as the house sells.

In July 2021, Claude sells the subdivided block and new home for $1,210,000 (GST-inclusive).

Here is how the tax works for Claude's scenario:

- Claude made an overall economic gain of $580,000.
- The overall gain ($580,000) is based on the GST exclusive sale proceeds ($1,100,000, although we are assuming the GST margin scheme isn't applied) minus the GST exclusive development expenses ($400,000) and the original cost attributable to the newly subdivided lot of $120,000 ($300,000 × 40%).
- The increase in the value of the newly created subdivided lot from when it was originally acquired (1 July 2001) up to when the profit-making activities began (1 July 2020) should be treated as a capital gain.
- The value of the newly created subdivided lot at the time Claude began to undertake profit-making activities on 1 July 2020 was $240,000. The original cost, attributable to the newly created subdivided lot was $120,000 (40% × $300,000) on 1 July 2001. This means there was a capital gain of $120,000.
- As Claude has held the subdivided block for greater than 12 months he is entitled to a 50% CGT discount, hence there is a discounted capital gain of $60,000.
- The increase in the value of the newly created subdivided lot from when the profit-making activities began up to the time of sale should be treated as ordinary income.
- The net profit ($460,000) will be based on the GST exclusive sale proceeds ($1,100,000) minus the GST exclusive development expenses ($400,000) and the value of the subdivided lot ($240,000).

If Claude is not carrying on a business, he cannot claim a deduction for the development expenses as they are incurred. They will be taken into account in determining the net profit on sale.

If Claude finished the development but decided not to sell the property, then this would complicate the income tax and GST treatment. We would need to explore what Claude plans to do with the property.

Do I need to register for GST?

If you are an individual who is subdividing land that has been held and used for private purposes then you might not need to GST, although this will depend on the situation. However, if you are engaged in a property development business or a one-off project that is undertaken in a business-like manner, then it is more likely you would need to register for GST.

In Claude's scenario because the projected sale price of the developed land was above the GST threshold of $75,000, he will probably need to register for GST. This will mean he:

- Has a 'default' GST liability of $110,000 on the sale price of the developed block, although it might be possible to reduce the GST liability by applying the GST margin scheme
- Needs to provide a notification to the purchaser of the amount at settlement to be withheld and paid to the ATO
- Is able to claim $40,000 credits for the GST included in the development expenses (subject to the normal GST rules), and
- Must report these transactions by completing business activity statements

The tax consequences of subdivision and other property projects can be complex. If you are contemplating undertaking a subdivision and any property development activities, please contact us. We can walk you through the scenarios and potential tax impacts of the project.

Quote of the month

"It always seems impossible until it's done." - *Nelson Mandela*