Tax – Taxation

Income tax

The main tax you'll pay is income tax which is calculated on income you receive such as salary and wages, investment income and business income. Generally, you pay income tax during the year as you earn it. For example, if you're an employee your employer will deduct tax from your wages and pay it to the Australian Tax Office (ATO). This is called Pay As You Go (PAYG) Withholding.

If you earn income that has not had tax withheld by the payer - for example, if you're paid as a contractor or you receive rent or interest income - you may need to make payments during the year to the ATO. These payments are called PAYG instalments.

How much income tax will you pay?

The amount of income tax and the tax rate you pay depends on how much you earn and whether you're an Australian resident for tax purposes. The more you earn, the higher your rate of tax. If you're an Australian tax resident, some of the income you earn is tax-free. If you're a non-resident for tax purposes, generally only your Australian sourced income will be subject to Australian tax.

You should seek tax advice from a registered tax agent to confirm how much tax you need to pay.

Income you must declare

You pay income tax on assessable income you receive such as salary and wages, certain Centrelink/Department of Veterans' Affairs payments, investment income from rent, bank interest or dividends and capital gains from selling assets such as shares or property.

Deductions and offsets you can claim

Your tax liability is based on your taxable income. You can reduce your taxable income and, in turn, the amount of tax you pay with deductions such as some work-related expenses, donations, rental property expenses and interest on loans used to purchase income producing investments. You may also be eligible for tax offsets that reduce the amount of tax you pay. You claim deductions and offsets when you complete your annual income tax return. You should seek tax advice from a registered tax agent to confirm what offsets and deductions you're entitled to.

Tax effective investments

An investment is 'tax-effective' if you pay less tax than you would on another investment with the same return and risk. While lower tax can help your savings grow faster, you should not invest based on tax benefits alone. A worthwhile strategy needs to be a sound investment first. Any tax benefit should be secondary. You should also be aware severe penalties can apply under taxation law where the dominant purpose for entering into an arrangement is to obtain a tax benefit.

A good way to understand how tax affects you is to know what 'marginal tax bracket' you're in for your ordinary income. This means if you earn an extra dollar, you'll know how much extra tax you'll pay.
If you can invest in a way that means you pay less tax on your investment returns than your marginal tax rate, then you're ahead. For example, superannuation is generally considered to be tax-effective as the maximum tax rate is 15% on investment earnings. This is generally lower than most individuals' marginal tax rates.

Shares and property

Income you receive from investing in shares and property - dividends or rent - will generally be taxed at your marginal tax rate. 'Franked' dividends are dividends paid by an Australian company out of profits it has already paid tax on. You'll generally be entitled to a credit for the (up to) 30% company tax already paid if the dividend is 'fully franked'. This credit is called an 'imputation credit' or 'franking credit'. This means a $7 franked dividend is effectively worth the same as a $10 unfranked dividend. As you pay comparatively less tax on a franked dividend than with an unfranked dividend, shares that pay fully franked dividends can be 'tax effective' investments.

A capital gain may arise from the disposal of your investment. A capital gain is the profit you make when you dispose an investment for more than what you paid for it and will form part of your assessable income. Please see the 'Managing gains and losses' section for details. You should be aware you don't need to sell the asset to realise a capital gain. If you transfer your asset or simply give up a right to something, you may be considered to have disposed of an asset and therefore may have to pay capital gains tax (CGT).

Managing gains and losses

When you make a profit from selling your investments from the increase in its value, you may have to pay CGT. A capital gain is added to your assessable income in the year you sell the investment and taxed at your marginal rate. If you hold the investment for more than one year, you're only taxed on half the capital gain (this is called the CGT discount). So if your marginal tax rate is 37%, your capital gains are effectively only taxed at 18.5% (not including Medicare levy). Special rules apply to non-residents which may result in no/limited CGT discount being applied.

For superannuation funds, if an investment is held for more than one year the fund receives a reduction of 33.3% of the nominal gain, instead of the 50% reduction received by individuals.

Keep a record of any capital losses you make as they may be used to offset capital gains. Capital losses that aren't used against gains in the current year can be carried forward for use in later years.

Superannuation

The Government gives incentives through the tax system to encourage people to save for retirement by using the superannuation system including:

- investment earnings being taxed at a maximum of 15% (effective rate of 10% for capital gains if the assets were held by the fund for more than one year)
- superannuation contributions made by salary sacrifice (up to the contribution caps) to reduce your income tax
- claiming tax deductions for superannuation contributions (up to the contribution cap), if eligible
- paying no tax on the money they take out of superannuation for people aged 60 or over (from taxed superannuation funds), and
- investment earnings being tax-free when you start a retirement phase superannuation pension.

Fringe benefits tax

What is a fringe benefit?

A fringe benefit is generally a non-cash benefit received by an employee (or an associate of the employee) as a result of their employment. This may include the use or ownership of something, enjoyment of a privilege or use of a service. While fringe benefits do not form part of your assessable income, the 'grossed-up' value of fringe benefits may be included in a broader definition of 'income' when determining your eligibility for certain Government benefits and concessions or liability for levies.

Reportable fringe benefits

A reportable fringe benefit is simply the 'grossed-up' taxable value of the fringe benefit provided and is the amount shown on the employee's payment summary. 'Grossing-up' involves applying a specific formula to the value of the fringe benefit received.

Your employer is required to include such reportable fringe benefits amounts on your payment summary. Examples where reportable fringe benefits are added to your other income are for the purpose of determining:

- Medicare levy surcharge
- child support payments
- Higher Education Loan Program (HELP) repayments, or
- Government co-contribution.

Adjusted fringe benefits are effectively reportable fringe benefits 'grossed-down' for the effect of the fringe benefits tax. Examples where adjusted fringe benefits are added to your other income are for the purpose of determining:

- Family Tax Benefit
- Child Care Subsidy, or
- the Parental Income Test for Youth Allowance

Fringe benefits tax

Fringe benefits tax is payable by employers and is based on the value of fringe benefits provided to employees or their associates. As fringe benefits tax is paid by the employer, the actual fringe benefit provided to the employee is generally not taxable in the hands of the employee.
Generally, employers may place restrictions on the amount and type of fringe benefits received by employees and this may involve adjusting the employee's total remuneration package to take into account any potential fringe benefits tax that may be payable by the employer.

Taxation of Employee Share Schemes (ESS)

Special tax treatment applies to shares, stapled securities and rights (including options) you acquire at a 'discount' under an employee share scheme (these are referred to as your 'ESS interests'). 'Discount' broadly means you either did not pay anything for the interest or what you paid was less than market value. This 'discount' on your ESS interest is subject to tax under the ESS tax rules. Under these rules, most ESS interests are subject to tax 'up front' (that is, at grant) rather than at vesting. Some ESS interests such as those that carry 'real risk of forfeiture', certain salary packaging arrangements and certain pre 1 July 2009 interests may be instead taxed on a deferred basis. However, to be eligible, the scheme must meet very strict criteria.

The tax treatment and calculation of your taxable ESS discount is determined by reference to the particular scheme you participate in and is not something you can choose. Your employer will advise you of the type of scheme you're participating in and will also provide you with an 'ESS statement' each year which details the ESS interests you have acquired during the year for tax purposes. Your employer also gives this information to the ATO.

The taxation implications may also be different if you were a non-resident of Australia for tax purposes at any stage during the ESS vesting period. Also, if you eventually dispose your ESS interest (such as if you sell your shares), there may be CGT implications which is in addition to the tax you might have to pay under the ESS rules.

As the taxation implications of ESS interests are complex, you should consult a registered tax agent who has specialist knowledge. Further information is also available at ato.gov.au

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