

# Personal income taxes

Why pay tax?

Tax sources and uses in Australia

Calculating personal income tax

Personal income tax in Australia

Preparing a tax return in Australia

Personal tax strategies for Australia

# You need to be able to ...

- 1. Identify the main sources and uses of tax**
- 2. Calculate personal income tax in Snowland**
- 3. Explain the key issues to consider when calculating personal income tax in Australia**
- 4. Identify the steps required to complete a personal tax return in Australia**
- 5. Explain the key personal income tax strategies in Australia**

Personal income taxes

# Why pay tax?

# Think and discuss

What are the first words that come to mind when you hear the word ...

# TAX

# 5 myths about tax

1. **Smart people avoid paying tax**
2. **Taxes just end up going to pay politicians**
3. **I don't receive any benefits from my taxes**
4. **Big companies don't pay much tax**
5. **Rich people don't pay much tax**

# Why governments make sense

1. International relations
2. Alignment and co-ordination
3. Defense and law and order
4. Reduce the problems of 'free-riders'  
Public goods such as defense, law and order, roads
5. Promote good things undersupplied by market  
Positive externalities such as research and development
6. Regulate bad things oversupplied by market  
Negative externalities such as pollution

# The big versus small government debate

**Big government is better**

**Government can solve  
problems in the economy**

**Government provides jobs**

**Stimulates the economy**

**Long-term national projects**

**‘Pie’ is distributed fairly**

**‘Looks after’ people**

**Small government is better**

**Government makes  
problems worse**

**Private sector better at  
providing sustainable jobs**

**Government is inefficient  
with long-term projects**

**Larger overall size of ‘pie’**

**Those ‘looked after’ have  
less incentive to be  
responsible**

# Tax is one of the two certainties in life!

**Personal income tax**

**Retirement savings tax**

**Investment tax**

**Duties and fees**

**Corporate tax**

**Stamp duties**

**Consumption tax**

**Payroll tax**

**Carbon tax**

**Fines**

**Resource tax**

**Dividends**

**Sales tax**

**Rates**

**Excises**

**Tobacco, alcohol, petroleum**

The other certainty is 'death' in case you were wondering!



# What do they do with all that tax?

Federal, state and local governments

**Public services**

**Health**

**Roads**

**Public transport**

**Education**

**Social security**

**Law and order**

**Disability services**

**Foreign aid**

**Energy infrastructure**

**Military**

**Emergency services**

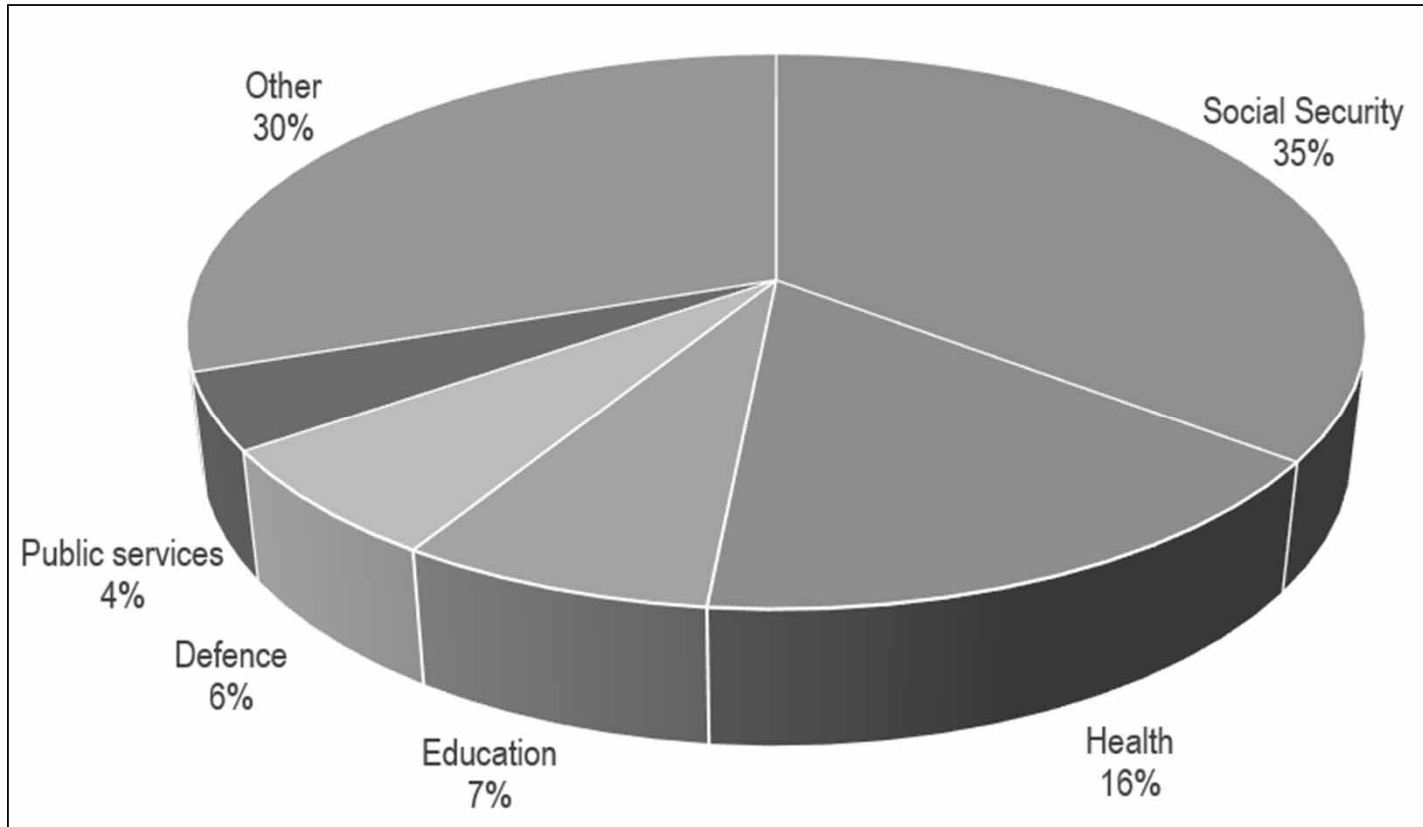
**Waste disposal**

**Local council services**

Personal income taxes

# Tax sources and uses in Australia

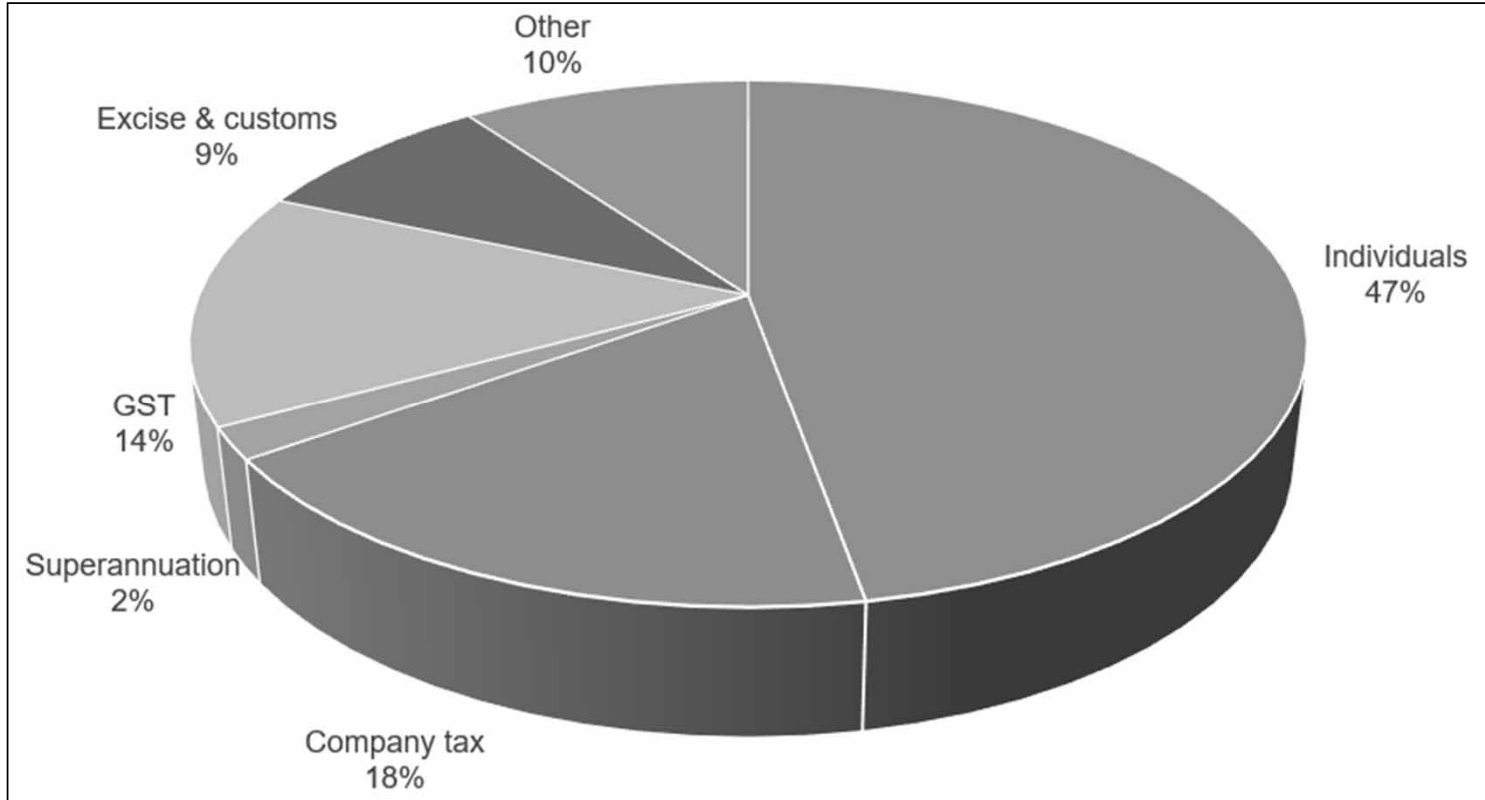
# How does the Australian government use tax?



**Tax revenue \$433bn - Expenditure \$464bn = -\$29.4bn Deficit**

Source: Australian Government Budget 2017-18 Paper No. 1, Statement 6, Table 3

# Who pays tax to the Australian government?

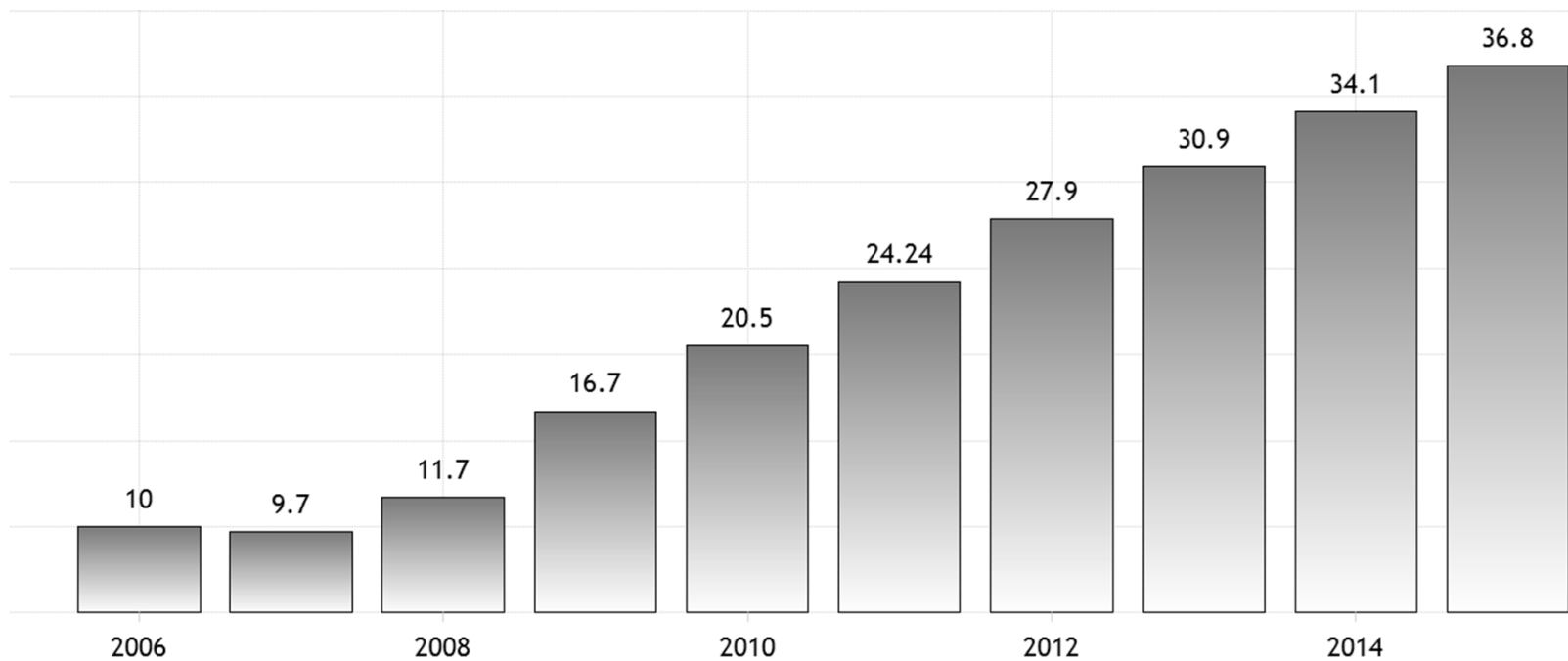


**Tax revenue \$433bn - Expenditure \$464bn = -\$29.4bn Deficit**

Source: [Australian Government Budget 2017-18 Paper No. 1, Statement 6, Table 3](#)

# What is government debt as % of GDP?

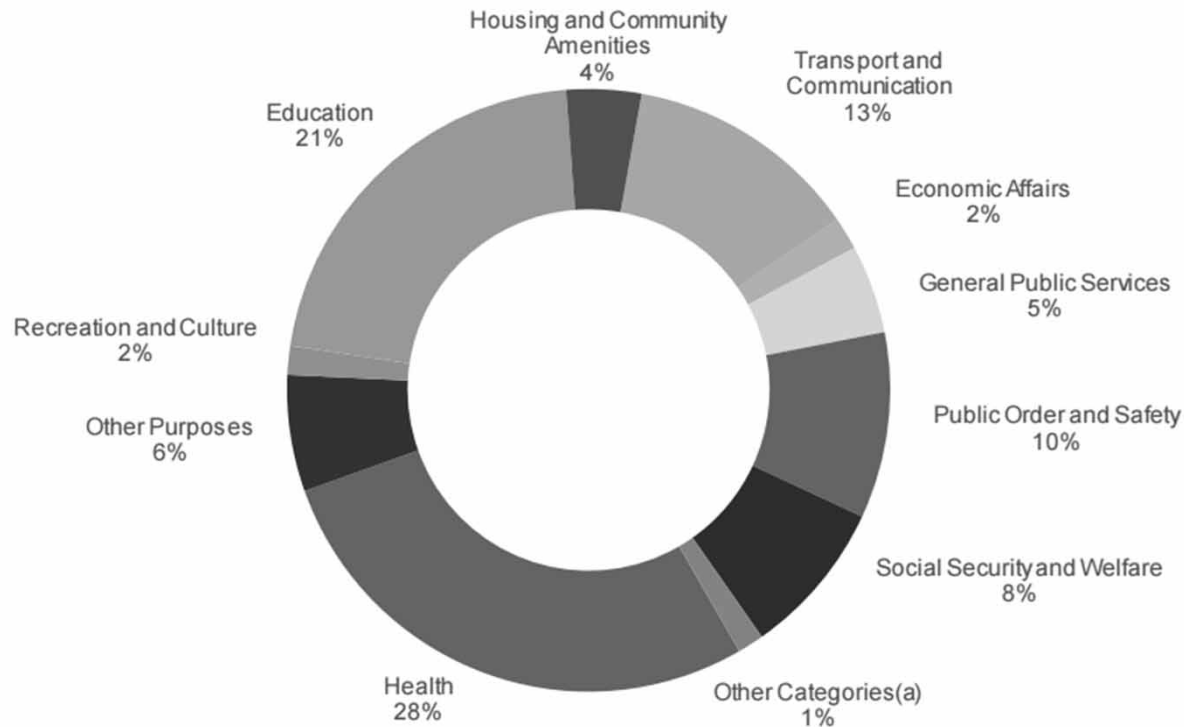
AUSTRALIA GOVERNMENT DEBT TO GDP



SOURCE: [WWW.TRADINGECONOMICS.COM](http://WWW.TRADINGECONOMICS.COM) | AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT

**<http://www.tradingeconomics.com/australia/government-debt-to-gdp>**

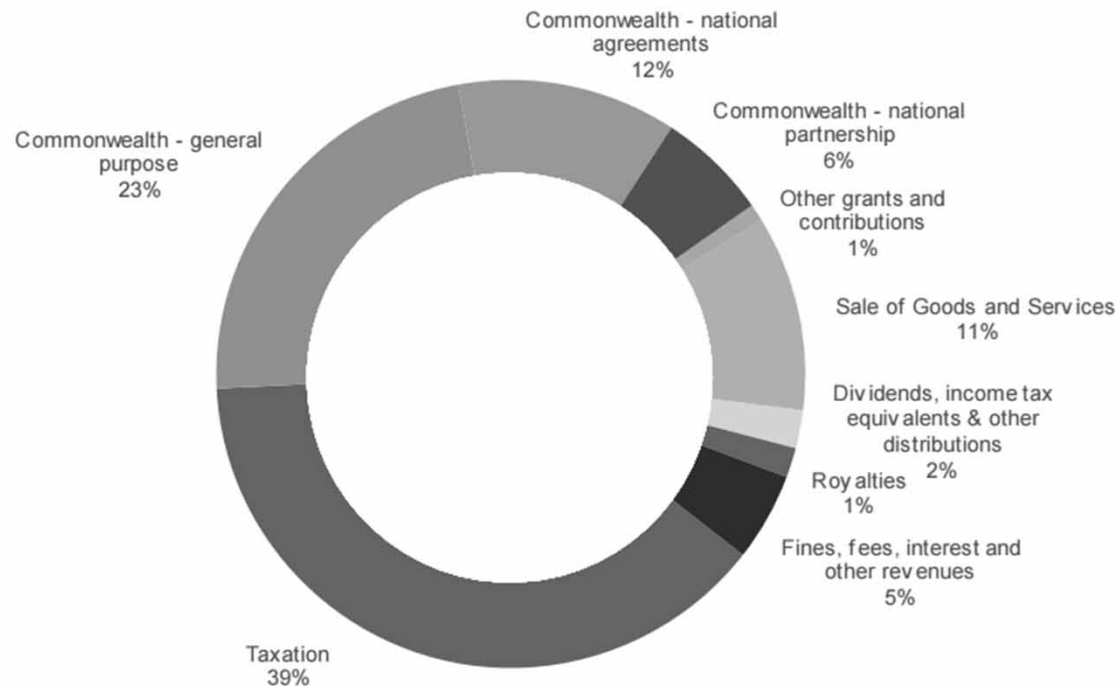
# How does the NSW government use tax?



**NSW Budget 2016/17** <http://www.budget.nsw.gov.au>

**Tax revenue \$77.005B - Expenditure \$73.292B = -\$3.713B Surplus**

# Who pays tax to the NSW government?



**NSW Budget 2016/17 <http://www.budget.nsw.gov.au>**

**Tax revenue \$77.005B - Expenditure \$73.292B = -\$3.713B Surplus**

Personal income taxes

# Calculating personal income tax



# Introducing the country of Snowland

**Tax varies from country to country**

**... and even state by state!**

**So we will learn tax for the mythical country of Snowland**

**Then compare it with other countries**

# How is personal income tax calculated?

**Step 1:** Calculate **Assessable income**

**Step 2:** Deduct **Allowable deductions**

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**Step 3:** Calculate **Taxable income** ( $1 - 2$ )

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**Step 4:** Calculate **Tax on taxable income using table**

**Step 5:** Add **Levies**

**Step 6:** Add **Other taxes**

**Step 7:** Add **Payments to government**

**Step 8:** Deduct **Tax rebates or offsets**

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**Step 9:** Calculate **Personal income tax** ( $4 + 5 + 6 + 7 - 8$ )

**Step 10:** Deduct **Tax already paid**

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**Step 11:** Calculate **Net tax payment** ( $9 - 10$ )

# 1. Assessable income

**Any income that tax legislation deems to be ‘assessable’**

**Salary or wages**

**Benefits provided by employer in many countries**

**Interest, dividends and rent in many countries**

We will handle these separately under ‘Investment income tax’

## **Example:**

**John earns a salary of \$40,000**

**John’s assessable income = \$40,000**

## **2. Allowable deductions**

**Expenses that you have incurred while generating assessable income that are ‘allowed’ by tax legislation and haven’t been reimbursed by your employer**

**Work-related training and education**

**Work-related travel or clothing expenses**

**Interest or other necessary expenses related to investment income**

**The colloquial term for these are ‘tax deductions’**

**Example:**

**John pays \$1,500 to do a work-related training course**

**John pays \$500 on some special clothing required for work**

**John’s allowable deductions =  $1,500 + 500 = \$2,000$**

## 3. Taxable income

**Assessable income** less **Allowable deductions**

**A key number in our calculations!**

**Example:**

**John's assessable income is \$40,000**

**John's allowable deductions are \$2,000**

**John's taxable income is  $40,000 - 2,000 = \$38,000$**

## 4. Calculate tax on taxable income using table

**The country of Snowland has a marginal tax system:**

$(\text{Taxable income} - \text{Lower bracket}) \times \text{Marginal tax rate} + \text{Tax on previous brackets}$

Bracket	Taxable income p.a.	Marginal tax rate	Tax on previous brackets
1	\$0 to \$10,000	0%	\$0
2	\$10,000 to \$20,000	10%	\$0 = 0% x 10,000
3	<b>\$20,000 to \$40,000</b>	<b>20%</b>	<b>\$1,000</b> = 0 + 10% x (20,000 - 10,000)
4	\$40,000 to \$80,000	30%	\$5,000 = 1,000 + 20% x (40,000 - 20,000)
5	\$80,000 or more	40%	\$17,000 = 5,000 + 30% x (80,000 - 40,000)

### Example:

**John has taxable income of \$38,000 which is in bracket 3**

**Tax on taxable income =  $(38,000 - 20,000) \times 20\% + 1,000 = \$4,600$**

## 5. Add levies

**Additional taxes may apply to taxable income or the components of assessable income**

**For Snowland there is a 2% Medicare Levy on taxable income to partly cover government healthcare**

**John has taxable income of \$38,000**

**Medicare Levy =  $38,000 \times 2\% = \$760$**

## 6. Add other taxes

**Additional taxes may apply to various investments**

**For Snowland there is a 15% tax on dividends received on any shares**

**John earned \$1,000 in dividends on shares (distributions of profit)**

**Dividend tax =  $1,000 \times 15\% = \$150$**



## **7. Add payments to government**

**Sometimes governments will also collect other money owed to them through the tax system that are not actually taxes**

**Snowland has a generous student loan scheme to help fund higher education**

**The interest rate of the student loan scheme is set slightly above the inflation rate (usually between 3% to 4% per year)**

**Loan repayments are collected through the tax system at the rate of 5% of assessable income**

### **Example:**

**John has assessable income of \$40,000**

**Student loan scheme repayment =  $40,000 \times 5\% = \$2,000$**

## 8. Less tax rebates or offsets

**Tax rebates are very different from allowable deductions**

**\$1 of tax rebate results in a \$1 reduction in tax**

While \$1 of allowable deductions results in  $(\$1 \times \text{marginal tax rate})$  reduction in tax which is nowhere near as good!

**They are usually associated with tax on investment income that has already been paid**

**Example:**

John has no tax rebates

## 9. Calculate personal income tax

### Personal income tax:

Tax on taxable income + Levies and taxes + Repayments – Tax rebates

**If positive then you owe tax to government**

**If negative then you get a tax refund from government**

### Example for John:

4. Tax on taxable income	= \$4,600
5. Medicare levy	= \$760
6. Dividend tax	= \$150
7. Student loan scheme repayment	= \$2,000
8. <i>Less</i> Tax rebates	= \$0
9. Personal income tax	= \$7,510

# 10. Deduct tax already paid

**Companies in Snowland estimate an employees expected income tax based on their fortnightly income and then deduct that tax automatically from their salary or wages.**

**The companies then pay the tax that they have collected to the tax office at the end of each month.**

**Example:**

**John's income tax already paid through payroll system = \$7,000**

# 11. Calculate net tax payment

**Calculated personal income tax (step 9)  
less tax already paid (step 10)**

**If positive then this must be paid to tax office**

**If negative then this is your tax refund**

**Example:**

**John's personal income tax = \$7,510**

**Less income tax paid = \$7,000**

**Net tax payment = \$510 (must be paid to tax office)**

# Q1: What is John's tax on taxable income?

**John lives in the country of Snowland. He is an engineer and has a gross salary of \$60,000 per year. He has allowable deductions of \$10,000 from an engineering course that he paid for himself.**

**What is John's tax on taxable income?**

Bracket	Taxable income p.a.	Marginal tax rate	Tax on previous brackets
1	\$0 to \$10,000	0%	\$0
2	\$10,000 to \$20,000	10%	$\$0 = 0\% \times 10,000$
3	\$20,000 to \$40,000	20%	$\$1,000 = 0 + 10\% \times (20,000 - 10,000)$
4	\$40,000 to \$80,000	30%	$\$5,000 = 1,000 + 20\% \times (40,000 - 20,000)$
5	\$80,000 or more	40%	$\$17,000 = 5,000 + 30\% \times (80,000 - 40,000)$

[Go to Answers](#)

## Q2: What is Lucy's net tax payment?

**Lucy lives in Snowland. Her gross salary is \$90,000 per year. She has work related deductions of \$2,000. She received interest of \$1,000 and also dividends of \$1,000. She has a tax rebate of \$300 from medical expenses. She has a government student loan of \$30,000. \$27,300 in tax has already been deducted from her gross salary. What is Lucy's net tax payment?**

Bracket	Taxable income p.a.	Marginal tax rate	Tax on previous brackets
1	\$0 to \$10,000	0%	\$0
2	\$10,000 to \$20,000	10%	$\$0 = 0\% \times 10,000$
3	\$20,000 to \$40,000	20%	$\$1,000 = 0 + 10\% \times (20,000 - 10,000)$
4	\$40,000 to \$80,000	30%	$\$5,000 = 1,000 + 20\% \times (40,000 - 20,000)$
5	\$80,000 or more	40%	$\$17,000 = 5,000 + 30\% \times (80,000 - 40,000)$

[Go to Answers](#)

Personal income taxes

# Personal income tax in Australia



# Assessable income in Australia

**Salary or wages**

**Any other 'business' related income**

**Interest on bank accounts (more in next topic)**

**'Grossed up' dividends on shares (more in next topic)**

**Gains in value on investments (more in next topic)**

# Marginal tax rates for residents in Australia

## Marginal tax rates for the 2016/17 financial year

Bracket	Taxable income p.a.	Marginal tax rate	Tax on previous brackets
1	\$0 - \$18,200	0%	\$0
2	\$18,200 - \$37,000	19%	\$0
3	\$37,000 - \$80,000	32.5%	$\$3,572 = 0 + 19\% \times (37,000 - 18,200)$
4	\$80,000 - \$180,000	37%	$\$17,547 = 3,572 + 32.5\% \times (80,000 - 37,000)$
5	\$180,000 or more	45%	$\$54,547 = 17,547 + 37\% \times (180,000 - 80,000)$

**For more info:**

**<https://www.ato.gov.au/rates/individual-income-tax-rates/>**

# Marginal tax rates for foreigners

## Marginal tax rates for the 2016/17 financial year

Bracket	Taxable income p.a.	Marginal tax rate	Tax on previous brackets
1	\$0 - \$80,000	32.5%	\$0
2	\$80,000 - \$180,000	37%	\$26,000
3	\$180,000 or more	45%	\$63,000

### For more info:

<https://www.ato.gov.au/individuals/income-and-deductions/how-much-income-tax-you-pay/individual-income-tax-rates/>

# Medicare levy in Australia

**Medicare Levy = 2.0%**

**Possibly less if you have a very low income**

**Additional Medicare Levy Surcharge = 1.0%**

**if you have no private hospital cover and ...**

Situation	Income Threshold
Single	\$77,000
Family with 0-1 children	\$154,000 total for family
2+ children	Add \$1500 for each dependant child after first one

# HECS Loan repayment

**HECS repayments are based on your Repayment Income (RI)**

**\* Note that 'RI' was previously called 'HRI'**

**RI = taxable income  
plus net rental losses  
plus reportable fringe benefits  
plus exempt foreign employment income**

**No HECS is payable below RI of \$55,874 (2017/18)**

**8% HECS is payable above RI of \$103,766 (2017/18)**

**Repayment rate increases from 4% to 8% between these two amounts.**

**For more info:**

**<https://www.ato.gov.au/Rates/HELP,-TSL-and-SFSS-repayment-thresholds-and-rates/>**

Personal income taxes

# Preparing a tax return in Australia

# **The responsibility is yours ...**

**Australia works on a “self-assessment” system.**

**ATO trusts you to:**

**Work out your own tax liability**

**Ask for the help of an accountant if needed**

**Submit a correct tax return that calculates how much you owe them (or they owe you)**

**The ATO then conducts random and also some targeted audits on people / companies.**

**ATO imposes heavy fines if you breach their “trust”.**

**ATO “monitoring” has improved significantly in recent years with better database systems.**

# Who has to lodge a tax return?

**You must lodge a tax return if:**

**You paid tax during the year; and/or**

**Your taxable income > \$18,200 (for residents)**



# Preparing your first return

## **Two options:**

**MyTax (Internet)**

**Tax Pack (paper version)**

## **MyTax is the best option for most people**

**You are not inundated with irrelevant information (questions are conditional on previous answers)**

**The website calculates totals and checks your answers**

**You can click on icons for detailed help on questions**

**Refunds are paid quickly**

**Can carry forward basic information from year to year**

# Sections of a tax return

**Income – to calculate assessable income**

**Deductions – to calculate allowable deductions**

**Losses carried forward**

**Tax offsets**

**Private Health Insurance**

**Medicare Levy issues**

**Various Adjustments**

**Supplementary sections for some investments**

# What you need before you start

**Copy of last year's assessment or other documents from ATO to prove your identity.**

**Tax File Number**

**PAYG Summary Statement(s) from employer(s)**

**Centrelink summary statements**

**Your June bank statement that summarises interest and fees for the year**

**Receipts for any deductions**

**Tax summaries for any managed funds**

**Buys, sells and dividends for any shares**

# Tax return tips

## **Due by October 31!**

**But can get extension if you call ATO 1+week beforehand with a good sob story!**

**Keep a special tax folder during the year and put any relevant documents in it as you receive them.**

**Make sure you have everything before you start your tax return.**

**If your spouse or parents prepare your tax return then watch them do it this year and do it yourself next year ... it's an important life skill!**

**Keep all records for 5 years**

# When to get help

**Get an accountant if you have:**

**Your own business**

**Investment properties**

**Depreciation calculations**

**Lots of allowable deductions (tax deductions)**

**A “questionnaire” from the ATO asking you how you derived your calculations for last year’s tax return (a prelude to an audit).**

Personal income taxes

# Personal tax strategies for Australia

# Allowable deductions

**ATO gives guidelines at [www.ato.gov.au](http://www.ato.gov.au)  
... Individuals ... Deductions Checklist**

**It is now very difficult to get any!**

**Main tax deductions are:**

**Bank fees**

**Self-education expenses**

**Transport and motor vehicle expenses while at work**

**Accounting fees for preparation of tax return**

**Depreciation on home computer used for work purposes**

**It's usually better to try to get your employer to  
reimburse you for the full amount!!**

# Allowable deductions for shop assistants

**Repayments of shortfalls from the register that you reimburse your employer—but not if the shortfall is reimbursed by someone else.**

**Special coats, dustcoats, overalls, aprons, and protective safety boots—but not conventional clothing and footwear such as shirts, trousers, sports shoes and joggers.**

**Retailers Association education expenses for traineeships; chemist naturopathy course.**

**Macworld or similar magazines for a shop assistant in a computer store.**



# Income splitting

**For people who are married or in long-term defacto relationship.**

**Generally used when one spouse is at home looking after children while other is doing paid work.**

**Worker's taxable income is \$80,000**

**Carer's taxable income is \$15,000**

**All savings and investments should be placed under carer's name to take advantage of \$6000 tax free threshold!**

**Self-employed or family businesses use this as well. Carer works as book-keeper in return for legitimate salary.**

# Income timing

**Income is usually taxed when it is paid  
(not necessarily when it is earned).**

**Sometimes you have a choice when to be paid (eg a  
bonus or payment for contract work).**

**If you expect to earn more money next financial year  
then get paid before June 30.**

**If you expect to earn less money next year then get paid  
after July 1.**

# Beware of ...

## **Complex personal finances**

- Added accounting and financial planning fees**
- Increased personal time**
- Increased “switching costs” to change structure**
- Decreased happiness because of time and hassle**

## **Adequate records**

- You must keep detailed records of deductions for 5 years.**

## **Stay away from investment tax schemes!!!**

# You need to be able to ...

- 1. Identify the main sources and uses of tax**
- 2. Calculate personal income tax in Snowland**
- 3. Explain the key issues to consider when calculating personal income tax in Australia**
- 4. Identify the steps required to complete a personal tax return in Australia**
- 5. Explain the key personal income tax strategies in Australia**

# A1: What is John's tax on taxable income?

**Assessable Income** = \$60,000

**Allowable Deductions** = \$10,000

**Taxable Income** = \$50,000

**Tax on taxable income** =  $\$5,000 + 0.30 \times (50,000 - 40,000)$   
= **\$8,000**

Bracket	Taxable income p.a.	Marginal tax rate	Tax on previous brackets
1	\$0 to \$10,000	0%	\$0
2	\$10,000 to \$20,000	10%	\$0 = 0% x 10,000
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4	<b>\$40,000 to \$80,000</b>	<b>30%</b>	<b>\$5,000</b> = 1,000 + 20% x (40,000 - 20,000)
5	\$80,000 or more	40%	\$17,000 = 5,000 + 30% x (80,000 - 40,000)

[Go to Question](#)

## A2: What is Lucy's net tax payment?

1. **Assessable income =  $90,000 + 1,000 = \$91,000$**
2. **Allowable deductions =  $\$2,000$**
3. **Taxable income =  $91,000 - 2,000 = \$89,000$**
4. **Tax on taxable income =  $17,000 + 0.4 \times (89,000 - 80,000) = 20,600$**
5. **Medicare levy =  $0.02 \times 89,000 = \$1,780$**
6. **Dividend tax =  $0.15 \times 1,000 = \$150$**
7. **Repayment of student loan =  $0.05 \times 91,000 = 4,550$**
8. **Tax rebate =  $\$300$**
9. **Personal income tax =  $20,600 + 1,780 + 150 + 4,550 - 300 = \$26,780$**
10. **Tax already paid =  $\$27,300$**
11. **Net tax payment =  $26,780 - 27,300 = -\$520$  (\$520 tax refund)**

[Go to Question](#)