TAX — IS IT UNAVOIDABLE?

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QUICK TAKE

- Businesses not making a profit are businesses going backwards.
- The businesses making a profit have to pay tax—tax is unavoidable.
- It is best business practice to minimise tax. Once all means are legitimately exhausted, tax considerations are largely based on timing of cash flow.
- Don't starve your business of cash.
- Interest rates may have bottomed out, so consider fixing a portion of your debt.

2013 was an outstanding year for grain growers in the western Riverina. The crops were early enough to avoid the frosts that severely impacted grain growers in the east, and a warm winter and good rainfall in September provided well-above average yields across a large area.

Many grain growers forward sold grain in 2013 for good prices. Prices at harvest (especially barley) were unattractive and a lot of grain sales were held over. Grain prices remain strong into 2014, providing good opportunities for the balance of crops to be sold. As a consequence of high yields and good prices, many growers are looking at the prospect of a profit in 2013–14.

Minimising profit

We all know profits mean tax! However, there are different ways of minimising profits such as deferring grain sales, using Farm Management Deposits, bringing forward operational expenses and purchasing capital items. Each of these strategies has their limitations.

Deferring grain sales until July 2014 exposes businesses to the risks of falling grain markets, creditor default and opportunity costs such as warehousing and interest of $5–$15/tonne.

Farm Management Deposits are a legitimate tax management option but interest rates are low and the money is locked away for set periods.

Bringing forward operational expenses, such as pre-purchasing fuel or fertiliser, is a sound option but there is a limit to how much expenditure can be brought forward.

The purchase of capital items is ineffective as they cannot be claimed as a 100% business deduction in the first year. So purchasing a capital item can impact on your cashflow but not assist in minimising your tax liability.

Irrigators may be able to bring forward expenditure on irrigation layouts, such as re-lasering, and claim a 100% deduction in same the year under the Income Tax Assessment Act (1997). This provides a worthy option for future planned works, but options are highly specific and will put pressure on cash flows. This could be a 'short-term pain for long-term gain' outcome, but don't starve your business of cash.

Paying tax

Every business has different circumstances, so individual specific tax advice is best sought from your accountant. In the first instance, carry-forward losses can be used to minimise profits and there other means such as trading through a company which allows for tax liabilities to be minimised. Beyond these legitimate strategies the message is simple "just pay the tax". Bankers desire to have their clients 'repair their balance sheets' when profits are made, in other words pay down debt. If you have no accumulated tax losses then debt can only be paid down post-tax.

I am not an accountant, so my apologies to all those in the profession as I attempt to provide a simple plain English summary!

Farming income varies year-to-year with seasons and markets, as do costs. Over time, if you make losses you can accrue those losses to offset future tax liabilities. If you have no accumulated

Upgrading your plant and equipment will not help minimise tax liabilities in the longer-term, and it can restrict your business of cash flow.

Capital expenditure on plant and infrastructure cannot be claimed as an operational expense to help minimise tax liabilities.

losses and make a profit, you will get a tax bill. If you defer income from one year to the next to minimise your tax liabilities, then all you are doing is deferring the time when the tax liability falls due. In other words, the timing of tax is a cashflow consideration and sooner or later you will get a tax bill. Businesses that record losses year-on-year will never pay tax, but they are going backwards. For a business to progress, it must make a profit and as a consequence will also have to pay tax. Tax is unavoidable.

If you make a profit and pay tax the next year, whilst also recording a loss, that loss can be carried forward to offset future tax liabilities. Tax losses can be accrued so the benefit is not lost by paying tax in any given year.

If you get a tax bill, you must have access to the cash when it falls due. Do not starve your business of cash. Your Financial Statements may not be lodged until March the year after the profit is made and your tax liability will be due before the end of the financial year. You may also be required to pay provisional tax, which means you may get taxed twice in the same year. If you make a loss in the second year, you will get the provisional tax refunded.

As only a portion of profit (for a company 30%) is required to be paid as tax, when you make the profit you should set aside your projected tax liability (as advised by your accountant) for access later. This will vary according to a business' specific situation and could be a variable loan with a redraw facility to reduce your short term or interest costs or a term deposit earning you interest.

Interest rates

The Australian interest rate market reflects the net pressures of world economic conditions and the Australian economic outlook in particular. Traders have diverse views especially in the short term. Some believe there is a chance of yet another fall in official rates but the great majority appear convinced that from now on (March 2014) rates will only rise.

It is not a given but the Reserve Bank of Australia (RBA) appears to be signalling that there is a much higher chance the next official rate change will be up rather than down.

The market is indicating that when rises do occur; the rate of rise will be relatively slow. As a guide, as at March 2014, the futures market has rates flattening at about 1.5% above current rates for the next three to five years, with fixed bank rates now about 0.5% for three years and 1.25% for five years above variable rates.

As expected the interest rate outlook in other countries is mixed and driven by the local economic conditions, in particular in key economies such as the USA, China and parts of the European Union. Belief is growing that the United States of America economy has turned the corner and the pace of improvement is accelerating. In recent times the Federal Reserve has talked about the possibility of rate increases sooner rather than later as part of the process of quantitative easing and controlling the risk of inflation.

Inflation risk

The general belief is the risk of inflation is low, with an outside chance of a bubble burst in the housing sector. Such a burst could see interest rates remain low. There is growing commentary seeing potential for acceleration in interest rates in order to control potential inflation as world economies become more robust and to reduce the value of high national debts around the world.

No one can accurately predict what will happen with interest rates. Therefore good risk management is to avoid having all your financial facilities maturing at a time in the cycle when interest rates are high.

Further information

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