Tax Planning vs. Investment Planning

G.O. Gutman, an investment adviser, tells the Bar to find time to manage its money.

According to Mr. David Bloom, QC * 'The nature of a barrister's practice does not permit of much tax planning - short of negatively geared investments, home investment .... and service companies or trusts....'.

This statement seems to strike an unduly gloomy note because few tax planning strategies come to mind from which barristers, by the nature of their practice, are excluded. More importantly, however, the statement misses the real snag as Mr. Bloom neatly recognises, when he says: 'One of the greatest problems is the barrister himself. A barrister is typically a person who can afford the price of a good suit but not the time it takes to have it measured'.

What such a typical barrister lacks time for is not so much tax planning, but the more crucial exercise of investment planning. Tax planning, for which expert advice is readily available, aims at defending the income stream against the depredations of the Commissioner: investment planning sets personal financial objectives and the best strategies for reaching those objectives. That exercise calls for personal input in weighing such distasteful and sombre questions as

- how much do I need to spend each year
- when do I want to retire
- what lifestyle will I adopt when retired and how much will it cost
- what risks can I afford to assume in the pursuit of accelerated income and asset growth
- how much do I want to leave to my heirs.

The effluxion of time eventually provides answers to all such questions, as options narrow, and as, in the absence of clear strategies, objectives once potentially attainable, drift out of reach.

In recent decades, especially in Australia, 'tax planning', 'tax minimisation', 'tax schemes', were the order of the day. With a good scheme many people thought asset growth could in practice be left to look after itself: no special plan needed. The events of the last decade have rung the changes on whatever plausibility this attitude might once have had. The broad sweep of economic and political reforms during the 1980s have sharply contracted the scope for 'tax planning' and have shifted emphasis to the need for investment planning for the higher income earner.

How has this come about? There are five main ways to achieve tax efficiency.

The first is through converting income into capital gain. This is most often done through negatively geared investments, where tax deductible interest payments finance the acquisition of assets which appreciate. Capital gains are still worth aiming at for those in the top income tax brackets. But they have become distinctly less attractive since the introduction of capital gains tax; with recent reductions in top marginal income tax rates; with the sharp rise in (real) interest rates, and the introduction of dividend imputation. Capital gains will lose further appeal as personal income tax is reduced and when inflation recedes.

Secondly, there is income splitting where part of a high income is distributed towards dependants or beneficiaries taxed at a lower marginal rate.

The opportunities for this have become more restricted as the classes of eligible beneficiaries have been narrowed; as top marginal tax rates have dropped and with the introduction of imputation which allows companies to make tax free distributions. The benefits from income splitting are as a result confined to no more than about $7,500 per eligible beneficiaries; say, $30,000 of tax saving in the case of a high income earner with a wife and 3 other eligible beneficiaries.

The third method is by investing in things for which the Government offers concessional tax rates e.g. gold (until January 1, 1991), occupational superannuation, Friendly Societies (taxed at 30% as against 39% for companies), film investments, rural investments and Management and Investment Companies (MIC's) etc. The scope and attraction of all of these has been sharply reduced in recent years. The best bet left is generally the domestic residence - for as long as it remains exempt from capital gains tax.

The celebrated economic guru, Milton Friedman, once said, 'the best tax shelter, always, is high living'. He meant that a yacht, a Rolls Royce or a luxurious residence tend to appreciate in value more than inflation and in addition yield an untaxed use value (enjoyment) which would otherwise need to be purchased from post-tax income, e.g. by hiring a yacht. The fringe benefits tax however, has sharply reduced the ways (once numerous) in which consumption expenditures could be made tax deductible.

The main remaining class of measures is concerned with shifting assessable income from one period to the next on the principle that (particularly with interest rates high) taxation delayed is income gained. Here, too, recent changes such as the introduction of quarterly tax payments have narrowed the scope for tax-effective conduct.

Overall, the general administration of tax laws has tightened. The fiscal authorities have become more aggressive and the courts more supportive of stricter application of the provisions in the tax code (Section 28) and more recently Division 4A) under which it is not acceptable to enter into schemes for the sole or dominant purpose of obtaining a tax benefit. The severity and uncertainty of enforcement provisions make sensible people more cautious in weighing the possible benefit from schemes against the potential psychic and financial trauma of having to validate them in the courts.

All this has been plain for some time. I mention it because few methods of tax minimisation come to mind from which barristers cannot benefit along with other tax payers. What has happened is that the whole universe of tax planning has shrunk, partly as a result of increased administrative prowess (or ferocity) by the Commissioner and partly as a result of tax reform, such as capital gains tax, lower personal and company tax rates, dividend imputation and elimination of many tax concessions. Moreover, the trend towards lower taxation and a more level taxation playing field is bound to continue. The trend is world wide and would be difficult to resist for Australia in view of the globalisation of markets which has resulted from financial deregulation.

It is this factor which, as the emphasis on tax planning is fading, has enhanced the role of investment planning and investment strategy. The reason is that global deregulation has expanded world financial markets and at the same time destabilised them.

Investment options and opportunities have become globalised along with fluctuations in asset markets resulting from unstable interest and exchange rates and domestic inflation.

There is no such thing as a risk-free investment. While this has always been true in a theoretical sense, the de-regulated environment is making questions of risk more central to investment decisions.

Basic tenets once widely accepted, such as 'putting your savings into Government bonds, or residential property or blue chip shares' have become less adequate.

The basic principle of providing against risk remains the strategy of 'spreading the risk'. This is no mere homely rule of thumb but a colloquial way of referring to the law of large numbers, first proposed by the mathematician Gauss in the 18th century, but rigorously proved only 200 years later.

Spreading the risk on the simplest level involves a carefully weighted balance between the five main types of assets: property, equities, fixed interest securities, foreign currency assets, precious metals and a range of collectibles. A more precise classification would, of course, be needed for purposes of portfolio allocation; thus it might distinguish between at least five types of property (residential, industrial, commercial, rural, retail) which can each follow quite diverse trends; while fixed interest securities run all the way from bank guaranteed bills to junk bonds and 30 year US Treasury issues.

The extension and deepening of financial markets has so far failed to improve their stability. It has, however, crated a widening range of products which cater for investors who are prepared to pay premiums to avoid risk; or, for that matter, for investors who wish to make profits by assuming those risks.

To revert to my point of departure. What would one say about a farmer who labours hard to get his crop planted in the field and erects scarecrows to keep the (taxation) birds at bay: but who fails to make provision to harvest and store his crop and to sell it? The same comment might apply to a professional person who in Mr. Bloom's words 'can afford the price of a good suit but not the time it takes to have it measured'. Inevitably, such a person will with time become sartorially derelict, much as one who begrudges the time to have a bespoke financial plan tailored to his requirements may eventually drift into financial dereliction. ❑

G.O. Gutman is Managing Director of Investment Funds Management Pty. Ltd., 140 Pitt Street, Sydney.

* David Bloom, QC - <u>Practice Companies and Service Entities</u> in Bar News Spring 1988, page 17.

Supreme Court of New South Wales Appointment of Sittings for 1990

1. Sittings of the Central Criminal Court shall begin on Monday 15 January 1990 and end when the fixed vacation begins.
2. The Sydney civil sittings will commence on 29 January 1990.

<u>Appointment of Circuit Sittings for 1990</u>

Court of Sittings	Commencing Date	Duration
Albury	Monday 23rd July (Civil)	2
	Monday 6th August (Criminal)	4
Armidale	Monday 26th March (Criminal)	3
	Monday 25th June (Civil)	1
Bathurst	Monday 9th July (Civil)	2
Broken Hill	Monday 11th June (Criminal & Civil)	3
Coffs Harbour	Monday 9th July (Civil)	2
Dubbo	Monday 25th June (Civil)	2
Goulburn	Monday 29th January (Criminal & Civil)	3
Grafton	Monday 30th April (Criminal)	4
	Monday 23rd July (Civil)	2
Griffith	Monday 25th June (Civil)	2
Lismore	Monday 25th June (Civil)	2
Narrabri	Monday 18th June (Civil)	1
Newcastle	Monday 5th February (Civil - Jury)	3
	Monday 5th March (Criminal)	3
	Monday 26th March - Civil - non Jury)	2
	Monday 30th April (Criminal)	3
	Monday 21st May (Civil - Jury)	3
	Monday 18th June (Civil - non Jury)	2
	Monday 9th July (Criminal)	3
	Monday 30th July (Civil - Jury)	3
	Monday 3rd September (Civil - non Jury)	2
	Monday 8th October (Criminal)	3
	Monday 5th November (Civil - Jury)	3
Orange	Monday 12th February (Criminal)	4
	Monday 23rd July (Civil)	2
Tamworth	Monday 2nd July (Civil)	2
Wagga Wagga	Monday 9th July (Civil)	2
Wollongong	Monday 12th February (Civil - Jury)	3
	Monday 5th March (Criminal)	8
	Monday 30th April (Civil - non Jury)	2
	Monday 28th May (Civil - Jury)	3
	Monday 18th June (Criminal)	9
	Monday 20th August (Civil - non Jury)	2
	Monday 3rd September (Criminal)	10
	Monday 19th November (Civil - Jury)	2

The fixed vacation begins on 17th December 1990 and the first day of term in 1991 will be 28th January.