MODULE 5 – 5 TAX AND GST

UNDERSTANDING GST

Goods and Services Tax (GST) in Australia is a value-added tax of 10% on most goods, services, and other items sold or consumed in Australia. Both businesses and consumers interact with GST in different ways:

How GST Works in Australia

GST-Registered Businesses:

- Businesses must register for GST if their annual turnover is $75,000 or more.
- They collect GST on behalf of the government on the goods and services they sell.
- They can claim credits for the GST included in the price of goods and services they purchase for their business (these are called GST credits or input tax credits)

Collecting GST:

- When a business sells goods or services, it adds 10% GST to the sale price.
- This collected GST must be reported and paid to the Australian Taxation Office (ATO).

Claiming GST Credits:

- Businesses can claim a credit for the GST paid on business-related purchases and expenses.
- The difference between the GST collected on sales and the GST paid on purchases is the net GST payable or refundable to the ATO.

Example: Business Paying and Collecting GST

Scenario:

Business: Example Pty Ltd

Sales: $110,000 (including GST)

Purchases: $33,000 (including GST)

STEP-BY-STEP CALCULATION:

Calculating GST on Sales:

Total Sales (including GST): $110,000

GST Collected on Sales: $110,00011=10,00011110,000=10,000

Calculating GST on Purchases:

Total Purchases (including GST): $33,000

GST Paid on Purchases: 33,00011=3,0001133,000=3,000

Net GST Payable to the ATO:

GST Collected: $10,000

GST Credits (Paid on Purchases): $3,000

Net GST Payable: 10,000-3,000=7,00010,000-3,000=7,000

Summary of Transactions:

Sales without GST: 110,0001.1=100,0001.1110,000=100,000

GST on Sales: 110,000−100,000=10,000110,000−100,000=10,000

Purchases without GST: 33,0001.1=30,0001.133,000=30,000

GST on Purchases: 33,000−30,000=3,00033,000−30,000=3,000

Net GST Payable to ATO:
10,000(GSTCollected)−3,000(GSTCredits)=7,00010,000(GSTCollected)−3,000(GSTCredits)=7,000

DETAILED EXAMPLE BREAKDOWN:

Sales Calculation:

If Example Pty Ltd sells goods worth $100,000 before GST, they add 10% GST:

Selling Price Including GST: 100,000×1.10=110,000100,000×1.10=110,000

GST Collected: 110,000−100,000=10,000110,000−100,000=10,000

Purchases Calculation:

If Example Pty Ltd makes purchases worth $30,000 before GST, they pay 10% GST:

Purchase Price Including GST: 30,000×1.10=33,00030,000×1.10=33,000

GST Paid: : 33,000−30,000=3,00033,000−30,000=3,000

Net GST to Pay:

The business collects $10,000 GST from sales

The business pays $3,000 GST on purchases

Net GST payable to the ATO: 10,000−3,000=7,00010,000−3,000=7,000

Conclusion

GST in Australia requires businesses to collect GST on sales and pay GST on purchases. They report these amounts to the ATO and the net difference is the GST they owe or the refund they receive. In our example, Example Pty Ltd collects $10,000 in GST from customers and pays $3,000 in GST on business purchases, resulting in a net payment of $7,000 to the ATO.

How Company Tax Works in Australia

In Australia, companies are required to pay tax on their taxable income. The company tax rate depends on whether the company qualifies as a base rate entity or not.

Company Tax Rates:

Base Rate Entity: For the 2023-2024 financial year, a base rate entity, which is a company with an aggregated turnover of less than $50 million and with 80% or less of its assessable income being passive income, pays a tax rate of 25%

Other Companies: Companies that do not qualify as a base rate entity pay a tax rate of 30%

Taxable Income:

Taxable income is calculated as assessable income minus allowable deductions. This includes revenue from sales, interest, rent, etc., minus expenses like operating costs, wages and depreciation.

Example Calculation of Company Tax

Scenario:

Revenue: $500,000

Expeses: $300,000

Total Income: $200,000

Base Rate Entity:

Tax Rate: 25%

Tax Payable: $200,000 * 25% = $50,000

Non-Base Rate Entity:

Tax Rate: 30%

Tax Payable: $200,000 * 30% = $60,000

Drawing Income from a Company

An owner can draw income from a company they own in several ways, each with different tax implications:

Salary or Wages:

The owner can be employed by the company and receive a salary. This salary is a deductible expense for the company and is taxed as personal income for the owner.

Dividends:

After-tax profits can be distributed to shareholders as dividends. Dividends may come with franking credits, which are credits for the tax the company has already paid. Shareholders may receive a tax offset for these franking credits

Director's Fees:

Directors may receive fees for their services, which are also deductible for the company and taxable to the individual.

Drawing Income as Salary:

Alice decides to pay herself a salary of $80,000

The salary is a deductible expense for the company, reducing taxable income.

New Taxable Income:

Revenue: $500,000

Expenses: $300,000 + $80,000 (salary) = $380,000

New Taxable Income: $500,000 - $380,000 = $120,000

Tax Payable at 25%: $120,000 * 25% = $30,000

After-Tax Profit: $120,000 - $30,000 = $90,000

Alice's salary of $80,000 is taxed as personal income according to her individual tax rates.

Drawing Income as Salary:

Instead of a salary, Alice decides to take the after-tax profit as dividends.

After-Tax Profit Available for Dividends: $150,000

Alice receives $150,000 in dividends, which may be fully franked.

Franking Credits: $50,000 (the tax already paid by the company).

Alice's Taxable Income from Dividends:

Grossed-Up Dividend: $150,000 + $50,000 (franking credits) = $200,000

Alice includes $200,000 in her personal income tax return and claims a $50,000 tax offset.

Personal Tax Implications for Alice:

Alice's personal tax rate applies to the grossed-up dividend.

The $50,000 franking credit offsets her tax payable.

Conclusion

In Australia, company tax is applied to taxable income at either 25% or 30%, depending on the company's status. Business owners can draw income through salaries, dividends, director's fees, or loans. Each method has different tax implications, both for the company and the individual. Careful planning and compliance with tax laws, such as Division 7A for loans, are essential to optimise tax outcomes and avoid penalties.

NOTES SECTION