

How to make your bonus grow

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It's bonus time again. With big players such as Macquarie paying out theirs at the moment and staff at other Australian companies expecting payouts after the end of June, one of the key questions is: how should you take it?

Fringe benefits tax has knocked on the head many ways of receiving the reward without losing almost half of it in tax, but there are still at least 10 ways you can get your bonus to work harder for you.

And there's still time to get it organised so it's working for you this financial year.

If you're in the running for a discretionary bonus - where there's a bonus pool to be distributed after the financial year-end at the discretion of the board - you still have time to arrange with your employer how you want to receive it, because you haven't yet become entitled to it. "These are easier as you've got more time to indicate how you'd like to receive [the bonus]," says Elizabeth Lucas, director, indirect taxes at Deloitte in Melbourne.

With a non-discretionary bonus, though, you've got to lock your preferences into your contract at the beginning of the financial year. These are usually formulated, says Lucas, where a certain amount of your remuneration is pegged to performance hurdles.

Even so, adds Gary Fitton, director of Remuneration Strategies Group in Melbourne, you can get around this. If you want your bonus paid a particular way and you haven't set it in stone at the start of the financial year when your entitlement began, you can request that the bonus not be paid this year but next year.

"Even if you have a fixed entitlement and it's part of the employment contract, you can ask the employer to wait until July 1," Fitton says. "It's based on a case called the Brents case (tax ruling, TR 2001/10)."

Superannuation is where most people choose to direct their bonus. With super contributions tax of 15 per cent and the highest surcharge rate at 14.5 per cent, the most you'd pay is 29.5 per cent - "a lot better than 48.5 per cent [income tax]," says Fitton.

The accompanying table (How you gain more in super) from remuneration consultant RPC Group shows how a \$40,000 bonus would leave you with \$20,600 in the hand if taken in cash and \$34,000 taken in super. This does not take into account the super surcharge, which cuts in at incomes from \$94,691 up to \$114,981 (up to a maximum of 14.5 per cent) and is indexed each year. From July 1 - under budget changes - the maximum surcharge is being cut to 12 per cent, 10 per cent in July 2005 and 7.5 per cent the following year.

Employee share plans and the ability to sacrifice your bonus into them are popular among employees of listed companies because of the tax concessions. There are two main plans. The "exempt" plan is where you can bonus-sacrifice a maximum \$1000 and there's no tax clawback. "If you got a \$1000 bonus and you were on the 30 per cent tax rate and took it in cash," RPC's Kris Chikarovski explains, "you'd lose \$300 of that in tax, whereas the \$1000 paid in shares is totally tax-free. The \$300 tax saving is never clawed back: when you sell, the cost base is \$1000 not the \$700 after-tax amount."

The second type, a deferred plan, has no dollar limits and offers a tax deferral for up to 10

years. "Say you get a \$10,000 bonus and your marginal rate is 48.5 per cent, if you took it in cash you'd have \$5150 after tax [to invest in shares]," Chikarovski says. "But if you put the bonus pre-tax into shares, you'd have \$10,000 worth of shares, earning dividends and with the potential for capital growth." (See table, How a share plan can put you ahead.) You pay income tax on the value of the shares when you sell the shares, when you leave your employer or 10 years after you get the shares (whichever happens first).

However, says Paul Ellis, specialist in employment tax and salary packaging at Ernst & Young, if you get the deferral there are restrictions on disposing of the shares, stopping you from selling them for a certain time.

Performance rights offer the same tax deferral advantages for executives whose share plans are not open to at least 75 per cent of the workforce.

In these cases, says Ellis, tax deferral only works with options or performance rights (the right to acquire a share for no consideration - for example the shares may be worth \$1 and if you get 10,000 performance rights you're in effect getting \$10,000 worth of shares).

"If you're deferring your bonus, ensure that the hurdles are not too onerous," advises Ellis. "If you're being given performance rights as an extra, it doesn't really matter. But if you've been given a \$50,000 bonus, then you want to make pretty sure that you'll be able to meet the performance or vesting hurdles."

Cars can be financed pre-tax via your bonus, although it's generally not advisable as it's a yearly commitment and your bonus may not keep up. "The main thing that drives cars is access to the statutory formula based on kilometres that deems them to have a certain value for FBT purposes which is well below their commercial value," says Les Szekely of Horwath Sydney.

Zero interest loans can help your cash flow. Instead of being paid a cash bonus of \$10,000 and losing \$4850 in tax, says Deloitte's Lucas, an employee could ask to have it paid as a zero-interest loan - as long as it is used for income-producing purposes, which is why there is no FBT payable. It's known as the "otherwise deductible" rule - if an expense would have been 100 per cent tax-deductible in the hands of an employee and the employer pays the expense on this person's behalf, there is no FBT.

For example, you may have an investment property loan and you package payment of the interest directly from the employer. Obviously, when interest costs are paid via pre-tax income you can't again claim a tax deduction in your tax return. There is still tax payable down the line, adds Lucas, but only when you leave your employer and at the lower rate of 31.5 per cent or less which applies to eligible termination payments (ETPs) or your leaving payout.

Under the same "otherwise deductible" rule, you could package your bonus pre-tax to pay the interest on an infrastructure bond - if you can find one - because of the huge tax deductions they can offer.

These, says Rowan Wall, principal of Eclipse Financial Group, can offset tax on other income - to get below super surcharge level as well as means-tested levies and family allowances. They're also useful in offsetting large realised capital gains.

"Infrastructure bonds are rare," Wall says. "You've got to be high up in the organisation [to get them]. But organisations [such as private banks] are using them to attract business at the moment."

He cites as an example a Westpac bond where if you'd pre-arranged with your employer to sacrifice your bonus, the employer would pay (pre-tax) the interest costs of \$46,511, and you would get a tax deduction of \$61,389.78 for that financial year. "There would be no FBT," says Wall, "because it falls under the 'otherwise deductible' rule."

And, of course, there is good old cash.

Most younger employees are taking their bonuses in cash, says Steven Travis, director of Northhaven Financial Management in Brisbane. They don't package it into super because of the "liquidity risk" - they can't access it until much later in their lives.

"Most of them are reducing the mortgage, or using it to start a share portfolio or fund a deposit for another property purchase - this time in the cycle might be different," says Travis.

"Gone are the days when they'd buy a Mercedes or BMW with the bonus - they're a bit more responsible, eradicating the mortgage or using it for investment. But there's always some used for a holiday or lifestyle expenditure."