

## Tax School Publication

### Concepts of Income Expenditure

- There are 2 basic concepts in relation to all financial matters.
- These are the concepts of 'income' and 'expenditure'.

#### Income

- Amounts received' by yourself in return for the provision of your services or the sale of your goods.
- Examples include the following:
  - Salary & wages received
  - Rental / Dividend / Interest received
  - Business income received (as per invoices issued)

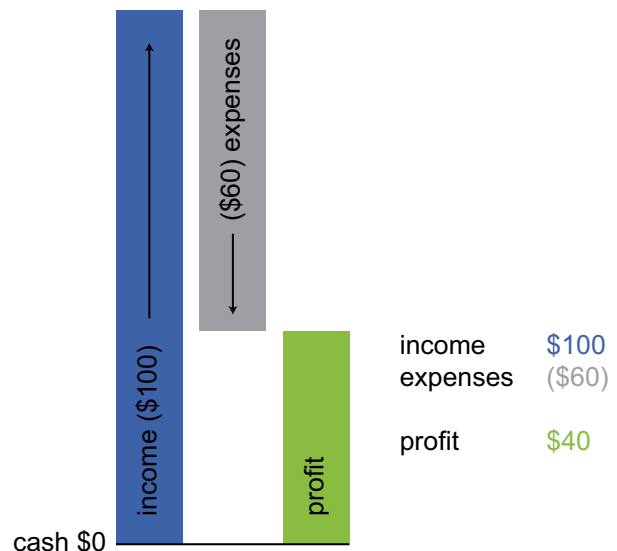
#### Expenditure

- 'Amounts paid' by yourself to someone else for the purchase of items or for the payment of services that were provided to yourself.
- Examples include the following:
  - Salary & Wages paid
  - Rent / Interest paid
  - Purchase of stock / materials

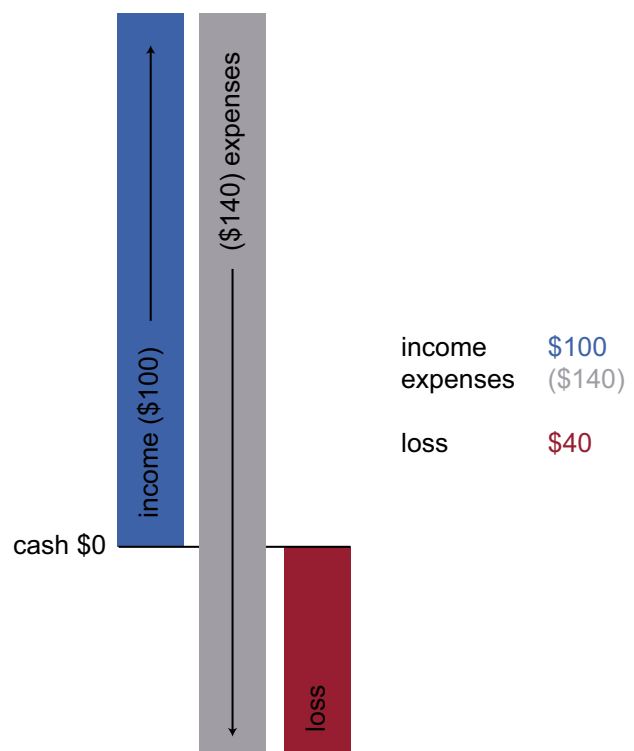
#### Profits compared to Losses

- A 'profit' arises when the amount of 'Income' received is greater than the amount of 'Expenditure' paid.

- The following diagrams illustrate how a profit is calculated.



- In contrast, a 'loss' arises when the amount of 'Income' received is less than the amount of 'Expenditure' paid



## The Tax System

- In Australia, income tax is generally payable on a person's 'Taxable Income' (which is very similar to the concept of a profit as discussed above)
- 'Taxable Income' is broadly defined as 'assessable income' less 'allowable expenses' (i.e.. income less expenses).

### Positive Taxable Income

- When a taxpayer's 'assessable income' is greater than their 'allowable expenses' – they are taken to have a Taxable Income / Profit.
- Income tax is then calculated by applying the applicable tax rate to the taxpayer's taxable income / profit.

*The calculation of tax payable will be discussed in subsequent publications.*

### Negative Taxable Income (Tax Loss)

- When a taxpayer's 'assessable income' is less than their 'allowable expenses' – they are taken to have a 'Tax Loss'.
- No income tax is payable on a tax loss.
- Subject to certain tests, tax losses may be carried forward to future years to offset any 'taxable income / profits' derived in subsequent years.

## Pay As You Go – Instalment System

- Once a taxpayer lodges an income tax return disclosing taxable income / profit they are generally entered into the PAYG Instalment System.
- Generally speaking, this requires the taxpayer to prepay tax instalments to the Australian Taxation Office towards their expected tax liability in subsequent the subsequent year(s).

### Example – PAYG Instalment System

*John Smith lodges his tax return for the income year ended 30 June 2006 with a taxable profit of \$10,000 from his plumbing business (in addition to his normal salary & wages).*

*The amount of income tax payable by John Smith in relation to his taxable profit from his plumbing business is \$4,000. Assuming John has been entered into the PAYG Instalment System, he will most probably be required to pay 4 quarterly instalments as follows towards his expected tax liability for the income year ending on 30 June 2007.*

- September 2006 - \$1,000
- December 2006 - \$1,000
- March 2006 - \$1,000
- June 2007 - \$1,000

*This will ensure that John has prepaid the majority of his expected income tax liability prior to the lodgement of his income tax return for the year ending on 30 June 2007.*

### Traps to look out for...

- A taxpayer will not be required to pay any PAYG Instalments in the initial year of conducting a business.
- This is because the taxpayer would not have yet lodged an income tax return with the Australian Taxation Office disclosing business income and therefore would not have been entered into the PAYG Instalment System.
- Taxpayers commencing business (or experiencing high growth) should therefore speak to their accountant to discuss a possible savings plan in relation to their annual income tax liability to alleviate any potential cash-flow problems.

*Should you wish to subscribe to our free monthly Tax School publications or if you would like any financial concepts explained in more detail, please do not hesitate to contact us.*

Please note, the above information is general in nature and is not intended to constitute advice.

You should seek professional advice specific to your circumstances before acting on any of the above information

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