Be careful out there...

As another financial year draws to a close we are moving into the sharp end of the tax planning season. Tax is a major headwind to any investment and everyone has the right to minimise the amount of tax they pay through legal tax planning arrangements.

Indeed the after-tax return is the critical measure for any investment. But sometimes the desire to reduce tax can blind people to the risks – both investment and legal – that certain tax schemes, sophisticated and otherwise, carry with them.
In recent years the collapse of a number of high-profile agribusiness and financing schemes have painfully served to alert people to the dangers of committing to tax schemes that promise upfront tax benefits and potential investment returns that ultimately never materialised.

This year the Australian Tax Office has produced a plain language guide - Understanding tax-effective investments - on what to look out for among some of the more common types of tax schemes that the ATO has encountered that have caught out both individual investors and businesses.

For individuals it covers a range of schemes from "mortgage management" arrangements where the promoter offers a way to create tax deductions equivalent to your home loan interest payments by refinancing your home loan, through to traps with scholarship trusts and

education funding programs, and on to illegal early release super arrangements.

One of the lessons from the ATO booklet is that not all these schemes fall into the obviously "too good to be true" category. Some are sophisticated trust structures with all the hallmarks of "expert" opinions and one of the challenges as an investor is being able to separate the tax scheme "promoter" from "adviser".

Participating accountants, lawyers and advisers have been generously remunerated for their support of tax schemes in the past – following the collapse of some agribusiness schemes, commission payments of between 10 and 15 per cent were revealed.

That is precisely the type of conflicted payment structure the government is aiming to outlaw with its ban on commission payments and volume-based incentives within the Future of Financial Advice reforms.

However, while that may provide a new world order for mainstream licensed financial planners it may not prevent the unscrupulous and unlicensed types from operating in the shadows between the accounting and financial planning worlds – indeed most mainstream financial planning businesses (like us) were advising clients to avoid those type of schemes.

A key question investors should ask themselves is if the tax deduction was not there would the investment still stack up on its own merits? The ATO suggests the alarm bells should be going off with arrangements that:

- Offer zero risk guarantees
- Do not have a prospectus or product disclosure statement
- Refer you to a specific adviser or expert
- Ask you to maintain secrecy to protect the arrangement from rival firms and
- discourage you from getting independent advice.

Any of those points ought to have the alarm bells ringing loudly but the last point is perhaps the most telling. If someone is trying to get you to sign up for an investment but really does not want you getting your own independent advice that should be a signal to walk away – fast.

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