money (SEM) to pay for your investments. I have dedicated a whole chapter to this subject later in the book (see chapter 9).

Have a look at your last two tax returns or ask your tax agent to explain them to you so that you can identify your gross income, deductions, taxable income and after-tax income. This will give you a much greater understanding of how your cash flow works and of how tax has affected the decisions you have made so far and, importantly, those you will make in the future.

> **Note to self (that's you!)**
>
> Obtain your last two years' tax returns or call your tax agent and book an appointment to have your taxes brought up to date so that you know exactly where you stand.

Understanding your cash flow in seven simple steps

Understanding your cash flow simply means knowing exactly what your income is and what your expenses are month by month over a given period. You need this information before you can make even the most basic financial decisions.

If, for example, you are wondering whether or not to buy an investment asset or whether to borrow money, these seven steps will provide you with your answer. They can be seen as a kind of financial litmus test, because they will reveal the effect that purchase decisions will have on your cash flow. Since your cash flow has a major impact on how you live your life, you are then in a position to decide if the sacrifice is worth the potential benefit. This is the risk–reward decision-making process—'short-term pain for long-term gain'.

Step 1: calculate your income

Each taxpayer has to lodge an individual tax return, so be sure to include only your own income and expenses. For example, if an asset, such as a property, is proportionately owned—you own 50 per cent and your partner owns 50 per cent—then list only the proportion of the income (or expense) that applies to you. In this case, you would include 50 per cent of the income from the property among your total income (and include 50 per cent of the expenses among your expenses). Fill in table 1.2 to calculate your income.

Table 1.2: your income

	Partner 1	Partner 2 (if appropriate)
Salary		
Investment property 1		
Investment property 2		
Shares		
Franking credits from share dividends		
Term deposit interest		
Other income		
(A) Total		

Step 2: calculate your tax-deductible expenses

Tax-deductible expenses are the expenses you incur in generating your income or in undertaking education relating to your work. See the Australian Tax Office website for more information on allowable deductions <www.ato.gov.au>. Some examples of tax-deductible expenses are work uniforms, education relevant to your work, motor-vehicle use to visit clients, and investment expenses such as interest on investment loans. Table 1.3 provides a useful starting point.

Table 1.3: your tax-deductible expenses

	Partner 1	Partner 2 (if appropriate)
Motor vehicle expenses		
Work uniforms		
Depreciation on investment properties		
Interest on investment loans for property		
Interest on margin loan		
Other expenses:		
(B) Total		

Step 3: calculate your taxable income

Your taxable income (C) is your total income (A) minus any allowable deductions (B). Simply subtract your deductions from your total income.

Partner 1

(A) $______________ – (B) $_______________ = (C) $______________

Partner 2 (if appropriate)

(A) $______________ – (B) $_______________ = (C) $______________

Step 4: calculate your tax

Tax is calculated on a sliding scale: the more you earn, the higher proportion of tax you will pay. If you earn $50 000 per annum, the first $6000 is tax free, the next $31 000 (up to $37 000) will be taxed at 15 per cent, and from $37 001 to $50 000, you will be taxed at

30 per cent. Using table 1.4 you can see your tax on $50 000 would be $8550* ($4650 + ($50 000 – $37 000 × 30% = $3900) = $8550). If you earn $80 000 per annum, you would pay $17 550 in tax ($4650 + $12 900.)

Table 1.4: tax rates

Tax bracket	% rate of tax*	$ amount of tax
$0–6 000	0	$0
$6 001–37 000	15	$4 650
$37 001–80 000	30	$12 900
$80 001–180 000	37	$37 000
$180 001+	45	(not applicable)

* Tax rates applicable for the 2010–2011 tax year, excluding Medicare levy of 1.5%.

Use the figures in table 1.4 and your taxable income from step 3 to calculate your tax payable and fill in below.

Partner 1

Tax payable on your taxable income is (D) $ ______________________

Partner 2 (if applicable)

Tax payable on your taxable income is (D) $ ______________________

Online tax calculators

Alternatively, there is a simple tax calculator on the Henderson Maxwell website <www.hendersonmaxwell.com.au> in the resources section. This can be saved in Excel format for you to keep on your own computer, and the tax brackets can be changed as legislation changes. For an official ATO tax calculator, see the ATO website <http://calculators.ato.gov.au/scripts/asp/simpletaxcalc/main.asp>.

Step 5: calculate your after-tax income

Your after-tax income (E) is simply your taxable income (C) minus the amount of tax you have to pay (D).

Partner 1

(C) $______________ – (D) $_______________= (E) $_______________

Partner 2

(C) $______________ – (D) $_______________= (E) $_______________

Step 6: calculate your non-deductible expenses

Your non-deductible expenses (F) are all your living expenses apart from those for which you can claim a tax deduction. For most people, they include things like food, rent, mortgage payments, council rates, entertainment, utilities (such as gas, electricity and telephone), and house and car insurance. A good guide to these expenses will be the past 12 months' bank statements, credit card statements, receipts or any other source documents you have. Fill in table 1.5 (overleaf) with these details.

Step 7: calculate your net income (also known as your surplus or deficit income)

Your net income (G) is your after-tax income (E) minus your non-deductible expenses (F). In other words, your net income is your surplus income, the money that you have available for saving or investing.

Partner 1

(E) $___________ – (F) $ ________________ = (G) $ _____________

Partner 2

(E) $___________ – (F) $ ________________ = (G) $ _____________

Table 1.5: your non-deductible expenses

	Partner 1	Partner 2 (if appropriate)
Rent/mortgage on home		
Groceries		
Entertainment		
Council rates		
Electricity		
Water		
Gas		
Medical (doctor, dentist, specialist)		
Clothing		
Child care		
Transport		
Motor vehicle expenses		
Insurance		
Gifts		
Boat/caravan/trailer		
Holidays		
Other non-deductible expenses:		
(F) Total		

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The importance of the seven-step process

Again, I'd like to stress the importance of undertaking this seven-step process each time you consider buying an investment asset or any major item. This is crucial, because the tax effect can be a real kicker when you find that the Australian government is contributing to your purchase via tax credits. Tax deductions are like having the government pay a large portion of your tax-deductible expenses, because those expenses are deducted from your gross income before you pay tax.

The budget planner in appendix A (which is also available to download from the Henderson Maxwell website <www.hendersonmaxwell.com.au>) will assist you to accurately record all of your income and expenses on a monthly basis.

Now that you have undertaken the seven-step process and understand your own cash flow, it stands to reason that you should monitor and review your cash flow as time progresses. Your cash flow will change for varying reasons, including job or career changes, having a child or more children, economic conditions and other challenges that may arise from time to time. While you should monitor your cash flow regularly, say every six months, it also needs to be updated each time something changes significantly. Changes will occur for better and for worse and so, too, your income will rise and fall throughout your life. If you have a solid grasp of your financial position, you can make informed decisions in a timely fashion.

Key points

- Don't rely on the government for financial assistance.
- Motivation, application and structure will see you through the financial planning process.
- Identify your goals and objectives and write them down.
- Establish a solid understanding of your cash flow, as that forms the basis of all your financial decision making, both now and in the future.
- Now you know and understand your budget, stick to it.
- Undertaking these activities places you firmly in the box seat for financial success. Well done!