Newsflash

BAN TACS Accountants Pty Ltd

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Welcome to the BAN TACS News Flash. Our aim is to provide short but succinct updates on all tax issues.

Column By Noel Whittaker

The collapse of Australian Capital Reserve (ACR) is another bitter blow for thousands of retirees who are already suffering from the recent demise of Westpoint and Fincorp. For years I have been warning about the danger of entrusting your money to companies that pay above average market rates, but the pattern just seems to continue. The tragedy is that it doesn't have to be like this.

Certainly, interest-bearing accounts should form a part of every investor's portfolio, but there are many ways to do it without risk.

First, think about the online accounts offered by almost all the major lending institutions. You can compare them all by going to www.ratecity.com.au – at date of writing, the website shows the highest rates offered are from BankWest (6.8%) and HSBC (6.4%). These are safe, your money is available at call, and there are no fees for deposit or withdrawal.

Property securities trusts are another good option if you are chasing income. Recently, they have been performing superbly well and some have produced returns of more than 20% per annum - you could realistically expect them to produce a long term return of around 9% per annum (made up of 5% income and 4% growth). A further benefit of property trusts is that part of the income carries tax concessions and can be tax-free or tax deferred.

Hybrid income trusts have been designed for investors who are seeking tax-advantaged income with a small amount of capital growth. They invest in a range of interest bearing securities and high yield shares, and offer the opportunity for higher returns compared to traditional interest bearing accounts; they also have less volatility than investments that are based only in shares - a reasonable long-term return from them should be around 7.5% per annum. Because they do invest in shares, you should not invest in them unless you have at least a five-year timeframe in mind.

If you can take a longer-term view, and are not frightened of the share market, it's hard to beat blue chip shares that pay franked dividends. When the tax rates change next month, the 15% tax band would extend from $6,000 to $30,000, which means most retirees will have a marginal tax rate of 15% at most. For them, franked dividends are not just tax-free; they also include a tax-free bonus, as excess franking credits can be refunded in cash. This takes the after-tax yield from a share that pays a 4.5% franked dividend to 6.5%. This is the annual yield, but of course you will get the long-term growth as a bonus.

Let me finish with a warning about the importance of seeking advice from an adviser or a stockbroker before investing in interest-bearing securities. At least if you seek advice, you have the benefit of the adviser's research and also someone who is accountable if your investment fails to perform.

Noel Whittaker is a proper authority holder for Whittaker Macnaught Pty Ltd - licensed dealer in securitiesABN 96 009 793 971. Reg office address is L22, 215 Adelaide Street, Brisbane 4000

David Thompson from Whittaker Macnaught is regularly available to see clients in our office.

Superannuation Strategies Before 30th June, 2007

There is just 15 days left before superannuation changes forever. Many readers may think that as all superannuation will be tax free once they reach 60 years of age they no longer need to worry whether their superannuation is made up of tax free or taxable components. The trouble is if you die and leave the balance of your superannuation to non dependants i.e. adult children they will have to pay 16.5% tax on the taxable component. So it is still important to have as much as possible of your superannuation categorised as tax free.

It is ok if the super or pension goes to a spouse or children still dependant on the deceased but in reality most people over 59 years of age without a spouse will end up coping this tax if they die before they spend all the money they have in a superannuation or pension fund. This could also apply to couples if they are killed at the same time.

Superannuation funds are only taxed at 15% and pension funds are tax free so there is a big incentive to keep the money in the fund as long as possible. Currently many clients are trying to get around this problem by signing an undated letter withdrawing all their superannuation and instructing their children to date it before their death and lodge it with the superannuation fund immediately that they find out their parent has died. It is not good that the Government has put people in this position and it is not fool proof

From 1st July, 2007 your pre 83 superannuation and undeducted contributions will be added together and simply referred to as the tax free component. From that date any withdrawals you make must contain both tax and tax free components at the same ratio as the totals in your fund. For example if $60,000 of your superannuation is tax free and $40,000 is taxable then each withdrawal you make will be 40% taxable and 60% tax free. If you are other 60 and still alive you will not have to pay tax on the taxable portion.

Before 30th June, 2007 your pre and post 83 amounts are calculated on the number of days since you started accumulating superannuation in that fund or in funds that you have rolled into that fund. So if for example you invested into superannuation 1000 days before 1st July, 1983 and the date of your draw down is 5,000 days after 1st July, 1983 then 20% of your pre and post amount would be considered pre 83. These days are called service days. This means if you have more than one superannuation fund you can increase your pre 83 amount by making sure all your superannuation is in the one fund which will allow it all to be treated in relation to your earliest start date. This will mean on 1st July, 2007 you will maximise the tax free amount that may one day go to you non dependants. The service day basis of calculating the tax and tax free amount will no longer apply after 30th June, 2007 so it is important that you put all your superannuation into the one fund within the next two weeks.

You can also increase you tax free amount by making an undeducted contribution and the way the formula works this undeducted contribution will increase your tax free component by more than the amount of the contribution. This is where a re contribution strategy can work well if you are over 55 years of age. If you are over 55 years of age and stop work (you can change your mind and return to work) you can draw up to $135,590 of post 1983 superannuation out tax free. Note this is a per life time limit, indexed each year. You then redeposit this amount into superannuation as an undeducted contribution, which will not be taxed in the hands of the superannuation fund and will increase your tax free amount at 1st July, 2007 leaving less of your superannuation subject to the 16.5% tax if paid to your non dependants on your death. There are limits on how much you can contribute as an undeducted contribution but this financial year the limit is $1 million. Next year it will be $150,000 though you can contribute up to $450,000 by joining 3 years entitlements together into the one year.

If you are 60 or over you can withdraw as much as you want tax free but your undeducted contributions are still limited as above. This is best done before your fund goes into pension stage as you cannot make contributions to a pension fund. This should not be a reason to delay going into pension stage as the zero tax bracket is probably a greater benefit. If you are already in a pension fund and want to utilise a re contribution strategy you will have to put the undeducted contributions into another superannuation fund and turn that into a pension fund when you have finished. Further, if you are in a pension fund already you will have to wait until after 1st July, 2007 before you can draw large amounts from your fund.

Now there are a few practical barriers to doing this. Firstly, if you move your superannuation into one fund it will increase the service days on the superannuation you had in the new fund. In some formulas such as the calculation of a disability lump sum this will work against you. So please don’t do any of the strategies discussed above without first talking to our financial planners to be sure, after considering your personal circumstances, that you are making the best choice.

Another barrier is liquidity if you have a Self Managed Superannuation Fund. It may not be worth the CGT on realising your investments to provide the cash to draw out of the fund and re contribute. After all the primary purpose of this strategy is to decease possible tax if you don't spend all your superannuation before you die and you leave it to non dependants. This may not be worth paying CGT now and the rules may change one day. Some of your fund's investments are going to be in cash anyway so you may have to do it over quite a few transactions. Drawing out what cash you can then depositing it back again and drawing it out again, you will eventually get up to the amount you need. This would be better than having to pay capital gains tax on selling any investments. Another option is for your SMSF to borrow the money to pay you the amount you need to re contribute, true superannuation funds are not technically permitted to borrow but they are allowed short term borrowings to meet an immediate need. These borrowings will be very short term indeed as you will be putting the money straight back into the superannuation fund. Or conversely you could borrow the amount of the re contribution and deposit that into the fund before drawing out the lump sum to pay back the loan. This method is not the best after 30th June, 2007 because it will increase the amount of tax free portion you will have to draw out which will cause you to have to draw money to get the same portion of taxable component out compared with using the strategy before 30th June, 2007.

If your fund is already in pension stage there will be no CGT payable on any investments you need to sell to finance the withdrawal.

Rental Property Check List of Dos and Don'ts

1) Pay off non deductible debt as soon as possible but if it is on a home you may one day rent out use an offset account rather than pay directly off the loan.
2) Only use a Line Of Credit with a Credit Card used for private purposes, on a non deductible Loan
3) If other loans for Rental Properties are Lines of Credit, only draw on them for rental property expenses and make sure these expenses are paid direct not mixed with in a private cheque account or a credit card used for private purposes as well.
3) Capitalise interest when financially necessary.
4) If you do not have a Main Residence or are considering buying a new one and renting out the one you are in, do not use funds in the offset account to pay the property's expenses. Draw them from the Line Of Credit keeping the offset amount as high as possible. The net result has no effect on interest but this will increase the amount of deposit you will have in the offset account for your Main Residence. When you draw this out, the original loan for the Rental Property or your old home once it is rented, is still fully tax deductible.
5) An offset arrangement is far better than a Line of Credit as it leaves the funds available for private purposes if needed.
6) If only one member of a couple is borrowing for their investment in a rental property try to persuade the bank to only put the loan in that spouses name. Maybe the other spouse could go guarantor.
7) Don't transfer borrowed funds into your personal cheque account.
8) Don't pay interest more than 12 months in advance.
9) Read Australian Property Investor Magazine

When Does A Home Become Your Main Residence For The CGT Exemption?

In Erdelyi v FC of T June 2007 the AAT decided that a home the taxpayers had constructed on vacant land was not covered by their main residence exemption because they had not lived there for at least 3 months. Note the full 3 months was only required because the house was constructed on vacant land but nevertheless this case is relevant in showing what constitutes making a house your main residence. The factors the AAT held against the taxpayers were the limited amount of furniture and household items kept in the house, the electricity consumption that was far too low for them to have spent much time there, the lack of a kitchen stove during that time and the lack of evidence that they had changed their address. The taxpayers tried to argue that they had intended to sell their daughter's home to pay for the new house and as they could not sell her home they sold their's instead. This argument was weakened by the fact that they

had since purchased another home for themselves. The taxpayers may not have covered their tracks very well in this case but it is also evident that to exempt a house as your main residence is not an automatic right. You have to have legitimately made it your home.

Don't Pay More Than 15% Tax If You Are Over 55

If you are over 55 years of age and earn less than $130,000 per year you should not be paying more than 15% tax. This can be achieved by taking a pension from your superannuation fund, continuing to work but salary sacrificing most of your wages into superannuation. Make sure you get professional help to structure this correctly.

Seminars

Mackay Money Show - Julia Hartman will be on the Whittaker Macnaught stand on both Saturday the 16th and Sunday the 17th June. Noel Whittaker will be talking about wealth creation in the auditorium on Sunday.

Ozinvest - will be holding a series of seminars on investment properties. The main feature of the seminars is their panel of experts from various industries who will answer questions from the audience. This is your chance to ask every question you ever had about rental properties and get the answer for free. Taxation questions will be answered by Katreana Hughes from our Nowra office. The seminars are free, to book your seat and enter into the draw for a holiday go to www.propertyinvestmentworkshop.com.au

Wednesday 20th June at 7.10pm to 9.30pm Rydges Parramatta 116 James Ruse Drive Rosehill

Where's Julia

Julia will be in the Mackay and Ayre areas from mid June till the end of July. In August she will travel to Darwin. Anyone in the area interested in learning more about how to claim your trip around Australia as a tax deduction should contact her on 0428381864.

Back Issues & Booklets

To obtain free back issues of the fortnightly BAN TACS Newsflash or any of the following booklets visit our web site on www.bantacs.com.au. You can also subscribe to our Newsflash reminder.

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FBT for PBI's including Hospitals
Fringe Benefits Tax
Year End Tax Strategies
How Not to be a Developer
GST
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Key Performance Indicators
Overseas
Overseas Backpacker Fruit Pickers
Wage Earners
Real Estate Agents
Rental Properties
Subcontractors
Miners
Secret Plans and Clever Tricks
Selling a Business
Small Business
Teachers

Disclaimer:

Please note in many cases the legislation referred to above has only just passed through parliament. The full effect is not clear yet but it is already necessary to make you aware of the ramifications despite the limited commentary available. On the other side of the coin by the time you read this information it may be out of date. The information is presented in summary form and intended only to draw your attention to issues you should further discuss with your accountant. Please do not act on this information without further consultation. We disclaim any responsibility for actions taken on the above without further advice as to your particular circumstances.