

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

Welcome to another financial year – the perfect time to take stock of your affairs to maximise your returns over the next 12 months. Once again there are tax cuts for all with a further relaxing of the tax scales; the 15 percent rate has been raised from \$25,000 a year to \$30,000 a year and the result is a tax cut of \$750 a year for most employees. Unfortunately, the majority will dismiss the tax cut as being insignificant and simply increase their spending.

However, the smart money managers know that financial success comes to those who pay themselves first and who realise that large portfolios come from the accumulation of small sums over time. They will take steps to capture that tax cut before it becomes part of the pay packet and is frittered away with all the other money. If you have a home loan, the easiest strategy is to simply call the bank and increase your home loan by \$63 a month. Even a sum like this will save you a huge amount of interest over time and also give you a safety buffer if rates rise. If your home is paid off, talk to an adviser about starting a regular gearing plan, a margin loan or some borrowing for investment.

If you are over 55 you should be pouring as much money as you can into superannuation. Yes, you need to keep cash on hand for emergencies, but there is no point in leaving money lying in bank accounts where the interest is fully taxable, when you can move it to superannuation where the income will be taxed at just 15%. There is no entry tax on undeducted contributions and, once you reach 60, you can make withdrawals tax-free as needed or leave the balance for as long as you wish. This is also a good time to track down any unclaimed superannuation that is lying idle; it's only a matter of going to www.unclaimedsuper.com.au and following the prompts.

No doubt the coming financial year will be as interesting as all the others – opportunity mixed with difficulty. Just make sure that you are well placed to make your money work for you.

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Capitalised Interest Update

The ATO has issued another ruling on capitalised interest. It is a Private Binding Ruling (PBR) so it will only protect the person who applied for it. Nevertheless PBR 69725 is well worth a read. In this example the taxpayer already has a home loan, they organise a line of credit to invest in shares. The line of credit was a distinctly separate account from the home loan but it was with the same bank. The taxpayer wrote to the ATO stating that he or she did not want to use personal funds to pay the interest on the line of credit. The limit of the line of credit would be used for further investments into shares and to cover the interest that would be capitalised. No mention was made as to how the dividends from the shares would be used. The taxpayer wanted to know if he or she was entitled to a tax deduction for the interest on the capitalised interest and the ATO said yes.

The PBR also concedes that the 2002 Harts case stands, in that if the interest is incurred on borrowings that are deductible then interest on that interest is deductible. As far as Part IVA goes the PBR concludes that “a reasonable person would conclude that you did not enter into the scheme for the dominant purpose of obtaining a tax benefit” and leaves it open to the Taxpayer to choose not to use personal funds to pay the interest. It seems a blatant omission that the use of any earnings from the investment is not addressed. I feel we can rest assured that if they thought they could argue that the earnings from the investment should be used to meet the interest then they would have repeated it several times over.

Those readers who are not afraid of a confrontation with the ATO may choose to redirect rental income towards their private mortgage. Why not get an ATO ruling first and let us know the result. In the meantime even the most conservative reader should not use income that is not directly from the investment to prop it up. Borrow the money necessary to meet the cash short fall and use all your personal income to pay off any personal debt.

Inheriting a Pre CGT Property

. Section 128-15 determines the cost base at which you will inherit the property. If the property had never been the deceased's home you inherit it at the same cost base as the deceased unless it was a pre CGT property to the deceased.

Pre CGT properties are inherited with a cost base of their market value at the date of death and they are deemed to have been acquired at the date of death. This means that the beneficiary will not be entitled to the 50% CGT discount until more than 12 months from the deceased's date of death. On the other hand a post CGT asset is deemed to be acquired at the date the deceased acquired it so the beneficiary will be entitled to the discount immediately if the deceased had owned the property for more than 12 months before death. Reference section 115-30.

Claiming Rental Property Travel Expenses - Update

Travel re Purchase and Signing of Contract to Buy or travel to improve the property - Part of cost base for CGT purposes, if the property was purchased after 20th August, 1991, section 110-25(4).

Travel to Improve the Property – Part of cost base for CGT purposes section 110-25(4)

Travel to Repair & Maintain the Property While Rented – Claimable against current year income

Travel to Repair & Maintain the Property While Not Rented – Part of the cost base for CGT purposes section 110-25(4) if the property was purchased after 20th August, 1991. This is the case even if you are living in the property at the time of the travel but for some reason during the time you own the property it is not covered by your principal place of residence exemption.

How to Pay Your Home Off Sooner

Here is an example of just how knowing the latest tax laws can help you build your wealth through decreasing non deductible debt. Bare with the story it has some very exciting numbers in it. This is based on a recent ATO ruling PBR 69725.

Firstly you need to understand the difference between good debt and bad debt. At its worse bad debt is that wide screen TV or expensive to run car that is not generating you any income. The debt on your home, while being part of a very worthwhile investment is also bad debt because it is not tax deductible. For example if you are earning over \$75,000 a year you will have to earn at least \$1.71 to pay your tax and then

have \$1 left to pay the interest on your home mortgage. On the other hand if the interest you are paying relates to a loan for investments you receive a tax deduction for it so you only have to earn \$1 to pay \$1 in interest. I think you can already see the benefits of getting rid of non deductible debt.

Here is my dream situation.

Mum and Dad own a home worth \$560,000 on which they still owe \$150,000. Even at an 80% lend, so mortgage insurance does not apply, they have another \$250,000 available that they can borrow. So they go to the bank and arrange a line of credit for \$250,000 that is completely separate from their home loan but secured by the same property. They decide to invest \$200,000 into a managed fund from which they expect a return of 4% in fully franked dividends and conservatively estimate capital growth to be 5%.

Mum and Dad have a good income of over \$80,000 a year each but they have a lifestyle to match. This is why they chose to only invest \$200,000, it gives them further available credit of \$50,000 should they not be able to afford the interest repayments on the investment loan.

Having read Noel's book Making Money Made Simple they can see the advantage of compounding their investment return so they advise their financial planner to organise for the dividends to be reinvested. Further, in accordance with Noel's advice they arrange with the bank that the term of the loan, originally used to purchase their home be paid off over 10 years. Now if they paid their home off over 30 years at 7.5% it would cost them \$1,049 per month. Over 10 years the repayments are \$1,781 per month so they need to find another \$732 per month. But let's see what this \$200,000 investment can do for them.

Now to the affect the \$200,000 borrowing has on their tax refund. If the first year they will have a deduction for \$15,000 in interest with \$8,000 in dividends and \$3,429 in franking credits this gives them a tax loss of $\$3,571 \times 41.5\% = \$1,482$ refund but wait there is more they also get the franking credits back $\$1,482 \text{ plus } \$3,429 = \$4,911 / 12 = \409 per month. By applying to the ATO to have the tax instalments in their wages reduced to give them the tax benefit of their refund cheque during the year they already have an extra \$409 per month towards their \$732.

Now the trick here is they do not pay any interest off the \$200,000 investment loan. There is nothing wrong with this PBR 69725 says you don't have to use your private funds to pay for an investment loan and the dividends are being reinvested so there are no investment funds available to pay the interest. The interest is then capitalised and, assuming, for simplicity, they pay their interest annually next year they will be charged interest on \$215,000 all of which will be tax deductible. So in year two their tax return will include interest of \$16,125. Now as the dividend has been reinvested and we are expecting 5% capital growth the dividend received in year two is \$8,720 with franking credits of \$3,737. This will give them a refund of \$5,259 or \$438.25 per month. By year 10 the tax refund is exceeding the \$732 per month in extra repayments but even at the start they only had to take an extra \$323 per month out of their household budget. The tax office is contributing more than they are.

So what have they got at the end of the 10 years. They have paid off all their non deductible debt ie paid off their house in $1/3^{\text{rd}}$ of the time, 10 years rather than 30 years for only a small increase in the repayments. They now have an investment portfolio worth \$434,379 yet the investment line of credit has only increased to \$390,279 so they could sell off the portfolio and have \$44,100 which would cover the capital gains tax if they want to take that road. But a much better path would be to continue with the investment and salary sacrifice the money they had been paying off their house into superannuation so they could pay out the debt when they retire. By saving to repay the loan in superannuation they are saving at a tax rate of 15% while still getting a deduction on the loan at 41.5%.

I must point out at this stage that PBR 69725 is a private ruling so you cannot technically enforce it against the ATO. It is only published to give taxpayers an idea of what the ATO is currently thinking. If you want to be confident you should apply for a ruling of your own quoting PBR 69725.

It is important that these loans are independent of each other, no linked or split facility and that they are not organised through a lender who promotes the tax benefits of such loans.

PAYG Summaries

Unless the only employees of your business are your immediate family you need to have issued all your employees with their PAYG summaries by now.

Minor Exempt Fringe Benefits

This FBT year the threshold for minor exempt fringe benefits is \$300. The ATO has just released a draft ruling TR 2007/D6 which discusses just what sort of benefits it could apply to. The benefit must be infrequent and irregular. The draft ruling states that it is the Commissioner's view that where a salary sacrifice arrangement is in place it is clear that any benefits provided under that arrangement are a reward for service so do not qualify as a minor benefit.

Child Care Fees

If you have children in child care, as part of your preparation to see your tax agent this year please go to the Centrelink web site and download your personal report on the fees for which you will be entitled to claim the child care tax offset. You will need to download the information for the 2005/2006 and 2006/2007 financial years.

Seminars

Ozinvest - will be holding a series of free 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. There will also be information provided on how the new superannuation rules affect property investors. 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 go to www.propertyinvestmentworkshop.com.au

Tuesday 17th July at 7.10pm to 9.30pm Rydges Parramatta 116 James Ruse Drive Rosehill

Thursday 26th July at 7.10pm to 9.30pm Wesley Centre, Sydney

Where's Julia

Julia will be in the Mackay and Ayre areas 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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Overseas

Real Estate Agents

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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.