

# 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

In the last few weeks we have been discussing what you can do with your super when you retire. Today let's think about annuities.

There is no exit tax for those aged between 55 and 60's when funds are rolled from the superannuation area into an annuity and the return of the annuity will somewhat in line with long term bond rates, currently around 6%. The advantage of an annuity is that it can give you a capital guaranteed income for life, but it is an extremely inflexible investment. It is almost impossible to vary your income from the annuity; you can't make lump sum withdrawals, and unless the annuity has a guaranteed period, the money is lost to your estate on death.

Obviously, the allocated pension is much more flexible, and if based on growth investments, should give a much higher effective return over time than an annuity. Given that today's retirees may live for more than 30 years, it is clear that an allocated pension could provide hundreds of thousands of dollars more than an annuity over a long term.

What about the fear of your money running out if you have an allocated pension?

This shows a basic misunderstanding of the way allocated pension funds work.

Certainly you are required to draw a minimum pension each year to prevent your accumulating funds in a tax-free haven forever, but once you transfer the money from the allocated pension fund to your ordinary account, you can spend it or invest it wherever you wish. Unfortunately, you can't put it back into your tax-free allocated pension fund.

Be aware that annuities bought before 20th September have unique benefits for retirees as Centrelink will count only 50% of the purchase price for the assets test. As usual, advice is critical because the best course of action will depend on your individual circumstances.

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

## Using Small Business Concessions on Your Home

In ID 2002/753 the ATO accepts that the portion of a house used in a business can be an active asset. In the Interpretive Decision a company purchase 30% of a house with the remaining 70% of the house being in the names of individuals who intend using it as their main residence except for 30% of the area which will be a place of business. In this decision the company was looking to use the Rollover relief available under the small business concessions which require you to purchase an active asset.

Apply this concept to a typical mum and dad partnership, where the business is run from home, could produce significant tax savings. If your home is also a place of business you are not entitled to exempt the business portion with your main residence exemption. Don't worry this doesn't apply just because you take work home, or give music lessons or do a bit of baby sitting. It is applicable when part of the house is set aside for business purposes. So let's assume Mum and Dad are running a tradesman's partnership so the office in the house and the shed out the back are used solely for business purposes and they represent 30% of the area. As a result they only get their main residence exemption on 70% of the capital gain made on the property, assuming all the time it was owned it was used at this ratio. The remaining 30% of the gain is subject to CGT but if it has been owned for more than 12 months there is the 50% CGT discount then as it is an active asset another 50% discount applies so we are down to only 25% of the gain on the 30% used for business purposes, being taxable. They can then choose to use the retirement exemption or rollover relief to exempt the remaining 25% of 30% of the of the gain on the house from tax.

If they are over 55 the retirement exemption means they get the money tax free. If they are under 55 using the retirement exemption means they have to put the money into superannuation but it will not even be taxed in the hands of the super fund. The retirement exemption can only be use to cover a maximum of \$500,000 worth of capital gains in a life time.

To utilise rollover relief they need to buy or improve another active asset for the business to the value of the remaining taxable gain. This could simply be a new vehicle for the business or just roll it over into the new house if it is going to be used in the business.

This active asset concession is part of the Small Business CGT concessions so let's just check what is necessary to qualify.

To qualify as a Small Business:

You and your associates need to have net business assets of less than \$6million or have elected to enter the simplified tax system (referred to from 1<sup>st</sup> July, 2007 onwards as small business entities). which requires your turnover to be under \$2million (net of GST). Net business assets in the above example would mean the 70% of the value of the house which is used for private purposes would not be included in the test. Other personal assets such as superannuation are also ignored.

To qualify as an Active Asset:

The asset must have been used in the business for at least half the time it was owned or 7 ½ years whichever is the lesser. Note an active asset can be owned by an associate rather than the business entity and still qualify.

## ATO Claims Interest is not Deductible if Your Spouse Earns More than You

In PBR 61949 the ATO claims that the cost of a laptop, used to produce income, is tax deductible but the interest on the loan to buy it is not. The taxpayer's income was spasmodic and when he applied for a loan to purchase a computer to use in his business the finance company would only lend based on his wife's income and the loan had to be in her name. The loan repayments were made from their joint bank account. But the ATO decided, in its wisdom, that the interest was not deductible to the taxpayer because his income was irregular so at times it may have been his wife's income that made the interest repayments.

We do not give this ruling a snowball's chance in hell of standing up in the courts. But who wants to go there? Accordingly, you should make sure your name is also on any loan documents and it maybe worthwhile arranging for the repayments on any equipment used in your business to come out of a bank account in your name only. Ideally income from the business should be used to make these repayments even if it means your spouse meets the private expenses of you both.

## When is it a Hobby for GST Purposes

If you are operating a business you must collect an ABN from every supplier you deal with, if they do not provide you with an ABN you must withhold 46.5% of the invoice amount and remit it to the ATO. The only exception is if the supplier provides you with a declaration that he or she and the activity they are invoicing you for is part of their private recreational pursuit or hobby.

It would be hard to argue that a cleaner is operating as a hobby but not a problem at all if you buy a work of art for reception. MT 2006/1 at paragraphs 365 to 375 outlines when the ATO considers an activity to be a hobby rather than a business. For example a spare time activity or pastime pursued for pleasure or recreation (relaxation, refreshment or enjoyment).

According to the ruling the following are indicators of a hobby rather than a business though any one point is not decisive:

- 1) No intention or future plan to make a profit
- 2) No repetition or regularity of sales
- 3) The activity is not business like in nature.
- 4) Lack of systematic approach
- 5) Small scale operation without the intention of creating a business.
- 6) Not dealing with the public

Considering how much of a buzz Julia gets out of delving into tax law maybe she shouldn't be charging GST and maybe even not paying income tax. After all, what could be more recreational to her than finding a little gap in the rules?

What was once a hobby can become a business without jeopardising the hobby status in the years before the decision was made to go full time.

For GST purposes the person involved in the activity is not required to register until his or her turnover from non hobby activities exceeds \$75,000 but they are required to hold an ABN should the activity be considered a business rather than a hobby.

## Definition of Substantial Renovations

If you are registered for GST and sell a new house or substantially renovated house for the first time you must charge GST. If you did not acquire the house with the intention of reselling it at a profit (ie you acquired it as a rental or to live in) the sale of the house is not part of your normal business turnover so it will not force you to register for GST if you aren't already.

There is a concession, in that if you continuously rent out a property for more than 5 years and then sell it as the first sale of a new or substantially renovated property you do not have to charge GST even if you are registered. In the case of a renovated property the 5 years starts from the last substantial renovation.

People who buy a property with the intention of doing it up and selling it, are considered in business so, if their turnover of sales subject to GST is more than \$75,000 they will be forced to register. This is where it is particularly important to know what a substantial renovation is. If it is a substantial renovation and you bought it with the intention of reselling it at a profit then the sale of the house is part of your normal turnover so you will have to register for GST and charge GST on that sale. But if the next property you renovate is not substantially renovated, even though you are already registered you will not have to charge GST because it is not considered the sale of a new or substantially renovated home, so it is input taxed. This means you cannot claim input credits on the costs associated with it and do not have to charge GST.

If you did not buy the property with the intention of resale at a profit and you are not registered for GST then you do not have to worry about this no matter how substantial your renovations to the house are.

If you renovate properties for profit it is important you understand exactly what a substantial renovation is. GSTR 2003/3 states that a substantial renovation does not have to be structural but it needs to substantially affect the house, so just about every area of the house must be affected. Of course this could simply be the case if you painted it inside and out. But painting is only cosmetic so cannot in itself be a substantial renovation. It is a question of whether a substantial part of the house has been removed or replaced. It gives as an example of a renovation that is not substantial, the removal and replacement of a kitchen and bathroom as well as repainting the whole house.

Replacing the floor boards, electrical wiring or plumbing in a property is dangerous because it usually affects every room in the house and is not merely cosmetic. Moving or replacing walls can have the same

effect but only if enough walls are changed that most of the rooms in the house are affected. A combination of various forms of non cosmetic changes that combined, manage to affect every room in the house will be a substantial renovation. Cosmetic work such as painting, sanding floors, changing fittings, curtains and carpet do not in themselves amount to substantial renovations even if they affect every room. Further, cosmetic changes to every room and substantial changes to only a few of the rooms will not amount to substantial renovations because the cosmetic changes are disregarded in considering if all the rooms are affected.

## Claiming your Car to visit your Accountant

Don't forget to claim for your travel to your tax agent as part of the costs of meeting your tax obligations. If you are using the kilometre method you would normally be limited to 5,000kms per car per owner for the year to cover working related and other income producing use of the care such as visiting a rental property. But travel to your tax agent doesn't contribute to the 5,000 km limit in fact you can use the kilometre rates of 70 cents a kilometre for cars over 2.6 litre, 69 cents a kilometre for cars under 2.6 but over 1.6 litre and 58 cents a kilometre for cars under 1.6 litre, for unlimited kilometres in regard to travel to see your tax agent.

## Where Is Julia?

In Darwin, the sunsets are blood red and over the water. Very dog friendly and great swimming weather, real tropical feeling even in winter. Needless to say that it might be a while before she heads south again, though apparently, the build up to the wet season is hard to bear. Before she leaves Darwin we hope to have a BAN TACS office established so any of our readers up that way please get in touch.

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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.