

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

Thanks to the sub prime crisis in the USA, 2008 has started off with share markets all over the world falling. Of course this all makes for great headlines and everywhere I go, people are asking if they should be getting out of the share market now in case things get worse.

It's one of those realities of life that the future is known to nobody and I certainly can't guarantee that things are not going to get worse before they get better. However, over the long term, shares have been the best performers of all, and a long term average return for them should be around 10-12 percent a year.

The last bad year was 2002 when the Australian share market produced a negative nine percent return for the 12 months. This was followed by a 17 percent return for the year ended December 2003 and ever since, it's been bounding along giving us double digit returns year in year out. After four straight years of returns at this level, it would not be unreasonable for the market to take some of those gains back.

This is certainly not a recommendation to get out of the market, because capital gains tax will take a hefty proportion of your sales proceeds and it's probable that the next bounce will catch you by surprise and leave you chasing a market that is rising again. A much better strategy is to accept that volatility is the price you pay for the flexibility and high potential of share based investments and simply hang in there and wait for the inevitable recovery.

If you are especially nervous and have money in superannuation, you can switch your funds to the cash area without leaving the superannuation environment. This strategy enables you to enjoy all the benefits of superannuation yet stay in cash if you think that is the appropriate course of action for your present situation.

You never want to put yourself in a position where you are forced to dump quality shares at a time when the market is having one of its normal slumps. This is why we suggest you keep at least three years planned expenditure in the cash area and never invest in share based investments unless you are prepared to leave your money untouched for at least several years.

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

Apology

Due to the demands of the final stages of Julia's and Noel's book – Save Tax on your Investment Property - there will only be one edition of Newsflash for February. By March the book will be at the printers so things should get back to normal. Despite February only having one edition of Newsflash the tricks and information in this one are as good as you would normally get in two editions. Lots of exciting tricks with recent ATO private rulings to validate them.

Julia would also like to apologise for being slower than usual to return phone calls and reply to e-mails. Please be patient as this is an extremely busy time for her. She should catch up by early March but if you haven't received a reply by then please contact her again as in the middle of all this she also had to replace her internet computer.

Salary Sacrificing Rental Property Expenses when Employee Only Owns 10%

Joint owners of a rental property that are in different tax brackets can gain considerable tax benefits by the high income earner salary sacrificing all the cash flow rental property expenses. This means that the high income earners package is reduced by the value of these expenses but the employer does not have to pay FBT because of the otherwise deductible rule. This is as good as the high income earner receiving a tax deduction for all the expenses with the added advantage that the employer can claim the GST back where applicable and Centrelink cannot add back the rental property loss because there is none. All that goes into the couple's tax returns is the rental income and depreciation so it is positively geared in the return. This works quite well when the property is owned 50:50, but imagine the advantage as the high income earner owns less of the property. This means the low income earner receives more of the rent and future capital gain but the high income earner still effectively claims all of the rental property expenses as a tax deduction.

Some conservative commentators have recommended that as the original test case on this type of arrangement was 50:50 ownership then investors should not vary from this. It is our opinion that as the legislation says jointly liable not equally liable then the ratio of ownership does not matter. This has now been verified by PBR78388 where 90:10 and 95:5 ownership ratios were approved. But be warned PBRs are private rulings so cannot be enforced by anyone other than those who originally applied for the ruling, so for your employer to be confident you need to apply for your own. Details of how to do this are on our web site.

Shifting Non Deductible Debt to Business Debt

PBR 79002 is about borrowing to pay business expenses including the purchase of trading stock and using the income of the business to pay off non deductible debt. Seems a bit cheeky but it is perfectly legitimate. Mind you a PBR is only binding on the ATO for the benefit of the person who applied for the ruling so if you are at all concerned you should apply for your own.

The key is being able to cover the arrangement as not being a scheme with the dominant purposes of a tax benefit. Nevertheless, it is not for the ATO to tell you how to run your business.

In the situation described in the ruling the taxpayer opened a separate bank account into which the business income was deposited. From this account the private home loan was repaid, some business expenses were paid and the interest on the line of credit used to pay the balance of the business expenses was paid. The ruling found that as the taxpayer was a sole trader he or she was not precluded from using the business income to repay private debt.

The ruling found that there was not a dominant purpose of a tax benefit in the arrangement because there was no tax benefit! In fact it was simply a finance option available to business. This finding was further supported by the fact the taxpayer intended paying off the home loan in 3 to 4 months and then working towards persuading the bank to accept the business as security on the loan for the business expenses, arguing that the dominant purpose of the arrangement was asset protection ie the family home. An argument the ATO accepted.

Low Income Tax Offset Now Very Important For Retirees

With the low income tax offset increasing over the next five years, accurate income splitting is more important than ever for retirees with an income source outside of superannuation. If retirees are over 60 and receive their income from a pension or superannuation fund it is tax free in their hands. If the fund is a superannuation fund the earnings are taxed at 15% in its hands but if it changes to a pension fund then even the earnings within the fund are not taxed. This makes it very attractive to receive your retirement income from a superannuation fund rather than investments you directly own.

Some retirees maybe too old to be allowed to contribute to superannuation or not want to sell up their assets outside of superannuation in order to transfer the proceeds into a superannuation fund. If you have a large capital gain on a rental property transferring it into a superannuation fund may not give the best result after tax. While the capital gains tax can be offset in your personal tax return by contributing it to a superannuation fund the fund will pay 15% tax on the portion of the contribution you claim as a tax deduction. If the property was not sold in the first place no tax would be payable.

If for one reason or another you are caught with your retirement income outside of superannuation all is not lost as there is the Senior Australian's Tax Offset which combined with the Low Income Tax Offset allows a single person to earn \$25,867 without paying any tax. The combined tax free amount for a couple is currently \$43,360 and any Senior Australian Tax Offset not used by one member of a couple can be used by the other. But the Low Income Tax Offset cannot be shared in the same way. Back when the Low Income Tax Offset was only \$150 this was no big deal but over the next five years this is set to increase as follows:

2007/2008	2008/2009	2009/2010	2010/2011	2012/2013
\$750	\$1,200	\$1,350	\$1,500	\$2,100

As a result it is now more important than ever to make sure your retirement income, that is outside of superannuation is split as equally as possible between husband and wife. This should be a consideration (among many other issues) when deciding which name to purchase a rental property in if you intend keeping it after you retire.

Interesting Statistics On Small Business

In his speech on delivering for the community Michael D'Ascenzo pointed out that two-thirds of small businesses are home base and one-third of small business operators were born overseas.

Small businesses with a turnover of less than \$2million account for two-thirds of the outstanding debt to the ATO.

SMSF Borrowing – ATO Concerned

In the December 2007 minutes of the Superannuation Consultative Committee concerns were raised about the instalment warrant products being marketed to SMSFs with a resolution to provide the public with better information on these products and watch for any associated risks. Unfortunately full details of the discussion were not available so we do not know what area of the use of instalment warrants the ATO is concerned about.

Claiming Your Motor Vehicle

Regular readers will be familiar with our tricks on claiming your motor vehicle, using a detailed reasonable estimate and the kilometre method, for home to work travel carrying equipment weighing more than 18kg, if there is no safe storage at work. The claim is limited to 5,000kms per car but you can swap cars with your spouse to claim up to 10,000kms.

There are a couple of traps to avoid. Firstly you can only use the kilometre method on a car. A ute designed to carry a load of more than 1 tonne is not a car. Secondly make sure you also "own" your spouse's car. If it is only registered in your spouse's name you need to get him or her to sign a declaration that he or she own it jointly with you.

Renovating or Building and Living There Before Selling

I hear over and over again from people in the property market how they are building or renovating homes then living there to apply their main residence exemption before selling and moving onto the next project. I am usually asked how long do I have to live there to cover it with my main residence exemption. They are usually shocked with the answer that it does not matter how long you stay there you are never going to get your main residence exemption on the property.

TD 92/135 states that if a property is built or renovated with a profit making intention the main residence exemption cannot apply. This is because the main residence exemption only applies to profits that are subject to CGT and CGT only applies if normal income tax does not. In the case of building or renovation with a profit motive (rather than as a rental property or private home) the profit would be caught as normal income. Note there are also GST ramifications which are discussed in our How not to be a Developer booklet.

The example given in the ruling is:

A builder constructs a spec home in which he and his family reside while construction proceeds on another spec home. Any profit on sale which gives rise to income is fully assessable to the builder even if a principal residence exemption is available for CGT purposes.

Booklets Updated

The following booklets have been updated with Newsflash articles up to 159 and generally tidied up:

Domestic Rental Properties

How Not to be a Developer

Capital Gains Tax

Claimable Loans

Seminars

29th March, 2008 – Ozinvest Interactive Property Investment Workshop starts at 1pm at the Wesley Centre, 220 Pitt Street Sydney. Bookings www.ozinvest.com.au. Julia will be speaking at 1.30pm on The Name you Should Hold an Investment Property in.

Where's Julia

Julia is down at the Nowra office at the moment but don't tell anyone as she is flat out and will continue to be so well into March. Late February and early March she will be in Canberra, Lithgow and Orange then back to Nowra. At the end of March she will be in Sydney to do an Ozinvest Seminar on the 29th March. On the 30th March she will be on the Plum Property Stand at the Sydney Property Expo.

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.

Alienation of Personal Services Income

Buying a Business

Capital Gains Tax

Claiming Your Trip Around Australia

Claimable Loans

Claiming Motor Vehicles

Death and Taxes

Defence Forces [Military]

Division 35

Divorce

FBT for PBI's including Hospitals

Fringe Benefits Tax

Year End Tax Strategies

How Not to be a Developer

GST

Investors

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.