

# NEWSFLASH

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## **BAN TACS** Accountants Pty Ltd

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### BAN TACS Accountants Pty Ltd

BAN TACS Accountants are a co-operative of accountants who pool their resources and knowledge to provide exceptional client service. All the advantages of a large national firm with the personal services of individual practitioners.

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

## Capitalising Interest in a SMSF

Generally a SMSF can only borrow against an asset once. This means a SMSF lacks leverage because it is very difficult to borrow against the increased value of the asset.

The recent changes to the SMSF borrowing laws has left a small window of opportunity here. Section 67A(1) of the SIS Act allows for the original borrowings on the property to be refinanced but then in an attempt to limit exploitation of this provision it states:

- (ii) money applied to refinance a borrowing (including any accrued interest on a borrowing) to which this subsection applied (including because of section 67B) in relation to the single acquirable asset (and no other acquirable asset); and

This means that you could stop paying the interest on the loan, if the bank would let you, and save the cash for a deposit on another property, then refinance the original loan and the unpaid interest.

## Column by Noel Whittaker

“How much do I need to retire?” is the question everybody asks. Unfortunately there is no simple answer, for it depends on many factors that include how long you will live and the state of your health.

A simple rule of thumb is 12 times your expected annual expenditure. Therefore, if you believed you could spend \$50,000 a year when you retire you should be aiming for total financial assets of \$600,000.

The sum you need to invest along the way depends on how soon you start and the rate of return you achieve. For example, if a 21 year old wanted to retire at 65 with an income of \$3 500 a week in today's dollars, they would have to invest only \$235 a month if the contributions were increased in line with inflation. It's a different matter for a person aged 40 as they don't have time for compound interest to work its magic. They would have to invest an indexed amount of \$880 a month.

That's the effect of time; now consider the rate of return. The calculations above assume an inflation rate of 3% and a net earning rate of 9%, which gives a real rate of 6%. If the investor managed to achieve only inflation plus 4%, the figures change dramatically. The 21 year old would have to invest an indexed \$523 a month while the 40 year old would have to invest \$1471 a month. .

Fortunately, we still have a generous aged pension system. If a couple had only \$300,000 in financial assets in retirement they would be eligible for a combined aged pension of \$26,416 a year. This should be enough to make up the gap.

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Noel Whittaker is a director of Whittaker Macnaught, a division of St Andrew's Australia. This advice is general in nature and readers should seek their own expert advice before making financial decisions. Noel's e-mail address is [noelwhit@gmail.com](mailto:noelwhit@gmail.com)

**David Thompson & Julie Lockeridge from Whittaker Macnaught are regularly available to see clients in our office**

## How The Banks Can Destroy A Deductible Loan

Don't ever assume the banks know how to organise your loans to ensure they are tax deductible nor can they fix things up later. It is important that you never put yourself in a position that you have to accept what the banks offer you. Be prepared to lose the contract rather than end up with a non deductible loan.

TR 2000/2 and Domjan's case enforce the basic principle that it is the use to which the borrowed funds are put that determines the deductibility of the interest on the loan. If you pay down that loan then redraw on it, the interest on the redraw is only deductible if the redrawn funds are directly used for an income producing purpose. It does not matter at all where the loan is secured.

You need to make sure there is a clear uninterrupted nexus between the withdrawal from the loan account and the tax deductible use. In Domjan's case (AATA 815 2004) Wilma Domjan transferred funds from the rental property loan account into her personal cheque account to pay for repairs but because there were personal funds in that cheque account, the ATO successfully argued that the drawings from the loan account had been mixed with private funds so it was no longer possible to distinguish between the two. The nexus was broken and the draw down from the loan account was not considered to be for deductible purposes. Don't think keeping good records will fix it, Mrs Domjan was complimented on her record keeping.

Once you have a deductible loan don't mess with it in anyway, do not use it for any personal expenses no matter how temporary because you can't undo a mixed purpose loan easily.

When you have a mixed purpose loan, for example you used some of the loan funds for private purposes, you cannot pay off the non deductible portion without also paying off the deductible portion. The only way you can unmix this loan is to split it into two separate loans and then pay down the non deductible one. TR 2000/2 paragraphs 18 and 19 explain that you need to organise two separate loans for the amount of the non deductible debt and the deductible debt then pay the mixed loan off at the same time from both these loans. Then the ATO will accept that each loan has its own individual purpose and is no longer a mixed loan. Don't let the banks muck you around on the timing, the refinance from both loans must happen at the same time. And don't let them persuade you that you only need one new loan and keep the original loan going.

The bank may try to tell you it is their policy that you must draw down from the loan and put the money in an offset account first, when you are trying to refinance a mixed purpose loan. Then draw from the offset account to pay off the old loan. TR 2000/2's concession on mixed loans talks about refinancing loans by paying out the old loan with a new loan. Putting the money in the offset account first could break the nexus.

An offset account is a savings account with an in funds balance not a loan account as required by TR 2000/2. It is not worth the risk of not following TR 2000/2 exactly.

If you leave it as a mixed purpose loan the rule is that each draw down from the loan needs to be allocated to its particular use of the funds and each repayment has to be apportioned on a pro rata basis between the mixed purposes unless it is the proceeds of the sale of one of the asset originally purchased by the borrowings. When you organise to refinance and split a mixed purpose loan you will need to work out the ratio at that date. There is a calculator in the shopping section of our web site that will assist you.

If you refinance a loan don't do anything fancy just replace the loan with a new loan for the same amount and make sure the funds do not detour along the way. If during the refinancing the banks put the new borrowings in the wrong account such as your own home loan, offset or savings account stop them right there and make them put the money back where it came from. If they realise their mistake before you do and they then take the funds from your personal offset or savings account to pay down the old rental property loan you have just lost all deductibility for that rental property loan because along the way the funds got mixed with your private money.

If the bank pays down the wrong rental property loan when a property is settled, that is it, it doesn't matter how quickly they take the money back out and pay down the right loan the nexus is lost. The other rental property loan is no longer tax deductible

If the bank puts the proceeds of your loan into your private offset account ready to use as a deposit on a rental property. The borrowed funds have been mixed with private funds so, as in Domjan's case will be considered private non deductible borrowings. Before you use it as a deposit for the rental property make sure you make the bank take the money back out and repay the loan that put it there. Note it is not acceptable to put it back into an offset account for the loan, it must actually repay the loan, an exact reversal of their mistake. Then draw down on the loan that has just been repaid to pay the deposit direct.

Don't believe the banks when they tell you to just use your own funds to pay the deposit while they are organising the loan and then you can simply pay yourself back. The interest on the loan from which you pay yourself back will not be tax deductible because the funds will then be used for private purposes. There is no way to fix this, once you have paid for the deposit with your own money that is it. The deposit was never borrowed for.

## When is it Not Good to Have a Pre 1985 (CGT) Asset?

When that asset is held in a company. You see any profit distribution you receive from a company is a dividend in your hands, not the proceeds of a pre CGT asset. The capital gain may have been tax free but only to the company. How do you get the funds out of the company other than as a dividend? One way around this is to sell the shares in the company instead though many buyers are hesitant to take on a pre owned company because they can be held liable for its history. Further this means they will have to continue to hold the asset in a company, which does not qualify for the 50% CGT discount but because of the change of ownership the pre CGT status of the asset is lost. Another option is to liquidate the company allowing the tax free capital gain to be returned to shareholders. The liquidation strategy is the most likely solution but there is a problem if you have other pre 85 assets in the company that you do not want to sell yet. They will have to be transferred out of the company before liquidation and which will mean they lose their pre CGT status and in the case of real estate there will be stamp duty costs.

The problems associated with transferring tax free capital gains out of a company were addressed in the CGT legislation. In the small business concessions there is a significant individual test and if passed the tax free gains can be transferred out of the company to the individuals. The small business concessions can in some cases result in no CGT being payable on a post CGT asset so considering the above it would appear that, in the case of a company a post CGT asset has more tax advantages than a pre CGT asset.

The way the CGT legislation works is pre CGT assets are simply excluded from all the CGT rules, except in one case, that is the 15 year rule. Of course all pre CGT assets have been owned for more than 15 years now so they qualify under this section for the small business concessions. Section 152-125(1) states:

### **Subdivision 152-B - Small business 15-year exemption**

#### **SECTION 152-125 Payments to company's or trust's CGT concession stakeholders are exempt**

##### **152-125(1)**

This section applies if:

(a) one or more of the following apply:

- (i) under section 152-110, a \*capital gain (the exempt amount) of a company or trust is disregarded;
- (ii) under section 152-110, an amount of income (the exempt amount) is \*non-assessable non-exempt income of a company or trust;
- (iii) subparagraph (i) of this paragraph would have applied to an amount (the exempt amount) except that the capital gain was disregarded anyway because the relevant \*CGT asset was \*acquired before 20 September 1985;
- (iv) subparagraph (i) of this paragraph would have applied to an amount (the exempt amount) if subsection 149-30(1A) and section 149-35 had not applied to the relevant asset; and
- (b) the company or trust make one or more payments (whether directly or indirectly through one or more interposed entities) in relation to the exempt amount within 2 years after the relevant \*CGT event to an individual who was a \*CGT concession stakeholder of the company or trust just before the event.

Of course you still need to make sure you qualify under the small business concessions by having a turnover of less than \$2 million or business assets under \$6 million and at least one controlling individual.

## Where is Julia?

Probably in the middle of the Nullarbor on her way back to the East Coast. She will be in Sydney briefly at the end of March then Queensland.

## Simple Solutions

Experience has taught us that more is not better. We have created some very simple excel spreadsheets that will show you, right before your eyes, what we have been trying to explain to clients for years. We have realised that you don't need an elaborate program that makes coffee as well. What you need is simple spreadsheets that not only helps you calculate the basics but gives you confidence that you have covered all the relevant issues without needing to produce a complex result you do not understand.

This is what we aim to achieve in each of our simple spreadsheets. A result where you understand how it was calculated and enough questions to ensure you have included sufficient relevant information.

All for a very cheap price because we almost feel embarrassed to charge for such basic programs but have now realised that it is more economical for you, if we create the template rather than you reinventing the wheel. Keep on buying these little spread sheets and we will keep them coming. Simply explaining basic business and investment concepts but helping you ensure that you have covered all the relevant items.

For the list so far take a look at the right hand column of our shopping page. Note these are not intended to eliminate the need to discuss with your accountant the answers, they are designed to prepare you for that interview to such an extent that they will save you more than their purchase price in accounting fees.

## Ask BAN TACS

For \$59.95 you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. For your Accountant, we will include ATO references to support our conclusion. Just go to [www.bantacs.com.au](http://www.bantacs.com.au) and look for the Ask Bantacs link under 'Most Popular' on the home page.

## Back Issues & Booklets

For free back issues of the fortnightly BAN TACS Newsflash or the following booklets visit our web site.

*Alienation of Personal Services Income*  
*Claim Your Trip Around Australia*  
*Defence Forces [Military]*  
*How Not To Be A Developer*  
*Fringe Benefits Tax*  
*Goods and Services Tax*  
*Key Performance Indicators*  
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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.