



## Noel Whittaker's Column

Late last year I was sorting out my affairs and decided to cancel a Visa card that was hardly used. The bank handled it without a fuss and I assume that the card was gone for good.

It was therefore with some surprise that six months later I received a statement for the cancelled credit card with a debit balance of \$129 for a donation to World Vision that had been made by bank authority.

When I rang the bank to enquire how a cancelled credit card could be reactivated, the bank told me that all direct debits remain current until cancelled by the card owner. Therefore the credit card would remain in force until I instructed World Vision to cancel the authority. They did this without question and I transferred the debit to a different credit card.

If I had been unable to stop the debit it may have gone on forever, and the bank would have charged me interest had I not paid the balance by the due date. I asked the bank what would have happened if I had reported the card stolen and they assured me that doing that would have stopped all debits for good. Of course this was impossible in this case because the card was 'cancelled' and therefore couldn't be classed as stolen.

It does seem a bizarre situation, but anyone cancelling a credit card may well think the best option would be to simply report it lost or stolen. According to my bank sources that would have the effect of nullifying any periodical debits.

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

## Claiming School Uniforms

The bill containing amendments to the education tax offset to include the cost of school uniforms has made its way through parliament. So make sure you keep your receipts from the 1<sup>st</sup> July, 2011 onwards. Logos etc are not necessary as long as the uniform conforms with the school colour. The tax offset is 50% of the cost.

## Unusual Medical Expenses that Qualify for the Tax Offset

As you collate your paper work for your tax return consider your medical expenses. For the 2010/11 financial year they have to exceed \$2,000 before you start to qualify for the offset. The offset is 20 cents for every dollar in excess of the \$2,000 threshold. The whole family's medical expenses can be added together to meet this threshold.

In case Q21 84 ATC 77 an allergy to cow's milk was considered an illness. Accordingly, because the milk substitute was prescribed by a doctor and purchased from a chemist it qualified towards the medical expense tax offset. But make sure the milk substitute is purchased from a chemist and the doctor makes a file note that it is recommended (IT 2146)!

Therapeutic treatment also qualifies if it is prescribed by a doctor. The doctor must name the therapeutic practitioner and specify the treatment. Examples of this would be chiropractors, osteopaths, masseurs, speech therapist and dieticians.

## Deducting Tax From Wages

Employers please make sure you obtain the new rates for deducting PAYG from your employee's wages. True the tax rates have not changed from 2011 to 2012 but the amount of low income tax offset that can be received during the year rather than through the tax return, has increased. On the high end of the tax scale there is also the flood levy to consider.

## Capitalised Interest Update – A Draft Ruling Issued

On the 29<sup>th</sup> June the ATO issued a draft ruling, TD 2011/D8 on arrangements where interest is capitalised on a rental property loan while the rent is used to reduce the principle on the non deductible debt on the private home.

This ruling may come as a shock for some investors who have paid many thousands of dollars to finance brokers and property spruikers for such an arrangement. It certainly makes us feel a lot better about our conservative, get a private ruling approach.

This ruling is only a draft and there will be many submissions by the profession because it goes way too far and ignores established case law. Nevertheless, it makes some very reasonable points.

Firstly a bit of background information. Capitalised interest is only deductible if it is not part of a scheme with the dominant purpose of a tax benefit (Part IVA). There have been a few private rulings allowed by the ATO where taxpayers were successful in arguing their dominant purpose was simply to pay their home off sooner or that they should not be required to use private funds to prop up an investment.

The draft ruling specifically and exclusively covers the argument that the dominant purpose was simply to pay their home off sooner. Of particular interest is a point that surprisingly has not been used before by the ATO. That, if the overall debt of the taxpayer remains the same then they are not really achieving their desired result. Of course the overall debt doesn't remain the same, it should reduce by that nice fat tax refund cheque but we are not too sure whether that is a good line to argue, considering we are saying the dominant purpose is not a tax benefit.

The ruling does go too far in implying that you must use your wages etc to prop up your investment possibly leading to borrowing for private expenses instead. It also claims to apply retrospectively which is unreasonable considering the number of rulings and case law it contradicts. Accordingly, we do not expect to see the final ruling taking this form and are aware of many submissions that will be made against it. In the seminar section of our web site there is an area for follow up material. Our submission against the draft will, once completed be posted there. If you would also like to make a submission against this draft you can find the arguments we consider relevant by visiting our site shortly. Submissions will need to be made by the 29<sup>th</sup> July, 2011 to [ruth.geary@ato.gov.au](mailto:ruth.geary@ato.gov.au)

So where to now? Don't let this prevent you from applying for a ruling if you feel you have another suitable argument that is not based on paying your home off sooner. Examples may be that you have high home loan repayments (the term of your home loan maybe 10 years) and didn't get the pay increase you expected or spouse has to take time off work etc. So cannot afford to meet all your commitments and need to use the rent for private purposes just to get by. There are many precedents that mean the ATO would loath to try to tell you how you should manage your money.

Here are the basics on when capitalised interest is allowed that we learned from the Harts cases.

- 1) Capitalised interest takes on the nature or the original borrowings – if the interest on the original loan is deductible then you can claim interest on borrowings to pay the original interest
- 2) If you can't afford to make an interest repayment and have to borrow it (ie allow the loan balance to increase because you have available credit) then interest on that borrowing is tax deductible
- 3) If you enter into an arrangement to capitalize interest with the dominant purpose of achieving a tax benefit then the interest on the interest is not tax deductible because it is caught by Part IVA a scheme with the dominant purpose of a tax benefit. In Harts case the ATO simply had to produce bank advertising material saying there was a tax benefit in the loan.

Note PBRs are private binding rulings so cannot be enforced upon the ATO by anyone other than the rulee, nevertheless here are some interesting ATO responses:

PBR 69725 – An investment in shares where the taxpayer said he or she did not want to use other wages income to prop up the cash shortfall in the investment. They ATO said they could borrow the shortfall instead and that interest on interest would be deductible. No mention was made of the use to which the dividends were put. If the ATO thought they could require the taxpayer to use the dividend to pay off the loan or interest then it certainly would have. There are many case precedents where the ATO has not been allowed to tell a person how they should manage their affairs.

PBR 81797 – Accepted dominant purpose was not a tax benefit but simply quarantining a rental property expenses, so Part IVA did not apply.

PBR 94265 - ATO accepted that the dominant purpose was to own their home sooner, not a tax benefit, so Part IVA did not apply

PBR 1011345133229 – ATO considers the arrangement is caught by Part IVA because just like Hart's case the loans are linked. The ATO claims the loans are linked because they share the same security.

Based on the above if you do have another dominant reason other than the tax benefit or owning your own home sooner you should apply for a ruling and take care that you LOC where the interest is capitalized is not secured, against the private home. This can be achieved by using all the equity in the home as a deposit for a rental property and then having spare equity in the rental property to secure the LOC where

interest is capitalized and rental expenses are paid. It is best to keep this LOC separate from the loan to actually buy the rental property just in case everything goes pear shaped, at least you have not tarnished the loan where interest is clearly deductible. Also make sure you don't enter into your arrangement with a lender that is promoting the tax benefits or that it is a way to own your home sooner.

## Gold Coast Office

Our Gold Coast office is still a satellite office with Whittaker Macnaught so you may need to get in early if you want an appointment. Lyn Gower will be there on 19<sup>th</sup> and 20<sup>th</sup> July and 16<sup>th</sup> & 17<sup>th</sup> August.

## Seminars

Full details in the seminar section of the web site.

### New South Wales:

**North Ryde Wednesday 27<sup>th</sup> July, 2011** – Lots of information to protect you from property spruikers. Speakers – Julia Hartman and Paul Wilson from We Find Houses. 6.30pm for 7pm start till 9.30pm North Ryde RSL Club Pittwater Room, child minding facilities with pagers, on the same floor. Bookings [educatingpropertyinvestors.com/july-seminar-sydney/](http://educatingpropertyinvestors.com/july-seminar-sydney/)

There will be a charge of \$39 payable when you book but this is just so we can be confident you will turn up if the night turns cold. You will receive property tools including vouchers, a cash flow calculator CD and Julia's book Saving Tax on Your Investment property, worth far more than the entry fee and there will be coffee, tea and sandwiches provided so you don't have to bother with trying to fit a meal in beforehand.

**Newcastle Saturday 30<sup>th</sup> May, 2011** – Getting started in property investing, professional advisers share secrets plus SMSF explained. Speakers – Frances Hesse, Lou Scarano, Julia Hartman and Paul Wilson. Conference Room, Mayfield Sports club 58 Crebert Street. 9.30am to 1pm cost \$25 per person or \$35 per couple, refreshments and gifts included. RSVP 02 9809 1777

## Affiliates

To further spruiker proof our clients we will be starting a page on our web site listing the various professionals that we have worked with for years and know you can trust. At this stage we have just got the page up and only got as far as placing two links there to test how this will work. With the tax season upon us it might not go much further for a month or two yet. Watch this space! It is in the left hand menu.

## Where is Julia?

She will be in Sydney until 27<sup>th</sup> July then finally heading north. Seminar in Newcastle on the 30<sup>th</sup>. Then arriving in Mackay on the 10<sup>th</sup> August.

## Back Issues & Booklets

To obtain free back issues of the fortnightly BAN TACS Newsflash or any of the following booklets visit our web site at [www.bantacs.com.au/publications.php](http://www.bantacs.com.au/publications.php). You can also subscribe to our Newsflash reminder.

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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.