

NEWSFLASH

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BAN TACS **Accountants Pty Ltd**

BAN TACS
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CPA Practice

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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

The ongoing volatility in interest rates has generated the predictable hype about borrowers taking matters into their own hands and switching lenders.

Unfortunately in most cases changing lenders is like swapping spouses - an expensive exercise with no guarantee that the outcome will be an improvement.

The main stumbling block is mortgage insurance, which is compulsory if the loan to valuation ratio (LVR) is more than 80%.

Think about a couple who are considering buying their first home, and who wish to borrow \$570,000. They have been attracted by all the huge newspaper advertisements and decide to go to Lender A because that institution is offering the cheapest rate.

They have only 5% deposit so the LVR is 95%, - they have not even given a thought to what the mortgage insurance premium may be.

The lender they choose charges them a premium of 3.9% or \$22,230 and they happily sign up. They have no idea that another lender, possibly offering a slightly higher interest rate, may offer them the same loan but with a mortgage insurance premium of 2.41% or \$13,737 -a massive \$8,493 difference.

Of course, the government gets into the act as well and adds a hefty sum for stamp duty which ranges from 5.37% in Queensland to 11.8% in South Australia.

The mortgage insurance and stamp duty is invariably added to the loan which means they will be paying it off over the life of the loan.

After a couple of years our young couple find that their chosen lender has elected to increase interest rates to a level which is higher than most of its competitors.

Even though their house may have increased slightly in value, their LVR is still going to be 95% because the loan has been increased by the mortgage insurance premium and stamp duty. To their horror, they discover that the new lender will want fresh mortgage insurance - they will be up for another lot of fees which would be at least \$13,737, even if they chose the cheapest premium on offer.

It would be most unlikely that they could obtain any refund of the original mortgage insurance premium. Noel Whittaker is a co-founder of Whittaker Macnaught Pty Ltd. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. His email is noelwhit@gmail.com

More Flexibility for Businesses Financing Equipment etc

From 1st July, 2012 small businesses accounting for GST on a cash basis will be able to claim the GST input credit up front for their equipment purchases even when they are financed under a hire purchase agreement. Chattel mortgages have always had this ability but are less popular because they are usually more expensive.

Generally no GST input credits are allowed on interest payments but under the new law the whole of the hire purchase arrangement will be subject to GST even if the interest amount is listed separately. This means the GST input credit will simply be 1/11th of the total price. This only applies to contracts entered into after 1st July, 2012.

The QuickBooks vs MYOB Debate Continues

The battle of the major software packages rages on, for more see edition 242 of Newsflash, QuickBooks:

- 1) Allows you to print a financial statement over any period of time, it is not restricted by the financial year period you have selected.
- 2) Speeds up data entry by allowing you to just enter the date without the / in between
- 3) Does not require you to find and allocate a number for each account you set up
- 4) Offers you the details of the last transaction for the supplier so you only have to enter the differences.

The Qld Building Boost Finishes on 30th April, 2012

In my home town of Beachmere there certainly seems to be a few people willing to do deals to get construction activity into the area. We have a developer selling duplex blocks for around \$170,000 and a builder prepared to deal with council and build a complete duplex for \$330,000. Recently a duplex block, in Beachmere, sold for \$145,000. Council also require a contribution of \$28,000 so in total the cost will probably be under \$528,000. If you qualify for the \$10,000 Queensland building boost, that means less than \$518,000.

Each unit has 3 bedrooms, two bathrooms and a lockup garage. The local real estate agent feels they will rent for around \$335 to \$340 per week each. I had a bit of a look around on realestate.com.au and feel confident they will rent for more than \$320 per week for each side.

Now I know quite a few people are feeling pressured to buy before the boost finishes so in this article we will analyse the duplex to give you a benchmark and a strategy to evaluate what you are being offered. Please take the time to absorb the numbers because they will really help you understand the importance of your tax bracket and the price you pay for the land, which unlike building costs will not deliver depreciation deductions.

The Numbers:

Purchasing Costs

Land	\$ 145,000
Stamp Duty	\$ 2,900
Building	\$ 330,000
Council	<u>\$ 28,000</u>
Total Cost & Borrowings	\$ 505,900

Purchasing Costs

Land	\$ 170,000
Stamp Duty	\$ 3,775
Building	\$ 330,000
Council	<u>\$ 28,000</u>
Total Cost & Borrowings	\$ 531,775

Annual Tax Consequence

Rent Return $335 \times 2 \times 52 =$	\$ 34,840.00
Less: Expenses	
Interest $505,900 \times 6.5\% =$	\$ 32,883.50
Rates	2,400.00
Water Rates	800.00
Insurance	1,500.00
Agent Management Fees 9%	3,135.60
Depreciation Plant & Equip.	1,121.23
Depreciation Fixtures, Div 43	<u>8,139.46</u>
Taxable loss	\$ 15,139.79

Annual Tax Consequence

Rent Return $335 \times 2 \times 52 =$	\$ 34,840.00
Less: Expenses	
Interest $531,775 \times 6.5\% =$	\$ 34,565.38
Rates	2,400.00
Water Rates	800.00
Insurance	1,500.00
Agent Management Fees 9%	3,135.60
Depreciation Plant & Equip.	1,121.23
Depreciation Fixtures, Div 43	<u>8,139.46</u>
Taxable loss	\$ 16,821.67

Simply multiply the taxable loss by your tax bracket to get your refund cheque then remove the non cash flow items (depreciation) from the list above and add your refund cheque to the income side to get the cash flow from the property. For example if you purchased the land for \$145,000 and you are in the maximum tax bracket of 46.5% your cashflow calculation would look like this:

Cash Inflows:

Rent	\$ 34,840.00
Tax Refund \$15,140 x.465	\$ 7,040.10

Cash Outflows:

Interest \$505,900 x 6.5% =	\$ 32,883.50
Rates	2,400.00
Water Rates	800.00
Insurance	1,500.00
Agent Management Fees	<u>3,135.60</u>
Net cash inflow	\$ 1,160.90

Per week basis \$ 22.33 Yes, that is right the property pays you \$22.33 per week to hold it. But of course this is the best case scenario.

Further if you qualify for the building boost of \$10,000 and use it to reduce the amount you borrow, the above best case scenario would result in the property paying you \$29 per week to hold not to mention the overall cost of the project being reduced by \$10,000 if you act before 30th April, 2012.

Based on the above figures here are some of the possible cash flow outcomes depending on how much you pay for the land and what tax bracket you are in, based on 2013 tax rates, ignoring the \$10,000 building boost. If the figure is in brackets then that is the amount you need to contribute to keep the investment afloat. If it is not in brackets then this amount is how much extra cash (positive cash flow) the whole property will pay you, per week, to hold it.

Holding Costs Per Week for Whole Property

Tax Rate Bracket and Rate (including 1.5% Medicare)	Land cost \$145,000		Land Cost \$170,000	
	Rent \$670	Rent \$640	Rent \$670	Rent \$640
\$66,661 to \$80,000 34%	(\$14.07)	(\$32.09)	(\$35.42)	(\$53.43)
\$80,001 to \$180,000 38.5%	(\$0.97)	(\$17.76)	(\$20.86)	(\$37.65)
Over \$180,000 46.5%	\$22.33	\$7.72	\$5.02	(\$9.58)

The higher your tax bracket the more the ATO contributes to the taxable loss of the property but because depreciation is a non cash flow item yet tax deductible you actually end up close to neutral cash flow even when earning only \$95,000 a year if you can find a block for \$145,000. If your income is \$198,000 even the higher priced blocks could leave you with cash in your pocket. Notice how the figures quoted in this paragraph are the bracket threshold plus the tax loss. This is because if you are only on \$80,001 per year and you have a rental property that makes a loss then that loss will only result in a tax refund of 34 cents in the dollar because the rental property will drag you down into the next, lower, tax bracket.

Just bear in mind that these figures do not include vacancies, land tax, letting fees, repairs and travelling expenses. On the other side of the coin they do not include the \$10,000 building boost.

Duplex Detail:

This particular duplex has a market edge because the Council generally allow it to be built on a 600sqm block so you are not paying a premium for a duplex size block. Recently in Beachmere a 600sqm block sold for only \$145,000 as a general rule you would expect to pay around \$170,000 for good blocks not far from the school, with access to parkland.

If you buy the land and enter into a contract with the builder rather than buy the property completed, you are the one who qualifies for the building boost and your stamp duty costs are only on the value of the land rather than the full value of the completed property. The down side of this is you wear the risk of council approval of the block as a duplex site. The developer is prepared to offer a 60 day contract with a subject to finance clause. Sixty days is sufficient time, due to the councils familiarity with the design, to know whether council will approve the duplex. If the application is unsuccessful you will be able to use the

finance clause to avoid settling on the land. This means the only funds you risk is the \$6,000 from the deposit that will be used to pay the council application fee. The builder makes the application to council after you pay an initial deposit of \$16,500. If the duplex application is unsuccessful \$10,500 of your deposit will be refunded. The \$28,000 council contribution is not payable until the duplex is completed.

Note the price does not include the cost of establishing a strata plan. If you are intending to hold the property as a rental then the duplex not being under a strata plan means no fees to run a body corporate. On the other hand the bank valuation will be higher with a strata plan in place. The additional cost to strata the units is \$5,000.

If you are considering buying the duplex in your SMSF you will need to enter into an off the plan purchase contract that will be slightly more expensive but necessary to allow your SMSF to borrow. Of course because you are buying the completed duplex, rather than the land, the stamp duty will be higher. The negative geared benefits flow though to you by you contributing part of your wages into superannuation. This concept is explained in detail in our SMSF booklet.

If you would like pictures and plans for this duplex email julia@bantacs.com.au I promise not to pass you details onto the developer or builder until you ask. Don't let the numbers blind you, still do your due diligence on Beachmere's potential and the type of housing in most demand there.

Seminar

Transition to Retirement – Speaker Noel Whittaker. Thursday 19th April 5.45pm for 6pm start finish 7pm Maroochy RSL Club, Memorial Avenue, Maroochydore
Presented by Whittaker Macnaught, free to BAN TACS clients.
This seminar will be of particular interest to clients aged between 54 to 61.
Please RSVP by 12th April sharon.altoft@whittakermacnaught.com.au or (07) 3029 4601 with the full name and contact details of those attending.

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This edition we preview Paul Wilson from We Find Houses and Educating Property Investors. Paul is an Independent Property Investing Expert who's been educating and coaching investors since 2001.

Paul provides valuable, independent guidance and support by teaching strategies on how you can invest successfully while protecting yourself from commission hungry sales agents and property spruikers. For more details on the services Paul provides go to www.affiliates.bantacs.com.au/we-find-houses.php or www.affiliates.bantacs.com.au/educating-property-investors.php

Where is Julia?

I will spend the next two weeks visiting clients from the NSW south coast through to Canberra, Carcoar, Lithgow and Tenterfield, then home for a while.

Ask BAN TACS

For \$59.95 at [Ask BAN TACS](#) you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. We will include ATO references to support our conclusion.

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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.