NEWSFLASH

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BAN TACS Accountants Pty Ltd

BAN TACS Accountants Pty Ltd is a 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

Noel Whittaker's Column

Interest rates appear to be on the way down and some lenders are now aggressively advertising fixed rate loans. Moving from a variable rate to a fixed rate is always a tough decision to make but when considering changing loans, or even changing lenders, it's important to compare like with like.

A useful guide is the comparison rate sheet which all lenders are required by government legislation to display, but keep in mind that it is only a starting point. Even though it includes the basic loan costs such as set up fees, interest rates and ongoing charges it does not include bank fees that are only charged in certain circumstances. These include fixed loan early termination fees and redraw fees.

When looking at some of the ads currently running, I am amazed at the difference between the base rate and the comparison rate. And don't forget, the comparison rate is the effective rate that you will be paying.

But there is more to a loan than the interest rate and the fees and charges. One of the most important things to consider is flexibility. Now you might believe that a no frills loan with low fees is perfect for you right now because your affairs are simple and your present intentions are to stay in the one house for many years, but keep in mind that change is always with us, and your present loan may not be appropriate if things change.

What happens if you decide to move house, or borrow some money for renovations or investment, or need to reduce your repayments as the kids are at high school. If you have one of the no frill loans it generally won't have a redraw facility and you may be required to take out a second mortgage for the extra money. Naturally the bank will be looking for a higher interest rate on the second mortgage and the extra fees could wipe out all your initial savings..

Noel Whittaker is a director 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 noel.whittaker@whittakermacnaught.com.au

Employee or Contractor?

The following is a link to an ATO tool to help you decide whether someone you are paying to provide you with services is really a contractor. Quite a hot spot with the ATO at the moment.

http://www.ato.gov.au/businesses/content.aspx?doc=/content/00095062.htm&mnu=42711&mfp=001/003

SMSFR 2012/1 Off the Plan Purchases and Construction

This ruling makes it clear that SMSF can borrow the deposit for an off the plan purchase, as part of the loan for the full purchase. In reality if there is a long construction period the banks are not going to allow that sort of borrowing so the most likely way a SMSF would purchase an off the plan unit is to pay cash for the deposit. Note you are still not permitted to borrow for the furniture package.

A SMSF can borrow to purchase a house and land package but only when the asset (both land and house) does not transfer until the building is completed.

A SMSF cannot borrow to buy a block of land and then later construct a house on it. This is the case even if the SMSF has the money to pay for either the land or the house. A SMSF can buy land and then build a house on it is if it does not need to borrow for anything associated with the property.

Diaries

Please make sure you start your diaries before the 30th June. The ATO is being particularly fussy about these now. If you want to claim a deduction for home office expenses or the use of equipment such as phones and computers that have some private use you will need to keep a diary for one month to determine the ratio of private to work use.

Discretionary Trust Distribution Minutes

Bamford's case resolved that the income of a trust is to be determined according to the wording of the trust deed and not in accordance with ordinary accounting concepts. This means that as a minimum the income clauses in your trust deed will need to be reviewed and possibly amended. In the following, a reference to a trust is a discretionary trust.

This article is based on a draft ATO ruling, changes to legislation that are less than a year old so untested and test cases that barely scratch the surface of the issue. In its draft ruling TR 2012/D1 the ATO creates some very bizarre circumstances where it claims that while some items are included as income for tax purposes they can't be included in trust income Accordingly, there are no guarantees with the following. It is compiled from a variety of material on the topic, looking for consistencies in opinions but also pointing out some possible traps. To truly cover yourself you should discuss this with a specialist lawyer in regard to your particular circumstances and the wording of your trust deed. The catch is the ATO hasn't finished with the changes yet! So of course if your trust is not in the danger zone below it would be great if you could delay a review of your deed until there is more certainty. To help in this regard we have listed the situations that may put you in the danger zone. If none of these apply to you then you may want to take the calculated risk of waiting for your review. For example previously it was thought that an income equalization (stating that trust income equals taxable income) clause was the solution but now in some cases this could work against you.

The Danger Zones - If any of the following apply to you, you need advice on the wording of your distribution minutes and may need to have your deed amended before 30th June, 2012.

1) There will be a small business capital gain made by the trust within the next 15 years. You will need to make sure there is continuity of ownership.
2) You will make a small business capital gain this year.
3) You want to stream (identify the beneficiary that is to get that particular stream of income) capital gains or franking credits.
4) You will make a capital loss this year. It will need to be recorded in the balance sheet to be carried forward.
5) Your deed states that trust income equals taxable income.

Our Ideal Income Distribution Statement In The Trust Deed – Would give the trustee the discretion to decide what is the income of the trust and the power to stream capital gains and franked dividends. This flexibility should be backed by a default definition of income, if the trustee chooses not to exercise its discretion, this clause should state that the trust income is to be determined in accordance with tax law.

Further, the trustee should be entitled to distribute gross income if it desires. This may be necessary to avoid the loss of franking credits as they are not entitled to be passed onto beneficiaries unless they follow at least some income. The Trustee should also have the power to make interim distributions.

The catch in all this is that you may trigger resettlement by making these changes. A resettlement will cause a CGT event.

Important Points For The Distribution Minutes - Do not delay organising your distribution minutes for the 2012 financial year. It must be done before 30th June, 2012.

The big concern when sorting out the wording of your distribution minutes is if the ATO later audit the trust tax return and decide that its taxable income is higher. Bamford's case determined that the taxable income is to be apportioned on a pro rata basis with the trust income. For example if the trust income was $1,248 and the distribution minutes gave $416 to a child and the rest of the income namely $832 to the parent then if the ATO later audited the trust and determined that the trust income was $1,500 then the child would have to include $500 in his or her tax return. The trap with this is children receiving passive income over $416 are subject to penalty tax rates.

It appears there is no way of wording the distribution minutes to avoid this problem so it is probably not worth the risk of distributing any trust income to children considering the little tax benefit gained compared with the risk.

As you are making the distribution minutes before the income of the trust is known it is important that the distribution minutes does not just list all dollar amounts. There needs to be a beneficiary that receives the balance, a mop up, as at this stage you only have a vague idea of the trust income.

Guidelines For Minutes In Simple Circumstances – First review the deed to check that the trustee has the discretion to determine income. Start with an explanation of how the trust deed defines income. If the trustee has discretion then make sure the minutes thoroughly covers how the trustee is exercising that discretion. Franked dividends, capital gains and other income should be individually addressed. Distribute at least $1 of gross income as it may help you distribute franking credits.

If your circumstances are very basic, with no expected capital gain or franking credits and the trustee has the right to determine income, here is an example of minutes of a distribution meeting. No guarantees, but it does have a few extra points that may help cover the unforeseen.

Minutes of the Meeting of –
Location –
Date –
Present –

In accordance with the powers granted to the trustee in the trust deed the trustee determines income to include all sources of income including if applicable gross capital gains and franking credits. From this gross income all beneficiaries listed below are to receive a distribution of $1. All expenses and outgoings from the trust are then to be deducted from the gross income to determine the net income of the trust which is to be distributed as follows:

A $ or %
B $ or %
C receives any balance of net income remaining

For the avoidance of doubt should any adjustment be made to the net income of the trust the dollar amounts stated above are not to change.

For the avoidance of doubt payments made by the trustee during the year do not necessarily constitute distributions unless expressly recorded by a resolution of the trustee. Further any interim distributions so recorded count towards the amounts shown above.

There being no further business the meeting was closed.

Signed as a true and correct record Dated

Traps - If the trust deed says income in ordinary concepts then only the net capital gain can be streamed. This could result in other beneficiaries paying CGT on a distribution they did not receive. To avoid this, an interim distribution of the whole capital gain will need to be made to the beneficiary who receives the capital gain.

A nasty shock in TR 2012/D1 was the ATO's opinion that franking credits, while taxable, cannot be considered trust income. If a trust does not have net income (ie does not make a profit) it cannot distribute its franking credits and they are wasted. A possible but not proven method of avoiding this problem is to distribute a small amount of gross income. If this could apply to you no harm in including it in your minutes just in case, as shown above.

Tip For Small Business Capital Gains - The small business concessions can reduce a capital gain to zero. On a $100,000 capital gain this could work as follows:

Capital Gain	$100,000
Less 50% CGT Discount	50,000
Less 50% Active Asset Discount	25,000
Less Retirement Exemption (Max $500,000)	25,000

When a beneficiary receives this amount it must be grossed back up again in their tax return but all the above discounts still apply. The trap is if that beneficiary had capital losses they would be wasted. If the beneficiary had capital losses of $20,000 the entry in their tax return would be:

Capital Gain	$100,000
Less Capital losses	20,000
	$80,000
Less 50% CGT Discount	40,000
Less 50% Active Asset Discount	20,000
Less Retirement Exemption (Max $500,000)	20,000

Still no capital gain but only 25% of the losses were effectively used. If instead of the retirement exemption the small business rollover was used by the trust then nothing would be distributed to the beneficiary in the current year. The trust has two years to buy a replacement asset. If it does not buy one then in two year's time the beneficiary will simply receive a capital gain of $25,000 (no grossing back up) this can be offset by the $20,000 capital loss and the balance of $5,000 applied to the retirement exemption leaving more of the $500,000 limit available in the future and requiring less of the funds to be locked away in superannuation if the beneficiary is under 55 years of age.

Where is Julia?

Still at home but will be heading north to Mackay and Townsville very soon.

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 by Julia. We will include ATO references to support our conclusion.

What Is New on www.bantacs.com.au

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2012 YE Strategies http://www.bantacs.com.au/booklets/Year_End_Tax_Strategies_Booklet_2012.pdf
Forum – Juggling the main residence exemption while travelling and when to do repairs http://www.bantacs.com.au/forum/viewtopic.php?f=5&t=83&sid=4e69b1e47342728ee811c3a4d9948629
Notice Board – Two askbantacsers have kindly agreed their question be made public on the notice board.
Granny Flats at trick to minimise the CGT exposure. This askbantacser emailed back to say it was the best $59.95 she had ever spent. To view go to http://www.bantacs.com.au/QandA/index.php?xq=386
Subdividing your home block http://www.bantacs.com.au/QandA/index.php?xq=385
Split and Linked Loans http://www.bantacs.com.au/QandA/index.php?xq=384
Churning A LOC by drawing for private purposes http://www.bantacs.com.au/QandA/index.php?xq=384