NEWSFLASH

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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

Why a SMSF?

SMSFs are costly to set up and run and the borrowing mechanism is cumbersome. You can't access the capital growth to secure further borrowings without first selling the property. This will slow down the growth of your portfolio.

Nevertheless SMSFs are the most effective way to minimise tax and protect your assets. Even if you are declared bankrupt your creditors cannot access your superannuation unless you have recently deposited an unusually high amount to defeat your creditors.

At best the tax benefits include being able to negative gear at your personal tax rate, pay only 15% tax on the money you use to make principal repayments and pay no capital gains tax on the sale or no income tax on the net rent when it is supporting you in retirement.

Consider a rental property that is running at a loss for tax purposes of $10,000 a year. Instead of purchasing the property in your name and reducing your taxable income by $10,000 you purchase it through the SMSF and salary sacrifice $10,000 into the fund. The salary sacrifice will have the same result of reducing your income by $10,000 and the SMSF will not have to pay the contributions tax on the $10,000 it receives from you because it can offset the rental property loss against your contribution.

This seems to be the area where the confusion arises. The 15% contributions tax is poorly named. It is not a tax on contributions but a tax on the SMSF's profit and your contributions are part of its income. So in this scenario (ignoring everything else that is going on in the fund) the SMSF has no profit so pays no "contributions tax".

If the deductions for the property include depreciation, which is a non cash flow item, the extra funds can be used to reduce the principal on the loan, effectively tax free as you have not paid tax on that amount nor has your employer and nor has the SMSF. If you want to make more principal repayments you will need to salary sacrifice more into the superannuation fund and that will be taxed in the fund's hand's but only at 15%. The only catch here is each member can only contribute $25,000 a year and that includes their employer support under the super guarantee.

Once you get to 60 years of age, meet a retirement condition and put the fund into pension stage it can sell the property without paying CGT or hold it without paying income tax on the net rent. You also do not have to pay tax when the SMSF pays you any of the proceeds.

If the SMSF is not in pension phase when you sell the CGT will only be 10%. Likewise if the property is running at a profit before you reach pension phase there will only be 15% tax on the net rent.

All the advantages of negatively gearing at the tax rate of the high income earner but the property is protected from his or her creditors and when it starts to produce a return it is the SMSF tax rates that will apply not the high income earners. That is why people go to the trouble and cost of setting up their own SMSF to purchase an investment property.

Column by Noel Whittaker

The new financial year has ushered in a range of consumer reforms. Judging by all the newspaper ads, the most publicised change is the one that compels your existing bank to provide all details of your periodical payments to another bank if you decide to move your business there.

That might sound good in theory but it's not so simple in practice.

Last year I cancelled my St George Visa card because I no longer needed it. Six months later a Visa card statement arrived out of the blue showing a debit to World Vision of $150. When I rang the bank to ask how they could possibly process a debit to a closed account, I was told to my amazement that the bank had no control over what debits came in and that my Visa account would be debited until World Vision cancelled the periodical payment authority I'd signed years ago.

In other words, according to the bank, it was out of my hands - if I refused to pay the credit card statement by the due date, I would be liable for the normal fees and charges.

Fortunately World Vision were happy to cancel the debit but I shudder to think how things would have ended up if they had played hard ball.

In any event, there is far more to changing banks than simply obtaining a list of your periodical payments. If you try to move a loan, there will probably be establishment and valuation fees - if mortgage insurance is involved, fees could exceed $15,000 as mortgage is generally not transferable, and a new policy would need to be taken out.

This is why you should explore all options available before undertaking the potentially costly and frustrating process of changing banks. Their interest rates tend to be competitive and their products are generally similar.

By all means have a look at what is on offer, and what kinds of products suit your particular needs. Then, as a first step, talk to your own bank to see if they have the kind of products and services you're looking for.

If they don't, and they are not prepared to help, switch banks if it is cost effective.

I'm all in favour of shopping around – my fear is that after going to the expense of changing banks, you'll find yourself exactly back where you started.

Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. Email: noelwhit@gmail.com

Considering Making an Undeducted Contribution to Super?

How about a related party loan instead? This is where the members of a SMSF lend it money. This can be done at zero interest rate, currently with the ATO's blessing as long as the SMSF is not charged more than market rates and the loan is limited recourse. Which means the lender can only recover the asset purchased with the borrowed funds with no recourse to the other assets of the SMSF .

This is a fantastic arrangement if you have spare cash that you would like to put into your SMSF but cannot claim a tax deduction for it. This can happen if you have already exceeded the $25,000 cap. You may be considering putting the money into the fund as a undeducted (non concessional) contribution. Once you have contributed the money to superannuation you will not be able to draw it back out should you need it before you reach your preservation age and pass a retirement condition.

I am all for getting the money into the superannuation fund so that its earnings are only taxed at 15% but why lock it away? Instead you could simply lend it to your SMSF interest free and call back the loan when you need it. The catch of course will be whether the SMSF has the liquidity to repay you. Note the SMSF cannot borrow to repay you. This strategy also works well if you are over 65 and can't satisfy the work test so unable to contribute to superannuation whether the contribution is claimed as a tax deduction or not.

Sounds too good to be legal? But what is the crime here? The interest, rent or dividend that is earned on the related party borrowing is now locked into the superannuation Fund. Nothing that has benefited from the concessional superannuation tax rates has been diverted away from retirement savings. The fund member has simply allowed the SMSF to use his or her money for a while and keep all the profits. So let's hope the wowsers leave this alone.

Landlords' questions answered

By RUN Property CEO Rob Farmer

As the saying goes, I'd love a dollar for every time I was asked by a landlord about how to improve the performance of their investment property. As the CEO of Australia's largest metropolitan real estate agency, I come into contact with people who own properties all over the country, so here are my answers to some of their common questions.

My tenant is always late with their rent. How do I fix this? Properties in areas that have low rents and high vacancy rates tend to have more tenants who pay their rent late than in areas where the rents are more expensive. But the number of tenants who are more than seven days in arrears should be no more than 1 per cent. Your property manager should thoroughly check tenants' references, their rental payment history and employment status because selecting a good tenant will help prevent problems later. Put their payments on direct debit because tenants who must organise each payment are more likely to fall behind.

Take action early if the tenant is late paying. Don't let them think it's OK to pay late or in part-payments. If the tenant is more than about seven days late (laws vary between states) you need to use the correct documents to advise the tenant and send them at the correct intervals. If this does not happen, it might impact on your success if the issue goes to a tenancy tribunal, or affect your landlord protection insurance.

I often talk with people who have never invested in property because they fear that getting tenants to pay will be too much trouble. But the number of serious issues with late payment is very small and if handled correctly should not turn into nightmares. Certainly this should not be a reason for failing to start building a portfolio.

My tenant wants to break the lease. What are my rights? There are different rules in each state, but generally, it is the tenant's responsibility to find a replacement tenant and pay any associated costs. The tenant must continue to pay rent until a new tenant takes over the lease.

Personally, I always prefer my agent to find the new tenant because they have far better resources to ensure I get a good one.

The landlord might also want to end the lease. If rents have risen sharply, the property owner might seek to gain more rent by ending the existing lease and advertising the property at a higher price. If so, the landlord would be responsible for finding the replacement tenant and any expenses of doing so.

Should I put the tenant on a fixed term or let them go month by month? This depends on how the market is performing in the area. If there are low vacancy rates (high demand) and increasing rents, I am more inclined to allow a month by month arrangement after a lease finishes because it gives flexibility to regularly increase the rent or do improvements to the property.

If there are steady rents and higher vacancy rates I would tend to renew a fixed term lease. This way I know exactly what income I will receive for the lease period and I can manage when to end the lease. Most areas have periods when rental inquiries are higher and it is easier to find a tenant. For example, many people want to live in Bondi in summer so it is best not to have the lease end in winter.

If you buy in a new development it is worth considering having a lease shorter or longer than the standard 12 months. When the building opens, all tenants will move in at about the same time so several might also vacate simultaneously a year later. An unusual lease term will avoid you competing for tenants at the same time as other landlords.

I want to improve my property. Should I do it now or wait until the tenant vacates? I am a big advocate of keeping your property in excellent condition to attract the best tenants at the highest rent with minimal vacancy. Improving the property is a great way to increase the cash flow. New paint, carpets and taps can make a big difference to your return.

Mathematics should decide when you do the renovations based on how much additional rent you are missing by not doing the improvements and the cost of the work.

Have a clear plan of what work you are going to do and how long it will take and have quotes done and tradesmen organised to start immediately the tenant vacates. Delays cost money.

Seminar

Self Managed Super Funds - Mackay SMSFs are costly and complicated to set up and operate, though in the right circumstances provide exceptional tax advantages. You need to be very confident that a SMSF is right for you before you go ahead. This is a chance to hear some objective insights. Accountants Julia Hartman and Tanya Read, Finance Broker Gail Roots and Financial Planner Kim Evetts have teamed up with guest presenter Dan Allman from Whittaker Macnaught to explain how SMSF's can be used in relation to property investment strategies and help you understand when a SMSF would benefit you as well as the purpose of an investment strategy and other more cost effective options that may be available to you.

To be held in our offices at 34 Wellington Street Mackay at **6pm on Tuesday 2nd October, 2012**. Space is limited in our board room so please ring and let us know if you intend to come by ringing 07 4957 8340 so we can let you know if there is still space available. A smaller group should ensure that all your questions are answered.

Welcome Julie Lockeridge

Julie Lockeridge is a financial planner and aged care specialist that we trust. She has begun advertising on our home page so is supporting the production of all the free information on our web site. Please support the people that support us in bringing you this information. Her details are http://www.affiliates.bantacs.com.au/julie-lockeridge.php

Where is Julia?

On her way to Townsville for a quick visit with a couple of clients then back to Mackay until the second week of October.

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.

What Is New on www.bantacs.com.au

Want more? Please go to bantacs.com.au/publications.php for back issues of newsflash or download our free booklets where past newsflash articles are collated according to their topic.

With the forum and the Ask BAN TACS Notice Board the information on the site changes daily:

Forum – Welcome to all our new members. If you haven't yet joined it isn't too late to join an receive your free diary. We now have 83 real people with real names participating in our discussions**,** though they do seem to be a little shy. There is no such thing as a dumb question. If you have a question it would be dumb to miss out on this ideal opportunity for free advice. Besides you can always edit your question.

Askbantacs – Two askbantacers have kindly allowed their questions to be published on our notice board. http://www.bantacs.com.au/QandA/index.php?xq=405 Looks at how to cope with the non deductible debt on your new home when you decide to rent out your old home.

http://www.bantacs.com.au/QandA/index.php?xq=404 Looks at the problems of having a loan in joint names when the rental property is in one name and organising loans so mortgage insurance is not payable.