NEWSFLASH

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

Cheap Rent For Relatives or Friends

If you do not charge market rent for a property that you rent to friends or relatives then you may not be entitled to claim all the expenses associated with the property.

First let’s look at just what is market rent. This is simply what you would charge an arms length tenant under the same circumstances. It is not unusual to keep the rent 10% below market for a good long term tenant. You might even be able to further reduce the rent if the tenants look after the place well and put their rent money in your bank account on time. This will save you having to pay management agent fees. So market rent may well be 20% below that advertised in the papers.

Now what to do if the rent you charge is still below the market? The ATO cover this in their rental property guide and IT 2167 which refers to Kowal’s case.

In Kowal’s case the judge found that the taxpayer’s predominant reason for owning the rental property was to earn income from it and one day make a profit. But nevertheless there was also the reason that he wanted to provide his mother with good accommodation. So the judge said the costs associated with the rental property had to be apportioned between these two purposes, deciding in this particular case that 80% of the taxpayer’s purpose was to make a profit and 20% personal, so 80% of the expenses were tax deductible, this means that in theory the property may still be negatively geared.

What the ATO ignores in its ruling on the matter but what the judge clearly stated in Kowal’s case was that should the 80% of expenses be less than the rent than the taxpayer could claim up to the amount of the rent or total expenses whichever was the lesser. So based on this case renting to relatives, at worse, will mean the property can only breakeven, not actually be negatively geared. Don’t feel you have to show it as profitable to appease the ATO just because it is rented to relatives of friends.

As you can see the “arms length” rental is crucial so it is important, if the property is negatively geared to work backwards from advertised rents for similar properties with commercially realistic reductions for your particular circumstances.

Column by Noel Whittaker

I have long believed that good shares and property will give the best returns over the long haul. However, it is important to keep in mind that the date you make the investment can have a huge effect on the outcome.

Think about two people we will call Jack and Jill who retired a few years ago. Jack put $100,000 into a fund that matched the All Ordinaries Accumulation Index (which includes income and growth) on 1 January 2008 – left alone it would now be worth $90,600.

Suppose Jill put $100,000 into the same fund on 1 January 2009 – it would now be worth $143,600.

The difference of just one year in the date of the investment means that Jill now has 50% more money than Jack.

But that's only on paper. It's highly likely that Jack got such a shock when the global financial crisis hit that he panicked and cashed in for just $66,500. He was probably telling himself that he would re-enter the market when it had turned.

As a result, he missed the surge that happened in 2008 and his money is still sitting in cash.

Jill may well have been too scared to invest in January 2009 and so also missed the upturn. If she had waited till 1 January 2010 to invest that hundred thousand dollars it would be worth just $104,000 now.
There are two lessons here. The first is that luck does play a part in investing, especially when returns are looked at over a relatively short term. Also, it's important to formulate a strategy and stick with it. Trying to time the market almost never works.

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

Maintaining a Home for LAFHA Purposes

The changes to the Living Away From Home Allowance came into effect at the beginning of this month and the tax office has updated their web site to define maintaining a home.

To qualify for the Living Away From Home Allowance concessions an employee must maintain a home in Australia that is immediately available for their use. So effectively the LAFHA is now more restrictive than being paid a travel allowance and employers should give consideration to paying a travel allowance instead.

The ATO web site requires the employee or their spouse to have an ownership interest in the home, this could be holding a lease over the property. It would not be sufficient for the employee's parents to be the ones with the ownership interest. The employee must incur the ongoing costs of maintaining the home such as mortgage or rental payments and be able to return to the home at anytime and live there immediately so it cannot be rented out or sublet while they are living away from it.

Stay tuned we will update you on any further advancements in this area.

Lending Your SMSF the Deposit

Due to the particular wording of the SMSF legislation we have always been uncertain whether a member of a SMSF can lend money to the fund to buy an asset that the banks are also lending for. This is because of the requirement that the asset pass from the security (bare) trust to the holding trust when the loan is repaid. This would be difficult when two loans exist.

This issue was discussed at the June 2012 Superannuation NTLG meeting, even the issue of the loans finishing at different times was raised. The ATO stated that both a bank and the SMSF member can lend for the same asset. Of course it is important that the right documentation is in place.

This means that a SMSF that does not have sufficient deposit to buy a property can borrow the deposit from a member. The member can use his or her own cash or borrow and on lend using an asset they personally own as security.

At the same meeting the ATO also stated that it does not have a problem with more than one security (bare) trust sharing the same trustee. Of course you need to be sure the bank will accept this too.

Transferring Shares to the Beneficiaries of a Deceased Estate

The executor of a deceased estate can make a huge difference to the value of the estate by simply considering the beneficiaries' individual circumstances. For example before an executor distributes shares owned by a deceased to the beneficiaries the CGT consequences need to be considered. The first step would be to calculate the capital gain associated with each parcel of shares. Even if the shares are not going to be sold this is very important as the beneficiaries still need to know their cost base.

If the shares were purchased by the deceased before 20th September, 1985 they are inherited with a cost base of the market value at the date of the deceased's death. This means that they can be sold now for with minimal capital gains tax. Or they can be passed to a beneficiary in specie and that beneficiary will only ever be liable for CGT on the gain from the date of death, the beneficiary does not inherit any ongoing tax bill. Obviously the beneficiary that gets these shares is truly getting a legacy of the face value of the shares.

On the other hand a beneficiary who inherits shares acquired by the deceased after 19th September, 1985 will inherit the deceased tax bill as well so their true legacy is less than the face value. To fairly divide the estate it may be necessary to take this into account.

With some careful planning the executor can maximize the benefit received by each individual by considering their tax bracket and asking them whether they intend to sell the shares or not.

If a beneficiary intends cashing in the shares then consider selling them within the estate and distributing the cash instead. For the first three financial years after the deceased's death the estate is treated like an adult for tax purposes so it will get approximately $18,500 tax free and then be taxed at 19% up to $37,000 etc but with no Medicare levy payable. So it is quite likely that the estate will pay less capital gains tax than the beneficiary. If the beneficiary intends to keep the shares then think about the tax bracket they are likely to be in when they sell the shares. If it is high then they will get the most benefit from inheriting the pre 1985 shares or shares that were purchased post 1985 but are now worth less than the price the deceased paid for them. Beneficiaries in a lower tax bracket are going to be less affected by inheriting the deceased's unrealized capital gain.

When planning your estate it is important to give your executor the flexibility to sell or distribute in species and to decide which actual shares go to which beneficiary even if the overall value they receive is defined by the will. It is also important that your executor knows where to access information about the cost base of your shares including any dividend re investment programs you have participated in.

Living Together But Separated For Centrelink Purposes

The Daily Telegraph reports on a Centrelink case where the female member of a married couple living in the same house was allowed to claim the Age Pension as a single person.

The problem seems to have arisen because the husband would not give her sufficient money to meet her needs including food and would not tell her what his income was for her to meet the Centrelink requirements of declaring your spouse's income.

Out of necessity they continued to live in the same house but the wife no longer cooked his meals, did his washing or shared a bedroom with him.

Tribunal member Jan Redfern ruled that "A person who is married may live separately, but together, under one roof. No doubt there are many couples who continue to do because of financial necessity,"

SMSF Related Party Loans

There has been talk in the press calling for member's loans to their SMSF to have the same restrictions as bank loans. Member loans are required to be limited recourse just like the banks. The additional restriction is that members should only be allowed to lend 70 or 80% of the asset's purchase price just as required by the banks. The banks only do this to protect their interest. In a related party loan the member and the lender are the same person. I just don't get this. The loan is limited recourse so if the investment fails the SMSF does not have to make the loan repayments out of its other funds, the lender is simply entitled to take back the asset the borrowed money was used to buy. So just how does the fund benefit and the member's retirement savings increase by regulating to say that a member can only lend the fund 80% of the price of the investment? All this does is insure that if the investment goes down the fund also loses money, namely its deposit as the lender gets first pick at what is left of the investment. If the investment goes up then the fund is making more money without risking one cent of retirement savings.

Thinking of Managing Your Rental Property Yourself?

I have always advised clients who chose to manage their property themselves to at least use a Real Estate agent to find their tenant so they can check out the prospective tenant's history and make sure they are not black listed. Now they can effectively do this for themselves.

Eezirent is a new website that provides self-managing landlords with all the tools they need to find tenants and manage their investment. Through eezirent, self-managing landlords can list properties on www.realestate.com.au, the site that most tenants use to find a property. An added bonus is the ability to verify applicants with the National Tenancy Database.

The eezirent property management tools include:

- a comprehensive suite of documents - fully compliant with each state's legislation
- detailed fact sheets giving instructions and advice on a diverse range of topics
- an online receipting and ledger tool
- access to a support desk staffed by qualified property managers for extra advice

Eezirent does not manage, buy or sell property for clients. Instead it gives self-managing landlords access to the tools and resources previously only open to real estate agents. Eezirent aims to level the playing field for self-managing landlords. For further information visit www.eezirent.com.au

Cash Flow Calculator

Before you buy a rental property make sure you know how much it is going to cost you to hold, after tax is taken into account. This is not difficult you just work out the effect it has on your taxable income including depreciation, multiply this by your tax rate and list all the cash flow items associated with the property i.e. exclude depreciation and add in the refund cheque. You could do a nice little spread sheet and put in some what if analysis for example what would happen if interest rates increased. If you would rather save you time for analysing properties and have the spread sheet created for you go to the shopping section of our web site and for $19.95 download our cash flow calculator. It is not rocket science, very simple and easy to use. Just saves you the trouble of putting your own together.

Where is Julia?

In Mackay until the 11th October when she heads to the Sunshine Coast for two weeks.

Ask BAN TACS

For $59.95 at Ask BAN TACS, www.bantacs.com.au/QandA/index.php, 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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