NEWSFLASH

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Issue Number: 259 Pages: 4 Date: Mid November, 2012

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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 traditional investments are cash/fixed interest, property and shares, and it's a fundamental principle that you need a portfolio that is diversified across these three asset classes.

However, there is another product which is becoming increasingly popular – the hybrid security - which has the characteristics of both an income investment and an equity investment. They usually pay a set rate of interest and often have the option of conversion to shares.

On the face of it they are a great alternative to leaving your money in the bank where you are now hard pressed to get 4.5% per annum on it, but to remember the adage "the higher the return the higher the risk" - it's a matter of history that not all hybrids have given a satisfactory return.

The purpose of this column is neither to encourage nor discourage investment in hybrids, but to point out that they are not capital guaranteed, and do carry substantial risks that are not generally understood.

Some hybrids allow the company to suspend interest payments and while the interest may compound, investors could be out of pocket while they are waiting for it. At the same time the value of the hybrid may fall, forcing investors to take a capital loss if they want access to their capital.

The ASIC website www.moneysmart.gov.au has a large section on hybrids which outlines the risks in detail. Anybody thinking of investing in hybrids should read this closely and then seek more information from their financial adviser or stockbroker. In the right circumstances, they can be a very worthwhile addition to a portfolio – if you pick the wrong one, you may well suffer many sleepless nights.

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

Christmas Parties

Just a short reminder that you may be better off paying your staff a Christmas bonus so they can fund their own Christmas Party. More detail in our FBT Booklet
http://www.bantacs.com.au/booklets/Fringe_Benefits_Tax_Booklet.pdf

Small Business Plant and Equipment

Most readers will be aware that from 1st July, 2012 small businesses are entitled to an immediate tax deduction for any plant they buy, including cars that cost less than $6,500. A little know trick is that there are no grouping provisions in that $6,500.

Employees or rental property owners only get a $300 immediate write off threshold. This means that if an employee buy's a set of 20 spanners for $400 they are not entitled to the immediate write off because each spanner is part of a set. Similarly if the owner of a rental property replaces some curtains in their property they have to add all the individual curtains together for the $300 test because they are like items.

Small businesses are entitled to apply the $6,500 to individual items whether they are part of a set or identical to other items.

Further, if small businesses buy a car for $6,500 or more they get an immediate write off for $5,000, the balance being depreciated at 15% in the first year and 30% after that.

For Our Seasoned Property Developers

There comes a time in every property developer's life when they should consider undertaking the development through a SMSF. The primary reasons for this are the 15% tax on the profits, maybe even zero tax if you put the fund into pension phase, can satisfy a condition of retirement and are 55 years or older. SMSFs are also an excellent method of asset protection. Enough said on that I am sure you are now convinced. Next I examine the hurdles and myths that keep most developers away from SMSFs.

SMSF are not allowed to borrow for development – This is the major hurdle but a "seasoned" property developer should have the cash by now to fund the development. Of course there is the small problem of getting that cash into the SMSF. If you are under 65 years of age each member can contribute up to $450,000 in undeducted contributions in one year as long as they don't contribute any undeducted contributions the next year. You can also roll into the SMSF superannuation from most other funds plus each member is entitled to put in $25,000 a year as a deductible contribution but this includes amounts paid by your employer. If this is not enough each member can contribute $150,000 this year, hopefully this is enough to secure the land and start the process with council then 1st July, 2013 put in another $450,000 per member. So you can see there is very little barriers to getting money inside a SMSF if you have the cash. If you have to borrow to make any of these contributions you will have to use assets held outside of the SMSF as security and the interest will not be tax deductible but considering the tax rate and possible short term of the project that may still be an option.

SMSF are not permitted to run a business – Myth, certainly most business would involve issues such as providing and receiving credit that could breach the SMSF rules but if you get professional advice on how to stay within the rules the ATO will accept SMSFs undertaking the business of development.

Not Being Able to Access the Profit – There are various rules regarding drawing funds, tax free, out of your SMSF before you are 60 but between 55 and 60 it is possible to access some of your super tax free. The question is at this stage in your life why would you want to? Leave it there and to bank roll the next development.

Life Interest In Shares – Deceased Estates

When your spouse is not a parent of your children you may be concerned about providing for your spouse's future in the event of your death but still leaving the bulk of your assets to your children. This is where a solicitor might recommend a life tenancy for your spouse with the assets eventually going to your children when your spouse dies.

This article only covers the situation for shares. So you would be looking to make sure your spouse received the dividend income but when he or she died your children would receive the shares. I have heard a few stories recently when the children have had to pay CGT upon receiving those shares but unfortunately I have not been privy to the details of the estate. This of course disturbs me so here is some ammunition for our readers to ask the questions if they, as the eventual beneficiary (remainderman), of the shares are presented with a CGT bill when they receive their shares from a deceased estate. Of course it is really the estate that would pay the CGT bill but the money will come out of remainderman's distribution. Legal and personal representative, executor and trustee can be considered the same for the purposes of this article.

The first point is section 128-15 (3) ITAA 1997 note the reference to your estate refers to the person who originally died leaving the shares to a life tenant (life interest):

> Any *capital gain or *capital loss the *legal personal representative makes if the asset *passes to a beneficiary in your estate is disregarded.

Leaving a life interest in your shares means that your executor will be holding them in trust for the life tenant until he or she dies, at which time the trust is wound up and the shares transferred to the remainderman (probably your children). A trust created by your will is called a testamentary trust. The next point is from ATO practice statement PS LA 2003/12

> 2. This Practice Statement informs staff that the Commissioner will not depart from the Tax Office's long-standing administrative practice of treating the trustee of a testamentary trust in the same way that a legal personal representative is treated for the purposes of Division 128 of the ITAA 1997, in particular subsection 128-15(3).
> 3. Accordingly, subject to the operation of CGT event K3 in section 104-215 of the ITAA 1997 (about assets passing to a tax-advantaged entity), any capital gain or capital loss that arises when an asset owned by a deceased person passes to the ultimate beneficiary of a trust created under the deceased's will is disregarded.

If that isn't enough for you how about this example in TR 2006/14

> Example 1: equitable life and remainder interests created under will - no dealings with interests - life tenant dies
> 121. Jarrod died on 1 February 2000. At the time of his death he owned shares in Australian public companies which he acquired after 19 September 1985. Jarrod's will provided that the shares were to be held on trust with the income to be paid to his sister Lauren for life and the remainder to his children, Jessica and Harry.
> 122. Lauren died in February 2005. During the period from 1 July 2004 to the time of Lauren's death, dividends that had been derived by the trust were paid to Lauren. Lauren's estate was also entitled to a portion of the dividends paid to the trustee after her death by virtue of the relevant state law regulating the apportionment of income. Jessica and Harry were entitled to the remainder of the dividends paid to the trustee during the 2005 income year.
> 123. The trustee transferred the shares to Jessica and Harry in June 2005.
> 124. When Jarrod's estate was administered CGT event E1 happened in relation to the shares. However any capital gain or capital loss was disregarded under section 128-10. The trustee acquired Jarrod's shares for his cost base/reduced cost base: subsection 128-15(4).
> 125. When Lauren died, CGT event C2 happened to her life interest. Again, any capital gain or capital loss Lauren made from that event is disregarded under section 128-10.
> 126. There are no CGT consequences for the trustee or Jessica and Harry when the trustee distributes the shares to them in satisfaction of their remainder interests. CGT event E7 in section 104-85 does not happen because of the exception for a trust to which Division 128 applies - that is, the trust assets being disposed of by the trustee were owned by Jarrod when he died and are passing to Jessica and Harry under section 128-20.[10] Jessica and Harry acquire the shares for the trustee's cost base and reduced cost base. They are taken to have acquired the shares on the day that Jarrod died - subsection 128-15(2).[11]

Now there are some situations that could give rise to a different outcome, nevertheless don't accept it, get professional advice, Some of these reason could be:

1) The trustee has bought and sold shares. In this case the new shares would not be entitled to the rollover under section 128-15(3) and the estate would be liable for any CGT on the shares that it sold.
2) The life tenant did not die but instead surrendered their right.

Basically the same applies when the spouse is left a life tenancy in a home, the children should not have to pay CGT when the property is transferred to them. This is reinforced in regard to dwellings in section 118-195 ITAA 1997. There is an exception to this rule, in the very rare case that the life interest creates a legal interest on the title. I don't believe this is possible in the case of shares so that side of the argument has not been presented here.

In short the reason some estates may pay CGT on the transfer of assets to the remainderman is because the people involved in administering the estate only refer to section 128-15 and see that it does not cover the transfer from a testamentary trust to a beneficiary. This is quite correct but they are obviously unaware of the concessions granted by the ATO in PS LA 2003/12.

If all this makes you think that a life interest is a good idea. Please don't, if at all possible, as it creates more problems than it solves and can result in your children being considered to have a lower cost base than the value of the asset when you died.

More About Holding Insurance Inside of Superannuation

Further to our article, in the last edition of Newsflash, on what insurance policies can be tax effectively held inside of superannuation, Tony Townsend would like to provide more advice on these types of policies. For more details about Tony visit our affiliates page http://www.affiliates.bantacs.com.au/index.php
The main disadvantages I see are as follows:

1. Insurance in super means the client must please two people/groups in order to get their hands on the money, the insurer and the trustee of the super fund. Whereas when the cover is held outside of super, if the client has met the policy terms/definition, then the money will be paid to the policy owner – it is that simple.
2. The government keeps changing the rules around super and insurance in super. Eg Once upon a time, you could hold TPD in super and claim a tax deduction. You could also hold Trauma in a SMSF if you wished - the premium wasn't tax deductible but it helped members with cash flow problems. Come 1 July 2013 a super fund cannot hold TPD Own occupation or trauma Cover.
3. Possible tax implications on benefits paid out of super. If the insured claims a TPD benefit and they are under age 55, they may have to pay up to 30% tax. Or if the super fund only pays a lump sum benefit and the death benefit is being paid to a non-dependent for tax purposes such as an adult child...there are tax implications as discussed in the last edition of Newsflash.
4. People purchasing insurance through a risk only super product and making contributions to meet the insurance premiums are eating into their concessional contribution cap of $25,000pa and this includes SG contributions made by their employer. This can be a challenge for high income earners or those clients who want to focus on accumulation.
5. Insurance cover in super may be limited in terms of benefits and features and when the super fund can release the benefit. Eg Some salary continuance policies still only have a 2 year benefit period and are indemnity only. Not good if a client has a fluctuating income where agreed value would have been best. Remember that under SIS regulation a super fund can release up to 100% of insured's pre-disability income when it comes to income protection and temporary incapacity. If the insured/member was not working at the time or on maternity or sabbatical leave, then 100% of nothing is still nothing. Meaning the person is unable to get their hands on the money when they really need it the most.

With all that said though, I do believe that if it comes down to affordability and cash flow for the client, then some cover is better than no cover, even if it is inside super.

Ideal Christmas Present

The perfect Christmas Present for the person who wants to have everything. Noel Whittaker and Julia Hartman's new book Winning Property Tax Strategies is now available for $29.95 plus $5.95 **www.bantacs.com.au/book_winning-property-tax-strategies.php** Here is the table of contents:

Your Investment Philosophy
Depreciation – Maximising your Tax Refund
Keeping Interest Tax Deductible
Capital Gains Tax Basics
CGT and Death
Strategies for Young People Starting Out
Superannuation Funds
Estate Planning
Granny Flats
Renovating for Profit
Mass Marketed Property and Courses
Commercial Property
Land Tax
The Best Tax Strategy is Good Record Keeping
Gearing and Cash Flow Strategies
Managing Your Money
CGT and The Main Residence Exemption
Changing Your Home to a Rental Property
Trusts and Asset Protection
Retirement Planning
Subdividing Your Home or Rental Property
Subdivision and Development Basics
Fire and Flood
Overseas
Buying off the Plan

Where is Julia?

Still in Sydney! I should make it to Lithgow and Orange by the end of November but then back to Sydney, not home for Christmas as planned.

Want more? Go to www.bantacs.com.au

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.