

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

Column by Noel Whittaker

Family businesses account for around two-thirds of all businesses. The typical Australian family business owner is now a 55-year-old baby boomer, getting close to retirement.

Many want to pass on their businesses to their children but the chances are that, with their own careers and their own lives, the kids might not be thrilled at the prospect of following Mum or Dad into the family business.

By the time they realise that the kids aren't interested, it's often too late to start planning another way to exit, and the value of the business (and what they can do with their retirement) is greatly diminished.

After seeing 12 businesses go into liquidation in two years because their owners didn't have them ready to hand over, Sydney insolvency expert Antony de Vries has created a handbook to help business owners plan for their exit.

Life after Business is a no-nonsense, easy-to-read book that gives business owners the information they need to achieve their ideal retirement – regardless of whether the kids want to take over or not.

The guide goes through every stage of business succession planning from deciding it's time to exit and working out how much you need to fund the lifestyle you want, to how to do it.

Making sure you have the right business structure before you sell is one of them.

Say the kids don't want to take over, and you're in the terrific position of receiving a good offer from a potential purchaser. If the business is run as a private company, you're ineligible for the 50 per cent capital gains tax concession available to individuals and trusts. That's a big hole in your retirement fund.

The book tells of a business for sale with assets valued in the tens of millions of dollars, with an asset register that was out-of-date. The business owner lost between \$3.5 and \$4 million at the sale as the purchaser wasn't prepared to pay for assets that couldn't accurately be accounted for.

I recommend it highly – full details are at www.lifeafterbusiness.com.au

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:

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Utilising the Margin Scheme

If you buy a property off someone who is not registered for GST or agree to have the margin scheme apply to the sale you will probably have paid the market price but you won't qualify for any GST input credits. This is fine if you are not registered for GST and are only going to use the property as a residential rental or your home because you would not have qualified for the GST input credit anyway. And what is even better for you is you don't need to read any further through this article.

If on the other hand you are entitled to a GST input credit on the property you are purchasing it is important you do not agree to the contract being under the margin scheme. Here is how the numbers work:

Using the margin scheme means, that GST is only paid on the difference (margin) between the selling price and the original purchase price. So let's say the seller originally purchased the land for \$200,000 but was not entitled to a GST input credit because the original seller was not registered for GST. Having purchased for \$200,000 she then builds a commercial shed on the land and sells it to you for \$530,000. If you agree to the sale being subject to the margin scheme she only has to pay \$30,000 ($\$530,000 - \$200,000 = \$330,000/11$) to the ATO netting \$500,000 from the sale. You are not entitled to claim any GST input credit but can use the margin scheme when you sell, if the buyer agrees.

On the other hand if the margin scheme was not used the property could change hands for \$550,000 the seller would have to send \$50,000 to the ATO, still netting \$500,000 but the ATO would pay you \$50,000 in GST input credits if you are using the property to make GSTable supplies. The difference here is whether you get the \$30,000 up front or when you sell by using the margin scheme. Not only is it better to have the money now while it is worth more but you cannot be sure that your purchaser will agree to the margin scheme. So if you are registered for GST and entitled to claim the GST input credits back on the purchase, do not agree to purchase a property under the margin scheme.

The trap is because you are registered for GST you are going to have to charge GST when you sell. If the property is still not a residential property at that stage and your purchaser has good advice, they will not agree to the sale being under the margin scheme. So while you didn't get any input credit on the property when you purchased it, when you sell you will still have to pay the ATO the whole 1/11th of the selling price. Assuming both your purchase and sale are at the market value, which for some strange reason seems to ignore GST, you have paid more than your fair share of tax.

If after reading this you are kicking yourself that you didn't use the margin scheme in a particular contract, it is not too late, providing you can get the purchaser to agree you can apply to the ATO for an extension of time to apply the margin scheme at <http://www.ato.gov.au/content/00315699.htm>

More Information On Living Away From Home Allowance

To qualify to receive the exempt fringe benefit Living Away From Home Allowance (LAFHA) you need to maintain a home other than where you are living for work. In the February FBT subcommittee minutes there seems to be a window of opportunity for people to claim that they maintain a home that they share with their parents. There are some conditions though, just paying board doesn't cut it but if there is a commercial rent agreement in place and an allocation of utility costs they may qualify. Best to apply for a ruling first.

Converted House Residential or Commercial For GST?

When is a house commercial premises? This is a very important question because if a house has been changed enough it will no longer qualify for the GST exemption that residential premises receive. If the property is considered to be commercial then the rent will be a supply that is subject to GST and the sales of the property will be subject to GST for up to 1/11th of the sale proceeds even when sold at market value.

This of course only applies if you are registered for GST. You must register for GST if your turnover exceeds \$75,000 (exclusive of GST). Turnover does not include supplies that are input taxed such as residential rents and sales of capital assets. So converting one of your rental properties to offices is not going to force you into the GST arena if your only other income is wages and rent on residential properties.

Nevertheless, for owners of converted homes who are registered for GST (for example they may operate their own business from the premises through the same entity as the owner of the premises) it is extremely important to know whether GST applies when you sell. You will probably get the same price for the

property, market value, but whether GST applies or not will determine whether you are required to send the ATO 1/11th of the amount you receive, so there are tens of thousands of dollars at stake.

Until the end of last year houses converted to commercial use would have been caught under paragraph 31 of GSTR 2000/20 which stated:

the purpose for which the premises are to be used will be evident from their form or fit-out. This is most clearly the case where premises have been fabricated, or altered, to accommodate commercial or professional activities.

GSTR 2000/20 has been withdrawn and replaced by GSTR 2012/5 which elaborates on when a house would be considered residential premises. Paragraph 10 states:

Premises that display physical characteristics evidencing their suitability and capability to provide residential accommodation are residential premises even if they are used for a purpose other than to provide residential accommodation (for example, where the premises are used as a business office).

Despite the differences between these paragraphs apparently the ATO has not changed their view only elaborated. Both rulings say it is all about the physical characteristics rather than the use to which the premises are put. GSTR 2012/5 points out at paragraph 36 that a shop that is used as a home is still commercial premises for GST purposes.

GSTR 2012/5 looks at the original intention of the design of the property and asks does it provide shelter and basic living facilities. Now you could say this was the case in many office blocks but the ruling differentiates by stating that they were not designed for that purpose. The next step is to consider whether the house has been modified to the extent that it is no longer residential premises. A significant physical modification that the ruling considers to have changed residential premises to commercial are a doctor's surgery where sealed car parking area, an operating theatre, hygiene facilities, industrial security, altering walls and additional lighting pushed it over the line.

Simply putting a sign out the front, fitting out an office and connecting the appropriate power and phone lines will not change a residence to commercial because it can still be used as a home without modification. On the other hand if you want to be sure the premises are considered commercial, remove the shower and bath. Anything in between get a ruling from the ATO because there is too much at stake.

GSTR 2012/5 has introduced a third scenario to the mix. You can be considered to have changed only part of the property to commercial so its sale or lease would be a mixed supply for GST purposes. In the doctors example GSTR 2012/5 found that the waiting room and store room were still considered residential premises because they had not changed in appearance (other than furniture) from the lounge and bedroom that they were in the original home. This means that on sale only part of the proceeds would be subject to GST. This is despite the GST Act at section 40-65 (1) on the sale of residential premises stating:

A sale of real property is input taxed (not subject to GST) but only to the extent that the property is residential premises to be used predominantly for residential accommodation.

If a property such as this, where some of the rooms still resemble residential property, is rented out then the rent also has to be apportioned, some of it subject to GST and some not. The same apportionment would apply to claiming GST input credits on expenses.

The worst consequence is that when you purchased it pre GSTR 2012/5 the sale may have been considered to be fully subject to GST because it had been "predominantly" modified to commercial purposes. Well now it seems that apportionment is necessary, you will have to pay some of that GST input credit back (even if you bought under a going concern clause).

Don't be upset about the advice you got at the time here is some extracts from the GST Act:

Section 195-1 – The term 'residential premises' means land or a building that:

- (a) is occupied as a residence or for residential accommodation or*
- (b) Is intended to be occupied and is capable of being occupied as a residence or for residential accommodation*

Yet the ATO make it clear in GSTR 2012/5 that whether the property is being used as a residence or not has nothing to do with the GST outcome ie a shop being used as a home is not residential premises. It is all about the design. That is what the word intended means, not the intended use by the buyer but what the designers intended it to be used for. This is how they can dissect up a house catching some rooms for GST and not others. They can look at the lounge room and say no real change since it was a house even though it is now being used as a waiting room but then look at one of the bedrooms and say it has now been changed, the last person who was involved in the design of that part of the property (ie modifying it) changed the

intended use to a commercial purpose because a wall was removed, extra lighting, hygiene facilities and industrial security have been added.

Our advice is that if you are buying, selling or leasing a property that was originally a house that has undergone some modifications to make it suitable for commercial use but still has a shower or bath tub, apply to the ATO for a ruling on how much of it is subject to GST and let the ATO sort out its own mess. Unfortunately, you will need to do this before signing a contract and you will have to wait at least 28 days before receiving a reply. If you are the seller it would be sensible to apply for the ruling before you even have a buyer.

Note, in Newsflash 261 there was a story about a reader who purchased a house converted to a medical practice but intended to use it as her home. Under this new ruling GSTR 2012/5 the property may well have been considered residential premises rather than commercial or a mixed supply. Where taxpayers have relied on the wording of GSTR 2000/20 for any sale contracts they entered into before 19th December, 2012 they are protected from the findings in GSTR 2012/5 but that is not going to help you when you sell and if you are charging rent you need to get it right from 19th December, 2012 going forward.

Free Seminar: www.bantacs.com.au/seminars.php

Monday 25th March 7 to 8.30pm – Granny Flats and Question & Answer session on any property tax topic. Speakers – Julia Hartman and Jane Zhang

Venue – Club Burwood, 97 Burwood Road, Burwood NSW 2134

RSVP – <http://events.constantcontact.com/register/event?llr=mbblfzdab&oeidk=a07e75884pod4a1937a>

Julia will discuss the taxation consequences of building a granny flat in yours or your rental property's back yard. Then she will take questions from the audience on any property tax related topic. The primary purpose of this seminar is to answer questions so start making a list.

Where is Julia?

At home in the pouring rain! Heading to Sydney in two weeks.

Winning Property Tax Strategies – The Book

Once again a brilliant combination of Noel Whittaker's easy reading style with Julia Hartman's mind numbing attention to detail. Lots and lots of new stuff plus updated basics for the first time reader so it is much bigger, 300 pages but still the same price. New chapters including young investors, SMSFs, renovators, granny flats, investment and budgeting strategies, fires and floods, mass marketing spruikers, commercial properties, subdividing and development. You can also purchase it online by going to www.bantacs.com.au/book_winning-property-tax-strategies.php The cost is still a low low \$29.95 plus \$5.95 postage – tax deductible of course!

Ask BAN TACS

For \$59.95 at www.bantacs.com.au/QandA/index.php, have your questions on CGT, Rental Properties and Work Related Expenses answered. We will include ATO references to support our conclusion.

What Is New on www.bantacs.com.au

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With the Forum, www.bantacs.com.au/forum, and the Ask BAN TACS Notice Board, www.bantacs.com.au/QandA/index.php?section=browse, the information on the site changes daily but here is a list of significant changes in the past couple of weeks:

Two very generous askbantacers have agreed to have their question posted on the notice board.

<http://www.bantacs.com.au/QandA/index.php?q=439> is about non-residents & carried forward rental losses.

<http://www.bantacs.com.au/QandA/index.php?q=440> is about the CGT calculation on a property that was originally the taxpayers home then rented out and later sold.

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.