NEWSFLASH

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Issue Number: 268 Pages: 4 Date: 1st May, 2013

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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

A recent email from a reader highlighted the importance of understanding numbers when you are borrowing.

The issue was the best way to buy a car. Her friend had invested $10000 in a managed fund 10 years ago and the value was now $24,000.

Without talking about options with her, he redeemed the capital of $24,000, paid capital gains tax, and then bought a second hand car for cash.

She argued that he would have been better off to borrow the money to buy the car and leave the managed funds intact. She wrote to ask if I agreed.

I certainly did agree. For starters, I hate to see investments cashed in, especially to buy depreciating assets such as motor vehicles - money, once used, tends not to be replaced.

Anybody who is considering borrowing for depreciating items, such as a car or furniture, should understand that if the term is fairly short the interest rate doesn't matter very much. For example, if he had obtained a personal loan for $24,000 at 9% interest and paid it back over two years the total interest payable would be just $2315. That's a tiny amount in the scheme of things.

There is also the opportunity cost of cashing in the managed funds. If they achieved 9% per annum the value after two years would be around $28,500. The potential capital gain is more than the interest that would have been payable.

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.

When Do You Need A SMSF?

There seems to be a lot of publicity lately about spruikers and Self-Managed Superannuation Funds (SMSFs). Scare tactics have also been employed by government organisations. Yes there are a lot of responsibilities in running your own SMSF but they are no more complicated than dealing with GST and other bureaucratic red tape the government seem to think it is reasonable to impose on the average taxpayer. And yes SMSFs are not for everyone but don't be lead to think that an adviser who recommends a SMSF is a spruiker. There are many, many good reasons to have a SMSF, especially if you are investing in property.

Once you reach 60 years of age and transfer your superannuation to pension phase its earnings and capital gains will be tax free to the fund and you providing they do not exceed $100,000pa and even if they do the excess will be tax at 15% in the worst case. Further superannuation is the best form of asset protection that you can get. Even before pension phase the maximum tax on your superannuation earnings is 15% and10% on capital gains yet you will get an effective tax deduction at your marginal rate for contributions to the superannuation fund. The main downside is limited access to the funds until retirement conditions are reached. There has been much discussion about the details of SMSFs in the last couple of newsflashes and our free SMSF booklet should cover all your questions www.bantacs.com.au/booklets/SMSFs_Booklet.pdf this article is not about the details of investing through a SMSF but whether it is suitable for you.

So superannuation has the best tax concessions and asset protection, it is just a question of whether this is the right time for you to lock your money away and whether you should do it in a SMSF or a public superannuation fund. It is a no brainer if you want to invest directly in a rental property. You cannot directly hold a rental property in the superannuation regime any other way than in your own SMSF. It is the same with investing in collectibles. On the other hand, if you want to invest in shares in public companies this can be achieved through the public funds. Some even allow you to make your own choice of the companies you invest in, from their range. So if you choose to direct your superannuation savings to shares then the circumstances when a SMSF is suitable are limited to when you want to diversify into property and/or your shareholding has reached the stage where the management fee that the fund charges you as a percentage of your investment exceeds the fixed costs of owning your own SMSF. This comes into play, as you approach the $200,000 mark in superannuation savings.

The simple solution to knowing whether you should buy your next rental property in a SMSF is to see your accountant before you buy a property; they will know exactly what is right for your circumstances. If you don't have an accountant, well now that you are going to own an investment property you will need one so find one and give them the chance to examine your circumstances before you go making one of the biggest decisions in your life.

Please don't let the entire scare mongering make you distrust advisers and think you have to nut it out on your own. Just make sure you consult an accountant that is independent and knows your circumstances well. They will cost a minute fraction of the amount you will be spending on the property.

Your accountant should be able to evaluate the property, telling you how much it is going to cost you to hold, how much it needs to go up in value on average to breakeven, how to manage your loans, how to keep the appropriate records for your tax return, what the ownership structure should be and why.

Now how to pick the spruikers? Glitz, glamor, lots of advertising and pressure are not the signs of a good advisor. There is probably no one fool proof tactic but word of mouth and independence is a good place to start. Our affiliates page was created to help our clients know who we trust, here is our word of mouth www.affiliates.bantacs.com.au/index.php

Becoming An Overseas Resident For Tax Purposes

It is not enough to leave Australia for a long period of time; you must also establish a home overseas, to be considered a non-resident of Australia for tax purposes.

This point was made very clear Sully v FCT 2012 AATA 582 where an Australian marine engineer left Australia to work and live on various yachts, returning to Australia between jobs. He left some belongings back in Australia, with family and rented out his home to his girlfriend. He did set up a home in Dubai for 2 years but was rarely there. He was working overseas for a total of 3 years. The AAT, after examining his relationships with girlfriends (he broke it off with his Australian girlfriend and had one in the US) and his thoughts about the future while he was overseas, found that he was still a resident of Australia for tax purposes. Once again who you sleep with and your private thoughts affect how you are taxed!

Rules To Keep Your Borrowing Tax Deductible

1) What the borrowed money is used to buy determines deductibility, not where it is secured.
2) Interest on a loan is deductible if the borrowed funds were used in relation to a property that is now income producing.
3) You need to have a clear nexus between the borrowed funds and the expenditure, no detours via personal accounts, once mixed with private funds the link is lost.
4) Reimbursing yourself from borrowings will not create the necessary nexus because the money actually borrowed is not used in relation to the property it is used for whatever purpose you put the reimbursed funds to i.e. buy groceries, so not deductible. This is important to remember when funding the deposit for an investment. Don't let the bank talk you into using your own funds while they get the loan organised.
5) If you borrow money to pay expenses for the renovation that you have paid for on credit card that is ok, as long as the borrowed funds are paid directly to the credit card. This is simply refinancing a debt.
6) If the credit card also has non property related expenses on it you will need to pay them at exactly the same time. For example you have a balance of $1,000 on your credit card, $600 for the renovation and $400 for private purposes. On the same day take $400 from your personal account to pay off the card and $600 from the loan for the renovations and pay it off the card.

If you think this is over the top, have a read of what the ATO did to Wilma Domjan in her 2004 AAT Case

Selling Your Business – Going Concern GST Concession

The Going Concern GST concession allows a business to be sold without having to charge GST. This can also include the building the business operates from if it is sold with the business. This is very relevant when a building is involved because the price will be lower so the stamp duty will be less. Of course reduced stamp duty only benefits the purchaser, so let's look at the risks on each side of the contract.

Firstly, a brief explanation of the requirements of a going concern clause: both the buyer and seller must be registered for GST and agree that the contract is the GST exempt sale of a going concern. The seller must also provide the buyer with all things necessary to continue the business and the seller must continue to operate the business up until the time of sale. If all these requirements are met the seller does not have to remit 1/11 of the selling price and the buyer is not entitled to claim GST input tax credits on the purchase. Accordingly, the property should be sold for 1/11th less than the market price for sales of similar properties that are not subject to the going concern concession.

From the Seller's Point of View:

All is good if you can still get the market value for the property, you have nothing to lose. But a well-informed purchaser would expect to pay less than market value for a property under the going concern concessions for reasons elaborated on in the Purchaser's point of view below. Your biggest concern is that the ATO will come along and decide that the going concern concession did not apply to the contract, for example because you did not supply all things necessary to continue the business. This issue is addressed in GSTR 2002/5 which has just recently been updated. Don't underestimate the ATO here; they even consider that key staff members need to agree to work for the purchaser. If the ATO considers that the sale does not qualify for the going concern concessions it can ask for 1/11th of the sale price in GST, which is totally unfair if you have sold for below market value because of the going concern clause. Solicitors will generally try to protect you from this outcome by putting a clause in the contract requiring the purchaser to pay you the GST if the ATO decide that the going concern concession does not apply. The problem may then be finding the purchaser and, if you do, then going through the court process of making them pay up.

From the Purchaser's Point of View:

The purchaser is considered to have received a GST input credit on the purchase even though no money changes hands. This means that should you change the use of the building to residential, de register for GST or just stop using it to make supplies that are subject to GST, section 135 requires you to pay back to the ATO the notional GST on the purchase. This of course is unfair if you have already paid full market value for the property, it could be as much as 1/10th of the purchase price.

If the ATO come along and deny the going concern concession to the sale then the purchaser, if they can obtain a taxed invoice, may be entitled to an input credit for the amount of GST the seller has to pay. This is quite a bonus if the contract doesn't have a protection clause stating that the purchaser has to pay the GST amount to the seller should the ATO deny the going concern concession.

The Margin Scheme:

A seller can reduce the amount of GST they pay out of the sale proceeds of a property by making the contract subject to the margin scheme. The catch here is you can't apply the margin scheme to sales that are exempt under the going concern concession and the purchaser must agree to the use of the margin scheme before settlement. So choosing to use the going concern concession instead of the margin scheme may completely eliminate the GST rather just a portion of it under the margin scheme but if the ATO decides that it didn't qualify as a going concern then you are left with full GST rather than the reduction under the margin scheme. You can apply to the ATO for an extension of time to apply the margin scheme after the contract is completed but the purchaser has to agree. In the event of the going concern concessions being denied the purchaser is unlikely to agree to the margin scheme because this means they are not entitled to any GST input credits, something that they would qualify for if the ATO deny the going concern concession.

The Fine Print:

Quite often the business and its premises are owned by different entities (within the same family group) for asset protection purposes. To qualify for the going concern concession the building has to be part of a going concern. This means it is either sold with the owners established business or it is leased out and the going concern business is considered to be the business of leasing out the building.

Getting back to the situation where the building houses the business, it is ok to sell say the business from your trading trust and the building from your holding trust and bridge the going concern concessions but only if both are sold to the same purchaser. This means that the purchaser cannot have the asset protection advantage of owning the building in a different legal entity than the business. The purchaser needs to consider whether this is really worth the risk just to save some stamp duty.

Where is Julia?

Still at home in SEQ. I just want to let everyone know that my mobile phone, which also provides my internet connection, broke so there has been a delay in responding to emails and possibly some missed when sorting through the hundreds that had backed up. Some phone messages would also have been missed and I have lost all my phone numbers.

Ask BAN TACS

For $59.95 at Ask BAN TACS, www.bantacs.com.au/QandA/index.php, you can have your CGT, Rental Property and Work Related Expense questions answered; with ATO references to support our conclusion.

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 include young investors, SMSFs, renovators, granny flats, investment and budgeting strategies, fires and floods, mass marketing spruikers, commercial properties, subdividing and development. Go to www.bantacs.com.au/book_winning-property-tax-strategies.php for online purchasing. Still a low low $29.95 plus $5.95 postage – tax deductible of course!

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Information regularly changes in the Forum, www.bantacs.com.au/forum, and the Ask BAN TACS Notice Board, www.bantacs.com.au/QandA/index.php?section=browse.

One very generous askbantacser has allowed their question and answer to be placed on the notice board. www.bantacs.com.au/QandA/index.php?xq=448 is about selling a property and instead of paying back the loan used to buy that property, using the sale proceeds to buy another investment property. The question is whether the old loan is still tax deductible.