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

It's a tough time right now for conservative investors, with interest rates at historic lows.

If you are an investor who prefers to stay in cash, you need to understand the term 'real interest rate', which is the difference between the current inflation rate and the interest you are receiving.

Suppose you invest $100,000 at 4% when inflation is 3%. The interest for the year would be $4000, but inflation would reduce the value of your investment by $3000, leaving you with a real rate of just one per cent.

That's bad enough if you are in a tax free pension fund, but the outcome is much worse if you have to pay tax. For example, if you were in the 32.5% bracket, tax would take $1300, leaving you with a real after tax return of negative $300. In other words, you've gone backwards.

It would have been a different matter if that same $100,000 had been invested in a growth asset (such as an equity trust or in property), and it achieved growth of 4% in one year as well as income of 4%. Because growth assets are subject to capital gains tax, the 50% concession would have been taken off before tax was calculated. This would have reduced the gain that was subject to tax from $4000 to $2000, and the overall tax would have been much lower.

In any event, no capital gains tax is payable until the asset is disposed of. This maximises the compounding effect of annual growth because nothing needs to be withdrawn each year to pay tax. Unfortunately, capital gain can never be guaranteed, so growth assets are not appropriate as short term investments.

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.

Holiday Rentals

If you own a unit or a house that you rent out as short term accommodation it is still considered a residential rental property. It would be different if you controlled the whole block i.e. a motel like organisation.

As a residential rental property you are not entitled to charge GST or claim GST input credits on expenses associated with the property or its purchase. You are entitled to hold an ABN but unless you have some other form of income you are not required to register for GST. It is important to note that if you are not registered for GST you must not provide tax invoices. Your invoices must not be described as tax invoices and they should not state or imply that GST has been charged. The second item on this page makes it clear that you must not provide a tax invoice if you are not registered for GST
http://www.ato.gov.au/Business/Bus/GST-for-small-business/?page=5

Be careful if you let your holiday rental out through an agent. You need to check that they understand this and are not issuing tax invoices on your behalf. As they are merely your agent you could be liable for any GST they imply has been charged and rightly so because if the traveller is on business they will be claiming this GST back.

Short term accommodation may not always be for private holidays, it may be used by someone travelling for business and they may want a tax invoice thinking they will be entitled to the GST back. You need to point out that you are not registered for GST so cannot issue a tax invoice, maybe refer them to the above link.

The trap for your business tenants is, that as part of an attempt to control the cash economy the government requires all businesses to obtain an ABN from anyone they pay or withhold 47% in tax from the payment. Refer
http://www.ato.gov.au/General/Contractors/In-detail/FAQs/No-ABN-withholding---questions-and-answers/?page=3#2__If_I_buy_supplies_or_services_from_a_business_that_does_not_quote_an_ABN__what_do_I_have_to_do_
Accordingly, if you own a holiday rental, it may be better if you apply for an ABN but not register for GST. Give them the ABN and avoid an argument.

Technically this 47% withholding rule does not apply to input taxed supplies so you may be able to persuade them not to withhold 47% by pointing out you do not own the whole block, you are not a business, just an investor so it is an input taxed supply. The last column on the first page of this booklet points out that withholding does not apply when the supply is input taxed
http://www.ato.gov.au/uploadedFiles/Content/MEI/downloads/BUS38509n3346_5_2012.pdf

Substantiation in Canberra

I wonder just how much thought our law makers give to the practical difficulties of meeting their substantiation requirements. On a recent trip to Canberra I found that the capital city for these law makers was the worst for compliance.

I was given a tax invoice for my accommodation without an ABN. Unless the tax invoice is for less than $75 before GST it is not actually a tax invoice without an ABN. Further tax invoices can only be issued by entities registered for GST. Tax invoice is a very specific term and should not be used lightly. Apparently my accommodation provider was neither registered for GST nor had an ABN. That is fine it was a short term holiday rental not a motel so they didn't need to be but they should not have been issuing invoices with the words tax invoice on them as this in theory entitles the payer to input tax credits.

When I bought my lunch, at a restaurant, I asked for a receipt, I was travelling so it would be tax deductible. I was told no we don't issue receipts; our till just doesn't do it. That is very convenient. I pointed out that a group of us were intending to have dinner there the following night and as we were all travelling we would need a receipt or we would not be able to claim the meal. If they couldn't provide that we would not come, this didn't change their mind, surely their little order docket would be enough, they claimed. Definitely not it was a little order book with the tear off number, with absolutely no identification of the seller at all.

I wonder if the ATO has ever done a cash economy blitz in Canberra? Mmm, my dogs don't do it in their back yard either.

I guess Canberra is not the place for the travelling self-employed; the travellers there are probably on travel allowances that do not require substantiation.

Div. 7A Loans (Borrowing From Your Company)

To avoid taxpayers paying only the 30% company tax rate on their earnings and then using the money for private purposes, Division 7A was introduced to deem these arrangements a dividend payment i.e. taxable in the hands of the person who is using the funds. To avoid the funds being deemed a dividend you can enter into an arrangement to borrowing the money from the company and pay interest. The ATO sets the interest rate each year and it is always higher than you would expect to pay a bank if you provide real estate as security.

There is a way out to make the day to day drawings manageable. As long as the loan is fully paid back to the company by the time the company's tax return is due to be lodged then Division 7A will not apply. But don't try to borrow this amount again the next day. The legislation prevents you paying the loan back on the day of lodgement of the tax return then just borrowing it back again, effectively giving you the use of the money 364 days of the year without paying the company interest. Here is a link to the relevant section, http://law.ato.gov.au/atolaw/view.htm?docid=PAC/19360027/109R though; you do get a year to put the loan agreement in place according to ID 2012/60
http://law.ato.gov.au/atolaw/view.htm?docid=%22AID%2FAID201260%2F00001%22

Choosing a Business Entity

The final choice should be made with your accountant who understands your situation completely. This article covers just some of the issues.

My favourite entity is a discretionary trust with a company as trustee. This provides asset protection, creates an employee situation, allows any CGT benefits to flow straight through to the beneficiary and provides flexible profit distribution even into another trust that may hold negatively geared properties.

A discretionary trust is fine when it is just a family business but if there is more than one family involved then a more defined right to profit distribution is necessary. I still recommend that you consider a discretionary trust but one for each family then bring them together to form the business entity. The idea being that the profits, which are strictly defined in the business entity, flow through to each family's discretionary trust where they can be dealt with as best suites that particular family.

There are a few ways that the discretionary trusts can come together;

Company - The business entity is a company in which the discretionary trusts own shares so their profit entitlement is clearly defined by the number of shares they hold. The main problem here is the difficultly in getting the tax free amounts from the small business CGT concessions out of the company and those companies do not qualify for the 50% CGT discount.

Unit Trust - Similar to above a unit trust where the individual discretionary trust own units in the trust that define their right to profit. Any capital gains made by the unit trust may qualify for the 50% CGT discount and other small business concessions and these should flow all the way through to the discretionary trusts and then through to the beneficiaries. There is a bit of mucking about with CGT event E4 when it comes to the tax free portion of the small business retirement and active asset concessions but it will all work out in the wash. What is concerning with unit trusts that combine more than one family is the controlling individual and significant individual test are going to be very difficult to meet at the Unit trust level so these small business concessions might not even get to first base.

Further Problems - Another problem with both of the above is that it will be necessary for the company or unit trust to be the entity to choose how to utilise the small business concessions. It could be possible that each family would benefit from a different approach especially if there is a difference in ages. There is also the risk that the venture will make a loss. This will be locked in the company or unit trust and can only be offset if the families continue with the business or take on something else. In reality if the business fails they will just close the entity and go their own ways so the tax benefits of the loss will be lost. In a partnership the loss flows through to the partners so each discretionary trust would be able to keep their share of the loss to use in another venture in that discretionary trust.

- If the discretionary trusts came together in a simple partnership where the partnership agreement gives each discretionary trust a fixed right to the profits then as is the case with the other entities, each family's discretionary trust can distribute the profit as it suits their particular family situation. In a partnership the assets are considered to be owned by the partners not by the business entity. So when the business makes a capital gain it is really made by each individual discretionary trust. Accordingly they can distribute it as it suits but also have a far better chance of meeting any controlling individual or significant individual requirements within their own family unit. All the CGT concessions are available to discretionary trusts and they all flow through to the individual beneficiaries without any change in their status. Further a partnership can distribute a loss so if the business does not work out each family trust can take its share of the loss into another venture without being tied to the same partnership.

Internet Problems

Our Bribie Island Road, Ningi office has had weeks of internet problems which are now under control but as they have had a sudden switch of providers some emails may have gone astray. If you have an email that has not been replied to please send it again. The email addresses remain the same.

This is also the reason the first newsflash for March was so late that it was impractical to provide a mid-month edition.

Skype Julia

I have also improved my internet access now that I am not travelling as much. This means that Skype has become a very effective way of consulting. I like to see the client's face so that I know they are following what I am saying. Most of the people who have used this service to date just want to talk about their overall strategy or get a straight answer to a difficult question. It is not intended to replace your current Accountant but it is an excellent method of getting specialist advice on property from investing to developing. http://www.bantacs.com.au/shopping.php

Where is Julia?

At home in SEQ heading to Sydney mid May.

Ask BAN TACS

For $69.95 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.

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!

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. There are over 30 topics, for example How Not To Be A Developer, Claiming Your Trip Around Australia As A Tax Deduction, Claimable Loans, Rental Properties, Overseas, Fringe Benefits Tax, Claiming a Motor Vehicle, GST etc.

With the forum and the Ask BAN TACS Notice Board the information on the site regularly changes. Two very generous askbantacsers have allowed their question and answer to be placed on the notice board. Askbantacs is becoming quite popular; it is a shame so few allow their questions to be placed on the notice board.

http://www.bantacs.com.au/QandA/index.php?xq=533 looks at the problems associated with holding a pre CGT property in a company and one of the shareholders wants out.

http://www.bantacs.com.au/QandA/index.php?xq=531 Discusses using company funds to reduce your home loan.