

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

ATO Guidelines on Professional Practice Profit Distributions

The ATO has warned it will be looking into professionals who use a partnership of family discretionary trusts to distribute income to other lower tax family members or entities. It is not the set up of a partnership of discretionary trusts that is the issue. It is whether they are used to divert taxable income away from the professional. You certainly can't distribute income you earn personally to someone else, for example a practitioner who operates with only the support of administration staff. Even if you are in a large practice where profits are also earned from the services of other professional staff you employ the ATO still wants to see a lot of the profit returned to you, the professional.

The following is simply a guideline issued by the ATO, not a binding ruling. It sets out the sorts of profit distributions that will attract their attention. The idea is to meet at least one of these requirements to stay under the ATO radar:

- 1) The Practicing Professional receives as wages at least the same if not higher remuneration as the highest paid professional employee in the firm that is providing similar services. If there is no such employee then you can use industry benchmarks. Some professional bodies provide wage rate guidelines.
- 2) The Practicing Professional receives as their personal taxable income at least 50% of the profit their family trust receives from the partnership firm. The calculation also catches income received indirectly from the firm.
- 3) That all the beneficiaries of the discretionary/family trust or those related entities that indirectly receive income from the firm all have an effective tax rate of 30% or higher on the income receive.

Note this will only apply for this (2014/2015) and future financial years, not retrospectively.

Column by Noel Whittaker

Anybody who has been involved in investment should be aware of the adage “there’s no such thing as a free lunch” or its fellow traveller “if it sounds too good to be true, it probably is”.

Unfortunately temptation can come from unexpected sources, as a friend I’ll call Carol received an offer which entitled her to 90% discount on accommodation in the heart of one of Australia’s prime beachfront resorts.

The offer purported to be “a marketing promotion” - the purpose of the bargain price was to enable prospective customers to sample the delights the resort had to offer.

The fine print did include a requirement that the couple attend a 90 minute presentation on the benefits of the resort, but Carol figured that wouldn’t be too much of a burden. As she said to me, “it would give me the opportunity to play some games on my iPad”.

They duly arrived at the resort where they were requested to make an appointment for the presentation. When they turned up, they found a large room containing a number of tables with a salesman sitting at each table. They were also handed a two page form to complete and sign.

The second page included a statement that the participants confirmed they had received a financial services guide (FSG), and, at the end of the presentation, would receive a statement of advice (SOA) and a product disclosure statement (PDS). The SOA would be based on the assumption that they were a two person family co-habiting for more than two years household earning more than \$70,000 a year.

There was also a clause where the participant agreed that they would pay full price for the accommodation if they didn’t buy whatever was being sold.

It must have been an interesting afternoon for the sales promoters. Carol tells me she got to her feet and launched a tirade of abuse at the organisers for wasting everybody’s time, and engaging in misleading and deceptive conduct. She and her husband then stormed out as, I gather, did all the other potential victims who had turned up.

Apart from the obvious lesson here, it is also important to keep in mind that the best investments are those that you seek out yourself after detailed research, and not ones that are pushed on you at a presentation. If real estate is your ‘thing’, the way to buy it is to find an undervalued property in a top location, and strike a bargain with a vendor who is exceptionally keen to sell. This is not going to happen at a 90 minute sales presentation.

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.

Mining Town Story of Woe

I used to advise investors to visit Broken Hill before they buy in a mining town. Here is another great example <http://www.abc.net.au/news/2015-02-07/house-passed-in-at-auction-after-million-dollar-price-dive/6077724>

Rental Property Booklet Split and Updated

Our rental property booklet has been updated to newsflash 294 and split into 5 separate booklets, Before You Buy, Buying A Rental Property, Owning A Rental Property, Selling A Rental Property and Your Own Home. All of these will soon be available free in the booklets section of our web site <http://www.bantacs.com.au/booklets.php>

Before You Buy http://www.bantacs.com.au/booklets/Before_You_Buy_A_Rental_Property.pdf
and Buying a Rental Property http://www.bantacs.com.au/booklets/Buying_A_Rental_Property.pdf are already available.

Buying and Immediately Subdividing To Sell

If you buy a property with the intention of immediately cutting it in half and selling off one of the blocks the ATO would argue that it is a profit making venture so you need to charge GST and the profit is taxed as normal business income. After all even with a short turn around it would be unusual for such an activity not to be profitable. In <https://www.ato.gov.au/rba/content/?ffi=/misc/rba/content/1012730145598.htm> PBR 1012730145598 a taxpayer successfully argued that they did not buy the property with the profit making motive. They wanted that particular property but not all the land to go with it. They bought it with the intention

of making a home and subdivided to simply reduce their maintenance. Don't just assume this could apply to your circumstances, make sure you get a ruling but it may be worth quoting this one.

SMSFs - Borrowing, Negative Gearing and Franking Credits

In Newsflash 293 I discussed how in ATO ID 2014/39 and ATO ID 2014/40 argued that favourable loan arrangements (for example zero interest rate loans) from related parties create non arms-length income and as a result the income will be taxed at the maximum tax rate. The premise for this argument was that the income is really earned by the holding trust and it is the holding trust that claims the expenses. The fact that these entries go through the SMSF is just an administrative efficiency.

Well only one month after the ID's were released, Treasury issued draft legislation to make it clear that the income from the asset held in the holding trust is really the income of the SMSF and the deductions are deductible to the SMSF, as long as the asset is still security for borrowing by the SMSF.

Last month I said stay tuned, this edition would discuss how the view held by the ATO in ID 2014/39 and ID 2014/40 had ramifications for negatively geared properties and franking credits on shares. The draft legislation is intended to remove this problem and it back dates to the date on which SMSF were first permitted to borrow.

So where are we at now? I contacted the ATO and their response is, it is too soon to comment on whether ID 2014/39 and ID 2014/40 will be withdrawn. They will be waiting until after the legislation has been passed. Accordingly, I will now continue on with the warning but with more confidence that the problem will be rectified.

Following on from last month's article on lending to your SMSF, the stance taken by the ATO in ATO ID 2014/39 and ATO ID 2014/40 also affect any SMSF borrowing. It is a statement about how the holding trust operates not just a comment on related party loans. The ATO is claiming the income and expenses from the investment go through the holding trust first and it is only the net income that goes into the SMSF. The ATO argue that the holding trust is not a bare trust because of the mortgage obligation it has to the bank.

Many of these investments are negatively geared. The idea is that superannuation contributions to the SMSF offset the losses. Trusts cannot distribute losses so if the investment is locked into the holding trust then so is the losses, at least until the holding trust makes a profit. Worse still, if the investment is shares that produce a franked dividend, the franking credit cannot be taken into account when determining if the trust makes a distributable profit. If the trust does not make a distributable profit then it cannot distribute its franking credits (according to the ATO) even if it makes a profit for tax purposes. Any franking credits that cannot be distributed are then lost forever.

Your ATO at work, trying to twist the law to suite a perceived risk to revenue has now undermined the whole of SMSF borrowing. We'll keep you posted.

When CGT Is Paid By a Beneficiary of a Deceased Estate

For more information on the whole process of how deceased estates are taxed please refer to last month's Newsflash, number 293. This article looks at the effect of Bamford's case on deceased estates.

Taxable income is not always the same as trust income. Some trust deeds specify that the trust income is to be calculated in the same way as taxable income but in the case of a deceased estate the method of calculation of the income relies on ordinary concepts. Ordinary concepts mean that the income of the estate will not include franking credits or capital gains. Yet these amounts are included as income for tax purposes.

Consider an estate that may have \$3,000 in interest income, \$700 in cash dividends received, \$300 in franking credits, a \$100,000 capital gain and maybe deductions of \$500 for tax agent fees.

Trust Income		Taxable Income	
Interest	\$3,000	Interest	\$3,000
Dividends	700	Dividends	700
	-----	Franking Credits	300
Gross Income	\$3,700	Capital Gain	100,000
Less:			-----
Tax Agent Fees	500	Assessable Income	\$104,000
	-----	Less:	
Net Income	\$3,200	Tax Agent Fees	500

Taxable Income \$103,500

Now Bamford's case says that the beneficiary who is presently entitled to the trust income is the one who pays the tax on the taxable income. If there is more than one beneficiary then it is apportioned on the ratio that the trust income was divided amongst them.

So take the example where a property is sold during the year and the estate is in the intermediate or final stage. If before the 30th June trust income (not the capital gain from the sale) is paid out to beneficiaries then those beneficiaries are deemed to be presently entitled and so liable for their proportionate share of the taxable income of the trust. Now in the situation described above it is most likely that the trust income i.e. the interest and cash received from the dividends is retained by the estate to pay bills, probably just left to accumulate in the estate bank account. Whereas, on the sale of the property the solicitor probably immediately distributed some or all of the sale proceeds to the beneficiaries knowing that there was still plenty of money left to cover any further expenses of the estate. In these circumstances the trust has not made any beneficiary presently entitled to the trust income only capital gain. The trust has kept that trust income itself, so it will be the trust that is liable for the tax on the capital gain. Just as it would be the trust who would be liable on the capital gain if no sale proceeds had been distributed.

So an alert executor might instead make a point of distributing the \$3,000 in interest income and \$200 of the dividends before the 30th June. This will trigger a tax liability to those beneficiaries for the whole taxable income of \$103,500 even if they have not received that. So say there were two equal beneficiaries of \$1,600 each, they would actually have to include in their tax return half of the \$103,500 each even if they were not the beneficiaries to which the sale proceeds were paid. From a beneficiaries point of view, keep an eye on this; you can refuse to accept a distribution.

Taking this just one step further, if say the tax agent fees were \$4,000 instead of \$500 then the trust will make a loss for trust income purposes but still have a profit for tax purposes. In this case it will be the estate itself that will be liable for all the tax, as no profit can be distributed.

Skype Julia

Skype has become a very effective way of consulting. Skype allows me to see the client's face so that I know they are following what I am saying. Most 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 or just a second opinion. <http://www.bantacs.com.au/shopping.php>

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 by Julia. I will include ATO references to support our conclusion; answers are generally 300 to 700 words long depending on the complexity.

What Is New on Askbantacs

<http://www.bantacs.com.au/QandA/index.php?q=625> Two apartments lived in as one home then split to sell.
<http://www.bantacs.com.au/QandA/index.php?q=626> Changing security when refinancing – no tax benefits
<http://www.bantacs.com.au/QandA/index.php?q=629> Subdividing a pre CGT property.
<http://www.bantacs.com.au/QandA/index.php?q=630> Subdivide and build but still merely realising an asset?
<http://www.bantacs.com.au/QandA/index.php?q=637> What interest can be claimed when you borrow to buy a new home and rent out the old one?

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.