NEWSFLASH

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Draft Legislation on Claiming Travel to your Rental Property

Treasury have issued an Exposure Draft on the Travel Deductions and Plant and Equipment Depreciation changes announced in the budget, go to https://treasury.gov.au/ConsultationsandReviews/Consultations/2017/Housing-Tax-Integrity?_ga=2.146278262.370438565.1500338192-515271741.1496197443
A link to the detail is in the top right-hand corner.

No deduction is allowed for travel to inspect or maintain a residential property that is being used to produce residential rents from 1st July 2017, unless:

1) You are in business, this means owning at least 9 rental properties and participating in their management
2) The property is owned by a company, now you wouldn't want to do this because companies do not get the 50% CGT discount
3) The property is owned by a superannuation fund, but not a SMSF
4) The property is owned by a widely held unit trust

This leaves Mum and Dad investors out in the cold unless the own commercial property. To further add insult to injury these expenses are also specifically excluded from the cost base for CGT purposes.

The definition of residential premises is taken from the GST Act which includes short term accommodation in resorts or the like. Residential premises can be just basic shelter and facilities but nevertheless cannot include a building that is not designed to be used as accommodation even if it is.

The explanatory memorandum states that travel not to the investment property but relating to the investment property is also not tax deductible, i.e. travel to real estate agents or body corporate meetings.

There is an interesting carve out. If the premises are also being used for another purpose such as supporting solar panels that directly produce income for you then you can claim for travel regarding the panels.

If the property is both residential and commercial i.e. a shop with a flat over the top of it, then travel needs to be apportioned.

Draft Legislation - Changes to Depreciation

The draft legislation for the removal of the deduction for plant and equipment depreciation has been released and it has far wider application than initially anticipated. If you would like to see the full detail of the draft legislation and the explanatory memorandum go to https://treasury.gov.au/ConsultationsandReviews/Consultations/2017/Housing-Tax-Integrity?_ga=2.146278262.370438565.1500338192-515271741.1496197443 and click on the links in the top right hand corner.

What is in and what is out - Building depreciation is fine if there is any part of the property that was built after 16th September 1987. It is second hand ("previously used") plant and equipment, in a residential rental property, that the average investor cannot claim a tax deduction for if, the agreement to buy the property was signed after 9th May 2017 or if they have previously used the plant and equipment for non-taxable purposes such as living in the home.

Second hand plant and equipment is anything that has been used before you use it to produce income. If you buy a brand-new house, the plant and equipment has not been used by the builder other than being held as trading stock, you can depreciate that plant and equipment. Even the common property in a block of units qualifies for this carve out if you are the first owner of the unit.

If you buy brand new plant and equipment but use it for private purposes first then when the house becomes a rental you cannot depreciation that plant and equipment. This is a trap for live in renovators. From the explanatory memorandum (EM) it appears even if you do not use the plant and equipment while you are living there, it is still caught. So, choosing not to turn the air conditioner on while you are living there won't help. The EM states:

. "Any assets installed in the premises while they are living there would therefore be previously used and any deductions for the decline in value of the assets for any subsequent owner would be subject to the reduction."

Exclusions - If the property is owned by a company, widely held trust or superannuation fund other than a self-managed superannuation fund the restrictions on claim plant and equipment depreciation do not apply. If the property is commercial premises the owner can still claim depreciation on previously used plant and equipment. There is also an exclusion for people wealthy enough to own enough properties to be consider in the business of renting out properties.

The definition of being in a rental property business is vague but from the few court cases in this area you would be looking at owning at least 9 properties and participating in their management.

Renos in Progress on Budget Night - If you owned a property before the budget announcement but it was not being used to produce income in the 2016-2017 income year then whenever you do use it to produce income you will not be entitled to a tax deduction for depreciation on any of the plant and equipment in that property unless you purchased it brand new after it became income producing. Among others, this will catch out renovations in progress on budget night.

Here is what the draft legislation says:

(2) The amendments made by this Schedule also apply to the entity, for income years commencing on or after 1 July 2017, for any other asset acquired by the entity, if:

(a) the asset's start time is during the income year that includes 9 May 2017 or during an earlier income year; and

(b) no amount can be deducted under Division 40, or Subdivision 328 D, of the Income Tax Assessment Act 1997 by the entity for the asset for the income year that includes 9 May 2017.

Employing a Builder to do Renovations – Unless these renovations are substantial then you might not be allowed to claim plant and equipment depreciation if the items are purchased by your builder. Until this is clear it is best you buy the plant and equipment yourself and get your builder to install them, if you are intending to rent out the property after the renovation.

Quick Tip – Tax Debts

The ATO is now reporting outstanding tax debts to the credit rating associations. I am not sure that they have thought this through as it will no doubt affect your ability to borrow money to pay your tax debt!

Draft Legislation Re Expats Main Residence Exemption

Expats working overseas with the intention of returning to Australia, possibly into a home they already have or to sell that home to upgrade, need to be very careful not to sell their Australian home while they are a non-resident of Australia for tax purposes and make sure they do not die while they are a non-resident! Proposed changes to the law will mean that you will not be able to utilise the main residence exemption, at all, if you sell your home while you are a **non-resident for tax purposes,** nor will you be entitled to the 50% CGT discount for the period of time you were a non-resident.

At the time of writing only draft legislation had been release on how the government intends to remove the main residence CGT exemption from non-residents and it is very very harsh. If you sell a property while a non-resident for tax purposes you will completely lose your main residence exemption for the whole time you owned the property. It is based on your residency status when you sign the contract to sell. So, the very simple strategy of accepting a job overseas but not putting your home on the market until you leave the country so you have somewhere to live in the interim will make the whole capital gain on your home taxable even if you have lived there for 30 years! You won't even get the 50% CGT discount on some of the gain and your tax rate will be non-resident rates starting at 32.5%.

For a family home of 30 years in Sydney this would mean a tax on inflation and very little chance of ever being able to afford to get back into the market. The simple solution is to **not sell your home while you are a non-resident for tax purposes**. This simple piece of knowledge will save you hundreds of thousands of dollars in tax, so spread the word. There is nothing fair about this tax it is just a trap for the unwary.

The draft legislation does not provide for any market value reset when you leave the country so if you are caught by this tax you won't have had the hindsight to have kept all the receipts for the expenses you incurred right back to the time you purchased the property. As a result, you will be tax on a gain that you did not really make because you can't prove the expenses you have incurred on the property.

It is also possible that the market value reset rule, section 118-192 ITAA 1997, when you first rent the property out, may not apply as it is conditional upon the property being 100% covered by your main residence exemption and this new legislation retrospectively removes that main residence exemption. There is nothing in the explanatory memorandum about this so we will have to wait and see.

Don't go panicking just yet. These changes will initially only apply to properties purchased after 9th May 2017. But come 30th June 2019 it will apply to all properties that were purchased after 19th September 1985.

As long as you do not sell your home while you are a non-resident for tax purposes you can continue to cover it with your main resident exemption while you are overseas providing you are entitled to use the absence rule. Section 118-145 which allows you to cover you home with your main residence exemption, in your absence, for up to 6 years if it is earning income or an indefinite period if it is not earning income.

There is another trap in the draft legislation. If you die while you are a non-resident of Australia for tax purposes then your estate, if it sells the house, is treated as if you did sell the house while living overseas. The estate will be taxed on all the capital gain you made in your lifetime on your home, right back to the day you purchased it. It appears from the draft legislation that there will be no changes to section 128-10. So, your estate will be able to transfer that property to your heirs without triggering a CGT event (assuming they are not non-residents) but if they ever sell it they will have to pay CGT on all the gain in your life time. They will also have to pay CGT for the gain on during their ownership period unless they choose to cover it with their main residence exemption but even then, the gain will be apportioned on days covered by their main residence exemption and days not. No consideration for the period it was your main residence.

If you are about to leave Australia and are concerned how this law will pan out, it may be worth renting the property out before you leave the country. This may allow you to utilize section 118-192 to reset the cost base to market value at that date but as stated above there is no certainty on that yet.

If your adult children are going to live in the home while you are overseas and you are concerned that you will want to sell it when they move out and you are still living overseas then maybe you should charge them rent in case you will be able to trigger the reset under section 118-192, mentioned above.

You may consider selling the house before you leave to avoid being forced to sell it while you are overseas or to avoid the huge tax consequences to your estate if you die while overseas and a non-resident of Australia for tax purposes. It's a decision which needs to take into account many factors, not just the CGT one. You must consider where you will invest the sale proceeds and whether prices may continue to grow on the home you are selling.

If you purchased your Australian home before 19th September 1985 you can relax, as CGT will not apply to it whether you are a resident or a non-resident.

When you return to Australia, as long as you pass the residency test i.e. you are not just here on a holiday, then you should be able to sell your home and cover it with your main residence exemption, even for the period when you were overseas, if you qualify to use the absence rule (commonly called the 6-year rule) in section 118-145 ITAA 1997.

The changes that the draft make to the example in section 118-145 are very telling. Previously it simply said that at the end of your time overseas you sell your home, then the main residence exemption will apply. This is now changed to say that you return to your home and live in it for 3 years after which you sell it and the main residence exemption applies. There are no changes to the wording of section 118-145 other than the example so this edit may just be so it can't be implied that the house could be sold with the main residence exemption just as you were leaving to come back to Australia. That may be all this means but until the dust settles it might be a plan to move back into the house upon your return to Australia, before you actually sell it, rather than come back and settle in another house and then sell.

Of course, all of this means that our Expats booklet that is only a month old has had to be updated. The latest version is available at
http://www.bantacs.com.au/booklets/Expats%20and%20Australian%20property%20booklet.pdf

Regarding All These Draft Legislations

Of course, all these proposed changes are not law yet so they may change, but whatever the final outcome it will apply retrospectively.

Tax Accountants Needed

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Your salary will be dependent on experience, linked to productivity and professional development. If you are looking for a great career opportunity in a firm that will grow with you please email jula@bantacs.com.au

Askbantacs - Free Notice Board

For $79.95 at Ask BAN TACS you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered by Julia. They will include ATO references to support the conclusion, answers are generally 300 to 700 words long depending on the complexity.

First check the Notice Board, your question may have already been answered at someone else's expense.

Two very generous Askbantacsers have allowed their questions to be published on the notice board this month:
http://www.bantacs.com.au/QandA/index.php?xq=833 Non-Resident Beneficiary of a Testamentary Trust
http://www.bantacs.com.au/QandA/index.php?xq=834 Living in a House Owned by a Trust