

NEWSFLASH

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BAN TACS **Accountants Pty Ltd**

BAN TACS
Accountants
Pty Ltd is a
CPA Practice



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Queensland

Gold Coast **PNA**

Level 5, Seabank Building Marine Parade
Southport Qld 4215

Mail to: 98 High St, Tenterfield NSW 2372
Phone: (02) 6736 5383
Fax: (02) 6736 5655
E-mail: goldcoast@bantacs.com.au

Ningi **CPA**

Shop 17A 1224 Bribe Island Rd,
Ningi Qld 4511

Mail to: Location
Phone: (07) 5497 6777
Fax: (07) 5497 6699
E-mail: ningi@bantacs.com.au

Stanthorpe **PNA**

37B Maryland Street, Stanthorpe Qld 4380

Mail to: 98 High St, Tenterfield NSW 2372
Phone: (07) 4681 4288
Fax: (07) 4681 4028
E-mail: stanthorpe@bantacs.com.au

New South Wales

Kiama **NIA**

3/114 Terralong Street,
Kiama NSW 2533

Mail to: PO Box 5062 Nowra DC NSW 2541
Phone: (02) 4447 8686
Fax: (02) 4447 8169
Email: kiama@bantacs.com.au

Nowra **NIA**

93 BTU Road,
Nowra Hill NSW 2540

Mail to: PO Box 5062 Nowra DC NSW 2541
Phone: (02) 4447 8686
Fax: (02) 4447 8169
Email: nowra@bantacs.com.au

Tenterfield **PNA**

98 High Street, Tenterfield NSW 2372

Mail to: Location
Phone: (02) 6736 5383
Fax: (02) 6736 5655
E-mail: tenterfield@bantacs.com.au

Victoria

Fitzroy **CPA**

151 St Georges Road,
Fitzroy North VIC 3068

Mail to: PO Box 8152 Newtown Vic 3220
Phone: (03) 5222 8489
Fax: (03) 5222 8489
Email: fitzroy@bantacs.com.au

Geelong **CPA**

7 Westcott Street,
Newtown Victoria 3220

Mail to: PO Box 8152 Newtown Vic 3220
Phone: (03) 5222 8489
Fax: (03) 5222 8489
E-mail: geelong@bantacs.com.au

Highbury **CPA**

1/487 Highbury Road, Highbury VIC 3190

Mail to: PO Box 8152 Newtown Vic 3220
Phone: (03) 5222 8489
Fax: (03) 5222 8489
Email: highbury@bantacs.com.au

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Welcome to the BAN TACS News Flash. Our aim is to provide short but succinct updates on all tax issues

Interest Not Deductible On Loan To Purchase Options

ID 2009/71 goes to the heart of many employee share ownership incentives. In ID 2009/71 the ATO ruled that the interest on money borrowed by an employee to purchase options for shares in his employer was not deductible.

An option typically only entitles you to purchase shares. Interest is only deductible if the borrowed money was put to some income producing use. The options themselves will not produce income. Income is only likely to come into the arrangement if the options are exercised and the shares acquired as a result, produce dividends. This is too far removed from the purpose of the borrowings.

If the option is exercised then the interest expense, and for that matter to price of the option can be included in the cost base of the share. But note the interest expense cannot go so far as to create a capital loss.

Apportioning Deductions on a Holiday Home

You are looking for trouble if you use your holiday home in the peak period but make it available for rent at other times in an attempt to claim a deduction for all expenses attributed to the period you are not using it. The ATO says in these circumstances simply being available for rent is not enough.

The question of genuinely available for rent was addressed in *Bonaccordo v FCT* 2009 AATA 385, where the AAT found that it was not sufficient just to have a sign out the front. In this case the taxpayer could not find tenants to his standard so the place remained vacant for 3 years.

In the case of a holiday house you cannot apportion the expenses on a days available for rent versus days used for private purposes when the peak rental times are being used for private purposes. In these circumstances the apportionment basis would be days actually rented out versus days not. Refer IT 2167.

Column by Noel Whittaker

Recently my son James Whittaker and I launched our latest book "The Beginner's Guide to Wealth" which has been written to help young people take control of their life and their finances at an early age. It is a sad fact of life that many people do not excel at school, even though they may have a wealth of talent, and so develop the feeling that success is destined for *other* people, but out of their grasp. In our new book we explain that life is a long journey and, irrespective of high school marks, it will still serve up many challenges and disappointments.

In our experience, the qualities that make for success in life are a good attitude, a pleasant disposition, an eagerness to build positive habits, and a commitment to ongoing learning and development. None of these require a high IQ.

Most young people I meet tell me they are unsure about what they want to do in life. This should not be a problem because many jobs that exist today were unheard of 20 years ago. The best way to handle uncertainty is to experience as many different types of jobs as possible – this will enhance your skills and widen your circle of contacts.

Once you get a job, resolve to be the one person that the boss can trust absolutely. Then, you'll be the one given the challenging tasks that nobody else wants and you are also most likely to be asked to relieve your supervisor when he or she is away. The person who keeps learning and who is always prepared to give 110% will find opportunities everywhere.

We have been very humbled by the overwhelming feedback since the book launched earlier this year and we are continuing our mission to make it available to as many people as possible.

"The Beginner's Guide to Wealth" is currently the Book of the Month in 'Money' magazine and is available at all good book stores or online at www.noelwhittaker.com.au.

Noel Whittaker is a director of Whittaker Macnaught, a division of St Andrew's Australia. This advice is general in nature and readers should seek their own expert advice before making financial decisions. Noel's e-mail address is noelwhit@gmail.com

David Thompson & Julie Lockeridge Kim Evets from Whittaker Macnaught are regularly available to see our clients

Latest for Trusts with Bucket Companies

Bucket company, describes the situation when a discretionary trust sets up a company as a beneficiary so that it can distribute profits to the company to hold at the company tax rate of 30%. TR 2009/D8 is the ATO's latest attempts to minimise the impact of this practice. Note it is only a draft ruling but it is intended to apply to distributions made after 16th December, 2009. This means it will apply to distributions of the profit for the 2009/2010 financial year. Accordingly, it is time to consider an alternative strategy because a discretionary trust must create a minute on how it will distribute its profit before 30th June. We probably won't have a final ruling by then so this draft ruling gets to rule this year without sufficient review.

The draft ruling looks at when profits, that have been taxed in the hands of the company, continue to be used by the trust. If the trust had retained the profits itself it would have been taxed at the maximum tax rate. This strategy allows the trust to use the funds as if it had retained them but a tax rate of 30% is only paid on them. The cash that does not flow through to the company (ie held back by the trust) is called an unpaid present entitlement (UPE). Until now, the ATO had accepted that while ever it remained a UPE not a loan. The draft intends to change this, stating that a UPE that has not been paid within by the due date for the lodgement of the company's tax return is a loan and caught in the Division 7A rules. The scary thing about this section (Division 7A) is that if the loan is not made under the strict conditions of Division 7A as to term and interest rate it is considered to be taxable income. So it is important that the loan or UPE is documented correctly.

So what is the decision when making your 30th June 2010 distribution minute? If you distribute some of the profit to the bucket company it will have to charge the trust market interest on the loan back of this money. Not too bad an outcome because the trust will get a deduction (assuming the funds are used to produce income) for the interest it pays and the bucket company will pay tax on this interest at 30% and probably lend it straight back to the trust. So you may choose to continue to distribute to the bucket company this year anyway, then wait and see if you have to charge interest. Then the important thing is to get the loan appropriately documented.

On the other hand if the UPE is not being used for deductible purposes by the trust it maybe time to reconsider you tax planning strategy. Remember superannuation is only taxed at 15% but it is locked away until you are at least 55 years of age and retired.

Fair Work Australia – Discrimination

Race, colour, sex, sexual preference, age, physical or mental disability, marital status, family or carer's responsibilities, pregnancy, religion, political opinion, national extraction or social origin, trade union membership or lack thereof are all considered catalysts for discrimination. For example if a pregnant employee applies for a promotion, even though you know she will be on maternity leave during a vital part of that new position you cannot refuse her the promotion on that basis. Of course these issues also apply to employing someone in the first place and if it is considered that you terminated an employees employment due to one of these factors it would amount to unfair dismissal. Discrimination includes treating an employee differently from other employees in their conditions.

It is also considered discrimination if you were to terminate someone's employment due to or during their absence from work because of illness, injury, bringing an action against you under Fair Work Australia, participating in an emergency management activity, maternity or parental leave.

Becoming A Property Developer

If you have a property that you want to develop but until now it has been held as a rental or your own home, there is probably already considerable capital growth. This article explains how this growth is treated for tax purposes.

The first question is why did you buy the property? If it was for the primary purpose of eventually developing it, then you are gone, any gain from that point of purchase forward will be taxable as normal income.

But what about section 70-30 and 70-80 that allows an item to change from trading stock to investment or private use at whim. This is a relative new law so will override our traditional case law on the issue and is worthy of consideration if you had development on your mind at the time of purchase.

Now back to the question at hand what happens when you take a property that was purchased as your home or rental and develop it. There are three possible categories you could fall into:

| | | |
|---|--|---|
| Merely Realising an Asset ie cutting off a few blocks CGT | One off Profit Making Scheme Business like but small ie specie CGT, GST and Income Tax | Serious Development ie units, townhouses, complex subdivision CGT, GST and Income tax |
|---|--|---|

A more detailed discussion on this topic is in our how not to be a developer booklet available under freebees on our web site.

If you are merely realising an asset that was once a rental then the tax treatment doesn't change but if this property was also entitled to your main residence exemption then you need to be careful to preserve it. You would only be entitled to cover one of the properties with your main residence exemption and then only if it is sold with a dwelling on it. A trick here if, before development, the property had been fully covered by you main residence exemption would be to rent it out. This would bring section 118-192 into play to reset the cosy base a market value at the date it was first rented out. This new cost base is then what is apportioned between the blocks and selling one with a dwelling on it is now necessary. Careful, section 118-192 also deems you to have repurchased the property at that date, so you have to wait another 12 months to get the 50% CGT discount.

One off profit making scheme. This is when you are considered to have changed the purpose for which you have held the asset but the development is not so business like that you produce trading stock. In this case you rely on the Whitford Beach case of 1982 which divides the eventual profit into capital gains and revenue in a very complicated formula that nevertheless manages to protect your gain up until development from normal income tax. The trap here is it may not protect your main residence exemption if the property is not sold with a dwelling on it so again it maybe better to rent it out and utilise section 118-192 to reset the cost base before development.

Serious development is where your property becomes trading stock. The outcome here is clearly defined in section 70-30. You can introduce it to the business at cost but that is only a good outcome if it is now worth less than you paid for it. Instead you trigger CGT event K4 which deems you to have disposed of it at market value and the business to have purchased it at market value so from that point onwards any gain is taxed as normal income but the K4 event will mean that any gain to date is taxed under the CGT provisions whether it be the 50% discount or your main residence exemption. The trap here is you have to pay your CGT in the year you start the development even though you have not sold anything, so it may be difficult to find the cash. Nevertheless, it maybe safer to argue that your development amounts to trading stock and

utilise section 70-30 because your rights are clearly defined in legislation as opposed to relying on Whitfords Beach case which was heard before the changes were made to section 70-30.

Rental Property Record Keeping

How well are you prepared to visit your accountant? Did you resolve that this year you were going to keep better control of your records? To help with tracking rental property expenses we now have a spreadsheet available on our Property Investor and Shopping page that will streamline the process.

The spreadsheet runs on excel, allowing you to enter each item then it totals the information and transfers it into a summary report of all properties for you and another suitable for your accountant.

The spreadsheet only costs \$49.95 and its use is unlimited. It is also available on disk from our offices.

Moss Vale Office

Moss Vale office has close so that staff and resources can be directed to the Kiama office which has moved into a bigger office but in the same building.

Stay tuned for more changes as we prepare for the onslaught of the tax season. We also expect to have a Sydney office up and running before 30th June in Burwood.

Seminars

How To Claim Your Trip Around Australia As A Tax Deduction - 4th July, South East Queensland Presented in association with No Boundaries. Speakers Julia Hartman and Kym Leech. Date claimer at this stage, location will be advised soon. We anticipate starting the presentation around 10am and following with a get together, BBQ lunch, informal discussions, yarns, travel tips etc.

Where is Julia?

Nowra area staying as still as she can stand and getting her own tax returns in order.

Ask BAN TACS

For \$39.95 you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. For your Accountant, we will include ATO references to support our conclusion. Just go to www.bantacs.com.au and look for the Ask Bantacs link under 'Most Popular' on the home page.

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Divorce

Investors

Overseas

Real Estate Agent

Selling a Business

Subcontractors

Wage Earners

Capital Gains Tax

Claiming a Motor Vehicle

Division 35

FBT for PBIs

Miners

Professional Practices

Rental Properties

Small Business

Teachers

Year End Tax Strategies

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.