PERSONAL FINANCIAL
STRATEGIES
YOUR PERSONAL GUIDE TO WEALTH CREATION

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FINANCIAL SERVICES
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Investment property renovations

Many investors purchase properties that require improvement, with the intention of renovating to create equity and generate extra rental income. Investors may be able to maximise their depreciation claims by taking the types of new fittings and fixtures into account before installing them, taking advantage of different depreciation rates.

Maximising depreciation claims

By way of example, a property investor might want to consider which is the most tax-effective new floor covering to install increase their depreciation potential - carpet, or tiles, for instance. The depreciation available on these items differs due to their varying effective lives.

A property investor spending $3000 on floor coverings, for instance, would achieve the following depreciation claims:

- *Carpet $600.00*
- *Tiles $75.00*

Installing assets for their depreciation potential can be beneficial. Investors need to take into account the size of the property and the extent of the renovations. The obtained deductions may improve your cash flow each financial year by thousands of dollars.

In some cases, the cost of renovations can be funded by the offset created from the immediate 'write off' of old items and the depreciation deductions from the new items.

Effective lives – explained

The Australian Taxation Office (ATO) describes an effective life as 'the period of time that a depreciating asset can be used by any entity to produce assessable income:

- assuming it will be subject to wear and tear at a reasonable rate,
- assuming it will be maintained in reasonably good order and condition, and
- having regard to the period within which it is likely to be scrapped, sold for no more than scrap value or abandoned.'

Depreciation on structural renovations

Structural construction work that is completed as part of a renovation can also be depreciated - for example, a new roof, walls or ceiling. Work carried out after 18 July 1985 (residential property) and 20 July 1982 (non-residential property) is eligible to claim the capital works allowance (Division 43) as well as any plant and equipment deductions.

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ATO acts on private loans

The Australian Taxation Office has commenced sending letters to tax agents representing shareholders of private companies.

The letters warn shareholders against breaching rules in relation to taking out personal loans from their businesses, and are part of an ATO early intervention program.

They are intended to warn companies which are not charging commercial interest rates to shareholders and associates. The warning also deals with circumstances where loan repayments are not being made, and with shareholders who are combining both their private and their company expenses.

If the ATO identifies a breach of any of these laws, shareholders could be subject to a penalty tax rate of up to 46.5% on their loans.

The letters, which are currently being sent to businesses with an annual turnover greater than $2 million, are designed to help businesses improve voluntary compliance. They are an attempt to give tax payers a reminder so they can get those matters right before the tax returns are lodged, and are building a growing emphasis on Division 7A over the past few years.

Division 7A of the tax act states that payments to shareholders are automatically classed as "unfranked dividends", unless formal loan agreements are place – with strict interest and capital payments required to meet minimum standards by the end of the financial year.

The ATO's objective is to crackdown on businesses disguising their profits as loans and therefore distributing them tax free to shareholders.

Business owners that face the risk of breaching section 7A, or are uncertain to what extent they may be exposed to this risk, should take steps now to rectify any issues. This may include establishing a loan agreement and implementing a documented repayment pattern before the end of the current financial year.

Losses on shares are not tax-deductible (AAT)

The slump in investment markets has seen super funds post negative returns for a second year. After a period of buoyant investment returns, many SMSF trustees are falling into the trap of incorrectly accounting for their investment losses.

Investment losses by a SMSF are generally considered capital losses.

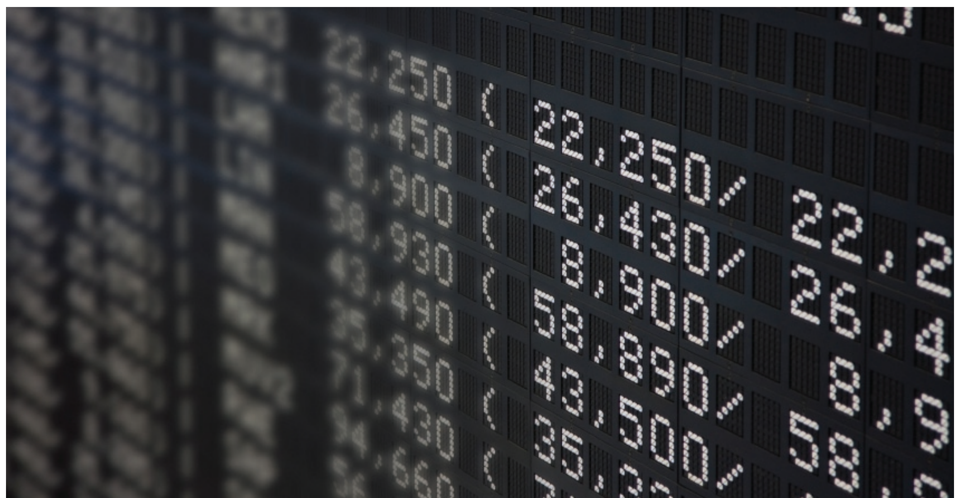
The ATO has shed light on the subject through its recently published Interpretative Decision 2009/92. The statement outlines:

- information for complying super funds (including SMSFs) about the correct tax treatment of investment losses, including losses on the disposal of shares
- why funds are unable to claim a loss on the sale of the shares as a deduction under section 8-1 of the Income Tax Assessment Act 1997 (ITAA 1997).

The Interpretative Decision states that section 295-85 of the ITAA 1997 provides that CGT is the primary reference point for determining the tax treatment of gains or losses a complying SMSF makes when it disposes of an asset (including shares).

SMSF may only offset capital losses against capital gains. A capital loss in an income year may be offset against a capital gain made in the same income year. Losses that cannot be offset in the same year must be carried and offset against capital gains of future years.

The beginning of the new year is an ideal time to conduct an interim review of a SMSF tax position. If you are uncertain to what extent investments have been accounted for incorrectly, please call our office to arrange an interim financial review.



ATO warns about illegal super schemes

The ATO has warned taxpayers to be aware of illegal super schemes that encourage people to take their super out before they retire. Those endorsing these schemes offer to help people access super to pay off debts, buy a house or go on a holiday by setting up a self-managed super fund (SMSF).

Schemes that help set up an SMSF with the sole intent of accessing super savings early are illegal.

Severe penalties apply to taxpayers that illegally access their super early. Participants in such a scheme will have to pay tax on money that is accessed early, and other penalties may apply depending on the level of involvement in the scheme.

In the worst case scenario, taxpayers that knowingly establish a SMSF with the intention of gaining early access to their super savings, may receive fines up to to $220,000 and a jail term of up to five years.

The ATO has indicated that where an individual voluntary discloses their involvement in a scheme, they will take their circumstances into account in determining any penalties.

Individuals who participate in these schemes may also become victims of identity theft. Some promoters of these schemes have used individuals' identities to:

- open false bank accounts
- set up super funds
- steal their super savings.

Through compliance activity, the ATO has identified and frozen $1.7 million from SMSFs to prevent the illegal early release of this money from the super system.

SMSFs risk concessional treatment

The ATO has warned trustees of SMSFs to keep their lodgments up-to-date.

Whilst the ATO have maintained an empathetic approach and encouraged trustees to lodge even if they are having problems fixing breaches or are in financial difficulty, some funds are still failing to comply.

Lodging the annual return is a primary compliance obligation that must be met by trustees. However, some SMSFs continually fail to lodge annual returns, even after numerous reminders.

Not lodging SMSF annual returns may seem minor but it is essential to a fund's compliance and can have a major impact on a fund's tax position..

Non-complying funds lose access to concessional tax treatment. This means that funds are taxed at the highest marginal tax rate, currently set at 45 percent.

In addition, total assets (less any member contributions for which no tax deduction has been claimed) are also taxed at the highest marginal rate.

The ATO will continue to maintain the higher tax rate until a fund's complying status has been reinstated.

SMSF residency rules

The ATO has recently issued a draft ruling to explain their views about enduring powers of attorney for SMSF members. The arrangement intended to provide a way to minimise the risks associated with a SMSF losing its concessional tax status if its members spend time outside Australia for an extended period.

An individual who holds an enduring power of attorney for a SMSF member is required to be appointed as a trustee or a director of the corporate trustee in place of the member. In addition, the member must resign as a trustee or as a director of the corporate trustee.

The status of a SMSF can continue with a new trustee in place.

The enduring power of attorney must be current, and must satisfy the requirements of the relevant state and territory laws relating to enduring powers of attorney.

An individual who holds an enduring power of attorney for a member becomes a legal personal representative. The legal personal representative performs their duties as a trustee of the SMSF, or a director of the corporate trustee of the SMSF. This means that the person holding the power of attorney is required to act according to their appointment to the position rather than as an attorney for the member.

Once appointed as a trustee or a director of a corporate trustee, the legal personal representative assumes the duties, responsibilities and obligations of trustee or director of the corporate trustee. They do not act as an agent for the member.

New crackdown on trusts

The ATO is maintaining their position that unpaid entitlements held in discretionary trusts should be treated as loans and taxed as such.

The crackdown, originally suggested in September, concerns the use of discretionary trusts with corporate beneficiaries. The ATO's view is that when a trust distributes income or capital to a company, that unpaid present entitlement is actually a loan made by the company back to the trust and caught by Division 7A.

If this view held by the ATO is accurate, a trust distribution to a company would be immediately treated as an unfranked dividend paid by the company back to the trust and would be taxable at 46.5%.

A recent audit by the ATO and review activity of high net worth individuals in Australia has highlighted that there are around 200,000 of these trusts in operation with an estimated $1 billion of trust distributions to companies that remain unpaid.

On the surface, it would appear that the ATO's approach of going public on issues of contention may be a means for them to discourage taxpayers from adopting approaches that the ATO may consider as objectionable.

At this point, the ATO have been unable to administer the law as it presently stands without having taken a case to court - given that they have not previously sought to apply the provisions in this way.

In the meantime however, this may be a good opportunity to review trust deeds to ensure that trust distributions have been administered in accordance with the terms of the deeds.

The Bookshelf

The Ascent of Money: A Financial History of the World

Author: Niall Ferguson
Published by The Penguin Press

In 'The Ascent of Money: A Financial History of the World', British historian and financial expert Niall Ferguson makes a compelling case for the development of money and finance as the catalyst for the advancement of civilization. Accompanying a six-part television series, the book provides a valuable insight into the inner workings of the global economy and explores the role of finance as the foundation of human progress.

Ferguson describes the evolution of credit and debt within our civilization, and explores the significance of this financial history within all history. He examines the role of money as the deciding factor in any cultural developments or events – including war, conflict, technological innovation and revolution.

'The Ascent of Money' provides a clear and comprehensible historical account of the world through an understanding of financial events and developments.

Recommended for a great read over the Christmas holidays.

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.

Advance to partnership not a loan

The Administrative Appeals Tribunal (AAT) recently announced its position on advances to a partnership. It confirmed that these are capital contributions and not a loan provided by the taxpayers.

In a recent case, the AAT held that the loan to a partnership was in fact an investment of capital in the partnership and, therefore, deductions claimed for interest and the cost of servicing the loan were not allowable.

According to the AAT, the taxpayers had failed the burden of proving otherwise. The Tribunal concluded that it was not a loan and was invested in the partnership with a view to earning a profit.

In reaching its decision, the Tribunal noted that there was no formal agreement relating to the loan.

A written agreement should be entered into to formalise a loan. In addition, the terms of the loan must be at arm's length.

From a tax point of view, care is essential when advancing funds in this and similar situations. Any advance should be clearly documented and properly described. Features such as interest rates payable, etc should be stated. In addition, any loan in the account should be rewarded as such.

If an advance is genuinely a loan, the related expenses are generally tax deductible, but establishing that it is a loan to the satisfaction of the Tax Office remains important.

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