PERSONAL FINANCIAL STRATEGIES

YOUR PERSONAL GUIDE TO WEALTH CREATION

"Wash sales" warning

Selling an asset for the purposes of offsetting losses in order to minimise capital gains could be a strategy that draws the attention of the ATO.

When a taxpayer makes a capital loss on the sale of an asset, that loss must be offset against capital gains or carried forward to future years, when sufficient capital gains have been realised to offset the loss. Capital gains therefore will be subject to capital gains tax or reduced by offsetting with a current or carried forward capital loss.

Those holding shares that have a value now less than when they were purchased may be tempted to dispose of those shares and realise a loss for the purposes of offsetting that loss against a capital gain, that may have occurred as a result of a property sale, for instance.

A problem occurs where the taxpayer wishes to retain the shares in anticipation of a share price recovery. A "wash sale" occurs when an asset is sold to an associate to realise the loss and the asset is subsequently bought back. The taxpayer effectively ends up in the same position except that they have been able to offset their capital gains (and thereby reduce their tax).

The tax office has released a taxpayer alert (TA 2008/7) explaining its concerns with these arrangements. This includes the possible application of the anti-avoidance provisions of the tax law.

The type of wash sale arrangement that is dealt with in the alert is where a taxpayer disposes of a capital gains tax asset (for example, shares) to generate a capital loss, but where in substance there is no significant change in the taxpayer's economic circumstances in respect of that asset.

The Tax Commissioner has confirmed that the tax office is not concerned with the genuine disposal of an asset at market value. However, in certain circumstances the tax office may determine that wash sale arrangements are schemes simply to reduce income tax.

Investors that wish to adopt this strategy must be prepared to demonstrate that the intention of the sale was for reasons other than to solely obtain a tax benefit. It may be, for instance, that the sale of the asset was a necessary part of a financial restructuring. Regardless, investors would be wise to take a very cautious approach as the ATO position is now much tougher.

HELPING YOU MANAGE YOUR FINANCIAL FUTURE

We can help you keep your personal finances and wealth creation strategies on track.
Call us now and we'll arrange a meeting to discuss:

- Tax effective saving strategies
- Planning for retirement
- Minimising capital gains tax
- Property ownership
- Asset protection
- Selling your business

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ISSUE NUMBER 4

Rental property claims: avoiding common mistakes

The ATO has recently provided a summary that outlines some common mistakes made in claiming rental property borrowing expenses. Ensuring that these mistakes are avoided when claiming deductions is important because it could also help to reduce the chances of being selected for an audit or review.

What are borrowing expenses?

Borrowing expenses are incurred when a loan is taken out. These expenses include:

- stamp duty charged on the mortgage
- loan establishment fees
- title search fees charged by the lender
- costs of preparing and filing mortgage documents
- mortgage broker fees
- fees for a valuation required for loan approval, and
- lenders mortgage insurance (taken out by the lender and billed to the borrower).

Common borrowing expense mistakes

There are several common mistakes made when claiming borrowing expenses:

Claiming a deduction for stamp duty on property title transfer. Stamp duty on the transfer of the title of the property is not a borrowing expense. It may however, be included in determining the cost base of the for capital gains tax (CGT) purposes.

Borrowing expenses claimed in full in the year incurred. Borrowing expenses that exceed $100 need to be spread over five years or the term of the loan, whichever is less. If the total deductible borrowing expenses are $100 or less, they may be fully deductible in the income year they are incurred.

Claiming a deduction for borrowing expenses in full where a loan used to purchase a rental property is also partly used for private purposes. Some taxpayers have taken out a loan to purchase a rental property and have used part of the proceeds for a private purpose, such as purchasing a vehicle. In these circumstances, borrowing expenses can only be claimed against the part of the loan that relates to the rental property, and not the portion used for other private purposes. Some taxpayers have dangerously formed the view that holding property is one of that last ways that the ATO allows individuals to enjoy some tax "perks". This is simply untrue and to adopt such a view places taxpayers in a precarious position. If you are uncertain about some of the deductions that have been claimed in the past or which you plan to claim this year, please call our office for a review.

Other Property Claim Errors

The ATO has maintained an active review programme focusing on taxpayers who derive income from rental properties. A number of mistakes are routinely made by property owners that need to be prevented to avoid being made the subject of closer scrutiny. These mistakes include:

- overstating interest on loans taken out to purchase or renovate investment properties where part of the loan has been used for private purposes.
- claiming the cost of improvements as a repair instead a as claim for capital works.
- claiming full year deductions for a property that has been used for free by family or friends for part of the year.
- claiming full cost of inspection when that visit is combined with a holiday.
- redrawing on an existing loan created for income producing purposes and using all or part of the proceeds for private purposes, claiming the interest deduction for the full amount.
- claiming deductions for properties that are not used for income producing purposes, such as a holiday house.

MONEY TALK

Reportable Fringe Benefits

When a employee receives fringe benefits exceeding $1000 a year, employers are required to record the grossed up taxable value of those benefits on the employees payment summary. Reportable fringe benefits do not form part of assessable income.

Taxpayers should be aware that the amount of reportable fringe benefits are used to calculate eligibility to claim superannuation rebates and deductions; liability for the superannuation surcharge, Medicare levy surcharge and entitlements to some means tested government benefits.

Implications for altering a trust

A trust can be described as an obligation of trust imposed on a person to hold property or income for specific purposes or for the benefit of other individuals or classes of individuals.

Although the trustee holds legal title to the property, they are obliged to deal with the property in accordance with the trust deed. Changes to a trust which can occur by way of amendment to the trust deed could cause one trust deed to come to an end and replaced by another for income tax purposes.

What is resettlement?

Resettlement occurs, for income tax purposes, when it is deemed that one trust is ended and another has replaced it. It is typically used to describe an alteration to a trust as a result of changes to the classes of beneficiaries or the nature of beneficial entitlements. Currently, there are few definitive rulings, which means there is very little guiding information as to when this occurs.

Implications for resettlement

A resettlement may have significant income tax and capital gains tax implications. These include:

1. Loss of any carried forward tax benefits will be lost.

2. Tax implications for the trust property with respect to inventory, depreciation and capital gains. This is a result of the deemed transfer of assets into the new trust.

3. The beneficiaries regarded as disposing of their asset and acquiring an interest in a new trust may face consequent capital gains tax implications.

4. Changes may lead to the creation of one or more separate trust estates for tax purposes.

The ATO view in relation to whether a new trust is created depends, among other things, upon the terms of the original trust and on the powers of the trustee. The original intentions of the settler must be considered in determining whether a new trust has been created.

Changes to class of beneficiaries. If the original deed intended a widening of the class of beneficiaries, a change is most likely to be acceptable where the class does not exceed the scope authorised by the original deed.

However, any major changes to the beneficiaries or re-definition of beneficiary class, or new class of beneficial interests of a trust may still be viewed as a resettlement for the purposes of the ATO.

Changes to the property held by the trust. Most trust deeds provide for changes and additions the trust property from time to time by way of changing investments. Generally in these cases there will be no issue of resettlement if the trust property is altered.

However, there are particular circumstances where the trust property is an integral part of the nature of the trust. The trust may have been specifically for the original trust property. In this instance the ATO may view a replacement of this or the addition of new and different property as the creation of a new trust. Changes to the features of a trust property, depletion of trust property and alterations of properties which may constitute a separate settlement.

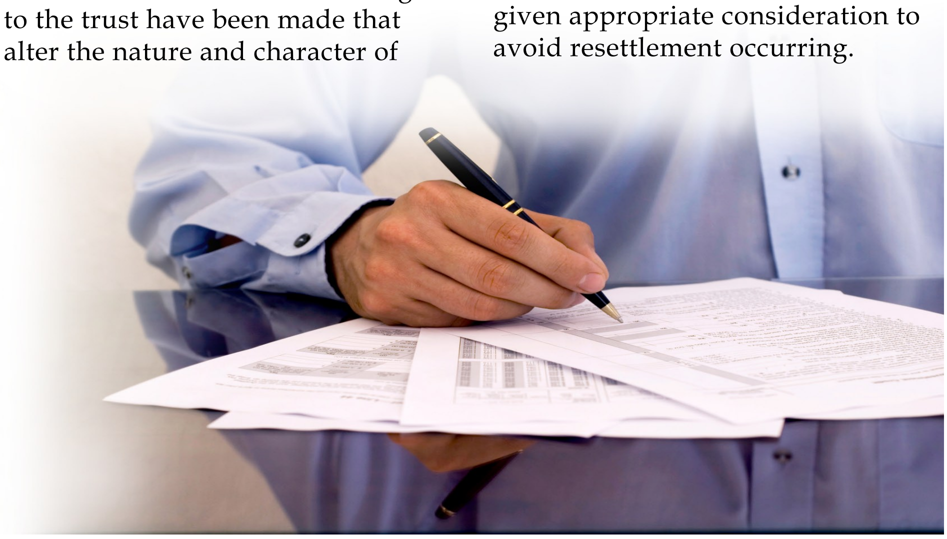
Changes to the trustee. Changes made to the trustee do not generally result in the ATO deeming a new trust has been created. However, if in addition to a change in the trustee, other fundamental changes to the trust have been made that alter the nature and character of the trust relationship between the trustee and the beneficiaries then the ATO may deem that a new trust has been created.

Changes to the terms the trust. Only alterations that result in changes to the relationship between the trustee and the beneficiaries in respect of entitlements from trust property will amount to the deeming of a new trust.

Changes to the trust deed which are merely procedural are unlikely to affect this relationship and so it follows that they are unlikely to have the effect of creating a new trust. However, it is sometimes very difficult to determine whether a change is merely procedural or whether it is one which is fundamental enough to affect the trust relationship.

Changes to definition of trust income. This type of change has the potential to alter the substantive rights of the beneficiaries. However the ATO has adopted the view that in the absence of other factors this will not in itself trigger the establishment of a new trust provided that: the intention of the redefinition is to clarify rather than redefine entitlements; or the redefinition of entitlements is one that changes the respective entitlements between a single beneficiary or class of beneficiaries not between beneficiaries or classes of beneficiaries.

Any plan to make changes or amendments to a trust deed, class of beneficiary or trust assets need to be given appropriate consideration to avoid resettlement occurring.



Not so simple super

Despite simplified superannuation reforms commencing over a year ago, there is still confusion about the new terms and how individuals can take advantage of the changes.

Non-concessional contributions

As part of last year's superannuation changes the term non-concessional contributions replaced the term undeducted contributions. These contributions refer to voluntary contributions for which a tax deduction is not claimed. From 1 July 2007, non-concessional contributions have a limit of $150,000 each financial year.

Individuals under 65 are able to bring forward non-concessional contributions, subject to limits of $450,000 over a three year period. This strategy is useful where individual has surplus cash as the funds can be invested in a tax effective manner by the super fund.

Non-concessional contributions include contributions made by a spouse and contributions made to receive the government's co-contribution.

Concessional contributions

A superannuation contribution for which a tax deduction is claimed is referred to as a concessional contribution, as they are concessionally taxed. Contributions may be claimed by an individual or employer (including super payments made under a salary sacrifice arrangement). One point to keep in mind is that individual contributions cannot add to create a taxable loss.

There are also some limits. Individuals under the age of 50 are entitled to claim contributions to a limit of up to $50,000 in any financial year. There is a transitional rule which limits contributions to $100,000 for individuals who turn age 50 or above between 1 July, 2007 and 30 June, 2012. This is subject to meeting the work-test of 40 hours in 30 consecutive days where they are age 65 or over but under age 75.

The upside is that individuals can make both concessional and non-concessional contributions, but simply need to assess strategically the best options to choose.

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.

Bank Bills v Term Deposits

Bank bills and term deposits are both forms of interest earning investments.

A bank bill is a short term investment with terms that range from 30 to 180 days. They have a face value of $100,000 and they are brought at a discount to the face value. This discount is determined by the prevailing interest rate. The amount of discount (the difference between face value and purchase price) represents the return to be earned by holding the bank bill to maturity. Cash management trusts are active buyers of bank bills.

Advantages: secure, easily sold at any time.
Disadvantage: pricing

Term deposits on the other hand have a term from several months to several years. Money is deposited and interest is received at rates specified by the borrowing institution.

Advantages: easily accessible, secure
Disadvantage: fund locked up until term.

The Bookshelf

The Warren Buffet Way

Author: Robert G. Hagstrom, Wiley

"The Warren Buffet Way" is mandatory reading for all investors as well as all individuals who are keen on learning about value investing. This book is the culmination of 20 years spent in search of a deeper understanding of the insight that Warren Buffet possesses.

Every theory he espouses is immediately followed by a series of case studies spanning Larson-Juhl, Geico, The Washington Post Company, General Foods, Fruit of the Loom and many more. These concrete examples serve to illustrate and emphasise the pragmatism of Warren Buffet's way.

The path is simple. It involves two major activities: firstly, it is an absolute necessity that one constantly reads everything about business, investment, the businesses in which you wish to invest and their respective industries. In his book, Hagstrom insists that research is king and reading is even more important than inhaling.

Secondly, one must have keen control of their minds and emotions. In order to avoid the trap of speculative investment, one must be willing to become an iconoclast and not be swayed by prevailing market conditions no matter how extreme.

This book represents a sharp departure from the current self help craze. It offers a realistic and well researched presentation of a solid investment philosophy. "The Warren Buffet Way" is a description of how investment works.

This book is ideal for the green investment novice as well as the weathered stock market veteran. It serves as the perfect introduction to a world fraught with confusion and littered with untruths. For the jaded veteran it provides a sharp reminder that investment is not a complex activity.