PERSONAL FINANCIAL
STRATEGIES
YOUR PERSONAL GUIDE TO WEALTH CREATION

Taxpayer confusion over losses

The global economic downturn has reduced the value of investments for many taxpayers. As a result, some taxpayers will be claiming losses from the disposal of investments (for example, selling shares) for the 2008–09 year.

The Australian Taxation Office (ATO) has recently indicated concern over taxpayer confusion in relation to the difference between losses on their revenue account (from carrying on a business, such as share trading) and capital losses (losses incurred from the disposal of an investment). It warns there are criteria that need to be satisfied for a taxpayer to be classed as a share trader following confusion amongst investors who have incurred losses and then tried to offset these against their other income.

Revenue loss

In order to claim losses against revenue, a taxpayer must be in the business of investing. That means there is a business activity, such as trading in shares or other instruments, with the view to make a profit. The intention itself to make a profit is not sufficient evidence that the taxpayer is in the business of investing. The volume and frequency of taxpayer transactions are important determining factors, not necessarily the amount of capital invested.

Taxpayers carrying on a business can claim receipts from share sales as income, declare purchased shares as trading stock, have allowable deductions for costs incurred in buying and selling and can include dividends in their assessable income.

Capital losses

For ordinary investors, the cost of acquiring shares is not an allowable deduction. Receipts from sales are not treated as assessable income, but rather the net gain is a capital gain. Losses from share sales cannot be offset against income but against future capital gains from the sale of the shares.

For the ordinary shareholder, the cost of purchasing shares is not an allowable deduction, receipts from sales are not assessable income and losses from share sales can not be offset against income but against future capital gains from the sale of the shares.

The ATO will be reviewing claims for losses and intends to check whether taxpayers have properly claimed a revenue loss. In particular, they will focus on claims for revenue losses where the taxpayer has claimed gains on a capital account (for example, claimed a 50% CGT discount) in earlier years. If losses have been claimed incorrectly, taxpayers may face penalties.

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ATO warns investors over 'wash sales'

Despite recent signs of improvement in the global economy, investors may be left holding unrealised capital losses. That is, investments or shares that are trading at a lower price than when they were purchased.

Some may have sold investments to crystallise or realise any loss before June 30, to offset capital gains from other investments. Whilst this is a legitimate strategy to reduce capital gains tax, the ATO will be closely watching how investments are disposed of, who they were sold to, and whether they are repurchased shortly after June 30.

The process of selling shares, to a related entity or even back into the stock market and buying them back a short time later, is referred to as a 'wash sale'. Wash sales are against ATO rules because there is no commercial benefit to the transaction other than to derive the tax benefit from it.

General anti-avoidance provisions allow the commissioner to reverse the effect of the tax benefit when a transaction has been undertaken solely to derive a tax benefit.

Disputes reduced with binding nominations

Many individuals who advise their superannuation funds to whom should receive their death benefit, are of the belief that their wishes are binding on the trustees of the fund or that benefits will be paid according to their will.

However, superannuation is not part of an individual's estate and most nominations lodged with funds are 'preferred' nominations and not binding ones. In the absence of a nomination, a trustee has the discretion to determine how the benefits should be distributed.

A death binding nomination, however, 'binds' a trustee of a superannuation fund to distribute the superannuation benefits of a deceased member to the recipient specified in the nomination.

In the absence of a valid binding nomination, trustees will normally pay the death benefit to the partner of the deceased member. It is often the view of trustees that superannuation provides income in retirement to those who would have benefited from the distribution had the person not died. That will normally be the surviving partner of the deceased person at the time of death.

The Superannuation Complaints Tribunal reports an increasing number of complaints from individuals who believe the fund trustees have given the proceeds of a death benefit to the wrong person. This is largely due to the increase in the number of blended families. In many cases, this involves the adult offspring from a first marriage who believe the death benefit should not be shared with a subsequent partner of one of their parents.

For individuals planning to make a gift of their death benefit to their adult children, the safest way is to make a binding nomination. The nomination must be signed and dated by the member in the presence of two witnesses, each of whom must be 18 years or older and neither of whom is mentioned as a beneficiary. Binding nominations are only valid for three years and then must be renewed.

The beneficiary of a binding nomination must be someone who is a dependent of the member, under their fund's rules or the executor of the member's estate.

A member that intends to give their death benefit to a charity, friend or to their grandchildren, would have to make a binding nomination in favour of the estate. In this case, their will would direct the death benefit to be paid to the charity, friend or grandchildren.

While a death binding nomination may ensure that the superannuation benefits of a member are paid according to the member's directions upon their death, a strategic approach is required when drafting the nomination. This approach requires reviewing the fund's deed, the operation of the superannuation legislation and any relevant taxation provisions. Failure to do so may result in the trustee not being bound by the nomination in recipients being subject to adverse tax consequences.

Equal treatment of same sex couples

The Government has passed wide-ranging reforms recognising all couples, regardless of sexual orientation or gender. The changes ensure that same-sex couples and their families receive the same entitlements and are subject to the same obligations as opposite-sex couples.

From 1 July 2009, the changes to definitions of 'spouse', 'de facto relationship', 'relationship' and 'child' will see all couples and families treated the same way for tax purposes, regardless of gender; changes which include having the same access to tax concessions.

Children from same-sex relationships will be recognised by law. The changes extend to children born following an artificial conception procedure or children born under a surrogacy arrangement where parentage has been transferred by court order.

There are a number of Government programs that will be affected by the changes including:

- dependant tax offset
- invalid relative tax offsets
- senior Australians tax offset
- pensioner tax offset
- Medicare levy surcharge
- fringe benefit tax
- education tax refund
- spouse super contributions tax offset
- main residence exemption in Capital Gains Tax.

All individuals will be considered to be partners for Centrelink and Family Assistance Office (FAO) purposes if they are living together, or usually live together, and any of the following apply:

- they are married
- they are in a relationship registered under certain prescribed state or territory laws whether they are the opposite or the same-sex
- they are in a de facto relationship (opposite or same-sex)

Same-sex couples receiving payments were given three months from April 1 to register their relationships voluntarily with Centrelink. From 1 July, individuals living in a same-sex de facto or registered relationship will be recognised as being partners for Centrelink and FAO purposes. Entitlements and payment rates will be determined in the same way as all couples. This may have an impact on people who receive social security and family assistance payments and services.

From July 1, same-sex couples who do not declare their relationship but are believed to be living together may be investigated as heterosexual couples are. This is because welfare payments, such as the aged pension, give couples a lower combined rate than separate payments to singles.

ATO monitors in-house assets

The Australian Taxation Office has indicated that it intends to closely monitor self managed superannuation funds. It has issued a warning to trustees of SMSF against intentionally trying to beat the in-house assets rule.

The warning comes after issuing a taxpayer alert regarding joint venture property development schemes designed to defeat the in-house assets legislation.

Under the Superannuation Industry Supervision Act, the market value of in-house assets held in an SMSF is not permitted to be more than 5 per cent of the total market value of the fund's assets.

An in-house asset of a super fund is an asset that is:

- a loan to, or an investment in, a related party of the fund
- an investment in a related trust of the fund
- an asset of the fund that is subject to a lease or lease arrangement between the trustee of the fund, and a related party of the fund

The arrangements that the ATO is concerned about, involve a third party establishing a joint venture between an SMSF and a related trust. The SMSF advances money in the form of a loan to the trust, which in turn acquires an asset which is normally real estate.

The asset is acquired in the trust's name and the SMSF only receives distributions arising from the investment.

The ATO views this tactic as an exercise to circumvent the in-house asset rules because the transaction is effectively an investment by the SMSF in the related trust.

The ATO is specifically concerned that investment constitutes an in-house asset that exceeds the 5 per cent limit. The joint venture is viewed as having been established solely to avoid the application of the in-house assets rule. The restriction to intentionally acquire assets from a related party may have also been breached.

In addition, the ATO suspects these schemes may breach the sole purpose test if they have been established to avoid the in-house asset rule and not to provide retirement savings for the SMSF's members.

If found to be in breach of the in-house assets rule, the SMSF may be considered a non-complying fund and as such may be subject to a tax rate of 45 per cent on its income.

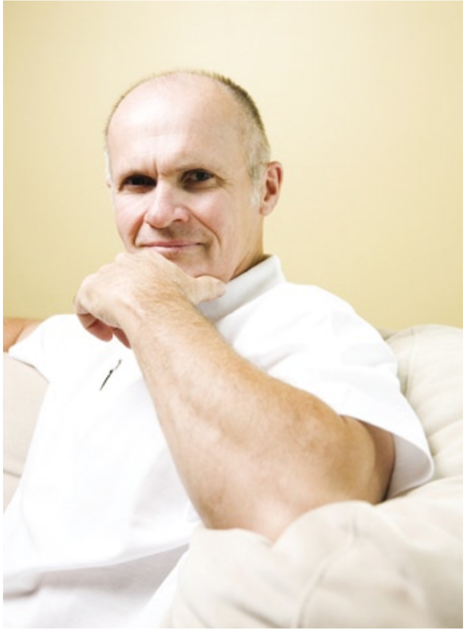
Family trust election

The family trust election rules were introduced to prevent the transferring of trust losses.

In 1997 however, important concession to these general rules were introduced to allow certain losses to be recouped where a family trust election is made. Once a trust has elected to be a family trust, distributions are restricted to those entities and individuals that form part of the family group relevant to the 'specified individual'.

Recent amendments have the effect of providing greater flexibility for family trusts and interposed entities by allowing taxpayers to:

- revoke family trust and interposed entity elections to be revoked in certain circumstances
- vary the 'specified' individual under an election to be changed in certain circumstances



Revocations must be made in the taxpayer's tax return for the income year from which it will be effective.

Concessional contribution changes

Concessional contributions are those made to a superannuation fund where a tax deduction is claimed and are taxed at 15% at the time of contribution. In addition, contributions are subject to a limit. This was previously $50,000 for individuals under age 50, and $100,000 for taxpayers over age 50 until 30 June 2012.

The Budget announced that from 1 July 2009 the **concessional contributions** cap will be reduced by 50%, which results in caps of $25,000 and $50,000 for those under and over age 50 respectively. If a member exceeds their contribution cap, the excess amount is subject to total tax of 46.5%.

The **non-concessional contributions** are those made from after-tax income and no deduction is claimed. The limit on non-concessional contributions remains at $150,000 per year. The ability for individuals under 65 to 'bring forward' two futures years of contributions and make a one-off contribution of up to $450,000 also remains unchanged.

Individuals who may have made superannuation contributions up to the previous limits review their position from 1 July 2009.

If an individual anticipates receiving a bonus which is paid in the form of a superannuation contribution, and it is paid after 30 June 2009, will find that the contribution will be included in the 2009/2010 contribution cap.

From 1 July 2009 it is important that salary sacrifice arrangements are reviewed to ensure that the total contributions for the year do not breach the new limit. Employer contributions (super guarantee and insurance premium amounts) must also be taken into account as these amounts count towards the cap.

The penalty for excess contributions is severe and the Australian Tax Office has already indicated that it has plans to closely monitor contributions.

The Bookshelf

Secrets of Economic Indicators: Hidden Clues to Future Economic Trends and Investment Opportunities

Author: Bernard Baumohl
Published by Wharton School

Each day, shares, bonds and currencies move around wildly in response to a range of economic indicators like these. These indicators are monitored obsessively by the world's leading money managers. Why? Because they provide crucial, subtle clues about the future of the market - and of individual investments.

Renowned economic journalist, Bernard Baumohl, helps readers find the numbers, understand their deepest meanings and use their knowledge to make immediate and informed investment decisions. For each key indicator, Baumohl presents a sample release, insider's information on the indicator's track record and step-by-step instructions for decoding it. Baumohl covers both local and foreign indicators that are becoming increasingly important to investors.

He answers key questions like: Which indicators are most likely to affect my personal investments or business? How does each indicator affect interest rates and bond prices? Stock prices? The value of the dollar? And what can these reports tell me where the economy's really heading?

This book is a plain English summary helping investors understand objective measures to formulate their individual investment strategies.

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