real estate tax answers

Real Estate Tax Answers

(Kindly produced in conjunction with BANTACS Julia Hartman B.Bus CPA)

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CGT: Principal place of residence CGT exemption

Basically if you make a capital gain when selling your home it is exempt from capital gains tax but there are some catches and extra benefits. Ensuring that you qualify for the exemption is now more important than ever because indexing for inflation no longer applies. If you hold the property for 20 years it would not be unreasonable to expect it to double in value but with no exemption you could lose 25% of that increase in value in tax. This would mean you would not have the money to buy a similar house elsewhere or possibly not be able to afford to move. The following is a summary of some important points to the exemption. PPR stands for principal place of residence.

1) CGT does not apply to your home if it was purchased before 20 September, 1985.

2) The PPR exemption can apply to a forfeited deposit or damages received from a defaulting purchaser providing the house is put back on the market and eventually sold.

3) A "Spec" builder who lives in the "spec" home technically qualifies for the PPR exemption but is taxable on the profit as normal business income anyway and this overrides the CGT exemption.

4) If the home is owned by a trust or company the PPR exemption cannot apply.

5) If you move into a house as soon as practical after you purchase it the house is deemed to be your PPR from the time you purchased it. Further, if at the time of purchasing your new house you have not yet sold your old house they can both be your PPR for up to 6 months. Providing during the last 12 months you have lived in your old residence for at least 3 continuous months and it was not used to produce income during the period in that 12 months that it was not your PPR.

6) If you sub divide the land your home is on and sell the new block separately from your home the PPR exemption does not apply. If you build another house on the block the PPR exemption can apply for up to 6 months if you sell off the old home in that time. Refer point 5 above and TD2000/13 & TD2000/14.

7) Other than the circumstances in point 5 above you can only have one PPR at a time. Providing you have at some time lived in the place (refer point 9 for qualifications) you can choose which house you want to be considered your PPR but only from the time you first lived there (except re point 10) and only up to six years after you move out if it becomes income producing during your absence. The time frame is unlimited if it is not income producing while you are not living there. Note if you move back in and then out again (refer point 9 for qualifications) you are entitled to another 6 years PPR exemption even if it is income producing.

8) If you earn income from your PPR while you are living there than your PPR exemption only applies to the percentage of the Capital Gain that represents the percentage of the house used for private use. Note in Walters case a person renting out rooms in the home unit she lived in was only allowed a PPR exemption for the portion of the unit not rented out, even though the rent was half of the market value. If you are going to take advantage of the circumstances outlined in point 6 but the home was partly used to produce income while you were living in it then you can only get the same percentage PPR exemption during the 6 year period as the percentage the house was used for private while your were living there.

CGT: Principal place of residence CGT exemption

9) When considering whether your house is your PPR the ATO considers the following factors (refer TD51), note not all have to be satisfied:

(a) Electricity and phone connected in your name.
(b) Registered on the electoral role to that address.
(c) The presence of personal effects in the house.
(d) The address given for mail deliveries.
(e) Where your family lives.
(f) The length of time you have lived there.
(g) Your reasons for occupying the dwelling.

10) You can elect to have vacant land or a property you are renovating classed as your PPR for a period of up to 4 years before you move into it providing you do not have another PPR (other than for the 6 months in point 5). But you must move in as soon as practical after the building is finished and live there for at least 3 months before selling or have died.

11) If your house is accidentally destroyed and you sell the land rather than rebuild, your PPR exemption can continue to apply to the land until sold providing you do not claim any other place as your PPR.

12) Families are discriminated against in that spouses and their children under 18 can only have one PPR between them no matter where they live. Spouses can elect to claim their spouse's PPR as theirs even if they never lived there and even if their name is not on the deed. If both spouses want their separate homes to be their PPR they only get half the exemption on each place.

13) If you acquired your PPR after 20th September, 1985 and used it as your PPR until some time after 20th August, 1996, when it became income producing you must use the market value of the property at the time it becomes income producing, as your cost base. Therefore any assessable capital gain will only arise on an increase in the value of the property after it ceased to be your PPR. Though considering the drop in some house prices in 1996 this may work against you. It is not optional.

14) Some thought should be put into whose name goes on the deed because they will all need to class the house as their main residence for it to be totally exempt from CGT. A classic example is a mother putting her daughter on the deed so she will automatically have a home when her mother dies. If the daughter decides to buy her own home then her mother will have to pay the stamp duty to change the deed or lose the exemption on half the property.

secret plans and clever trick CGT & non capital costs

There have been warnings of various ways you could lose your Main Residence Exemption for CGT purposes. If this has already happened to you don't despair just start collecting records including digging up old bank statements on the loan, asking Council and your insurance company for copies of all that you have paid them since you purchased the house. Section 110-25 subsections (2) to (6) cover all the relevant costs that can be used to reduce your capital gain. Subsection (4) allows owners of homes purchased after 20 August 1991 to claim as a deduction for CGT purposes non capital costs of holding the home if they have not already been claimed as a tax deduction against rent or other income earned from the house. Holding costs are rates, land tax, interest expenses, building insurance, repairs and maintenance. If you have lost the main residence exemption for only part of the period of ownership the holding costs for the whole period of ownership are first taken into account to calculate the whole capital gain and then apportion the percentage subject to CGT.

You should also do this if part of the house has been used for income producing purposes and that part is not considered a separate asset. The portion of the holding costs that have been claimed as a tax deduction cannot be included in the cost base but the private portion that was not claimed can be included in the whole cost base before apportioning the capital gain. Note holding costs cannot be used to increase the capital loss on an asset nor can they be used if the asset is a personal use asset (houses are excluded here) or a collectable. If in doubt throw it all in a big box. The biggest tax minimisation scheme is just plan keeping records.

the 50% CGT Discount

As you are probably aware you need to hold onto a property for over 12 months from the date of signing the agreement to purchase to the date of signing the agreement to sell in order to qualify for the 50% CGT discount. Some clients have been making a very quick gain on properties and are impatient to sell in case prices fall. The choice is sell now and lose a lot of the profit in tax or hold on and take a risk on future prices. From the buyers point of view they are probably more concerned that prices will continue to escalate but are not in a rush to start paying interest on the loan. In fact the chance to fix a contract at today's prices but not have to pay anything for several months could be very attractive to some buyers.

ATO ruling TD 16 states - if an option is granted the date of the acquisition for the buyer and the selling date for the vendor, is the date of the exercise of the option.

Of course an option gives a purchaser the chance of avoiding entering into the contract to buy the property so you must charge a large enough amount for the option to ensure that the purchaser will exercise it after the date you specify.

Note at an ATO Tax Liaison Meeting the ATO announced that it was reconsidering its position on TD 16 so professional advice should he sought at the time.

CGT 50% Discount — Timing

In order to qualify for the 50% CGT discount you must hold an asset for more than 12 months. That is 12 months and at least one day from the date of the agreement to buy to the date of the agreement to sell. TD 94/D92 and Case 9451 (1194) 28 ATR state that a simple condition in the contract such as subject to finance will not delay the date of the contract. Only a condition precedent to the formation of the contract delays the date that the contract is deemed to be entered into. Most conditions on contracts are conditions subsequent so will not delay the contract date. To be a condition precedent it really has to be a condition that must happen before the contract comes into being. Accordingly, it would be difficult to use a condition precedent to delay a contract yet have a binding sale.

house swapping

If considering swapping houses to claim rental deductions as discussed in Noel Whittaker's 19-10-03 column make sure you live in the home you purchase before swapping. This will allow you to exempt the home from capital gains tax for up to 6 years. Section 118-145 allows you to move out of your main residence and continue to give it your exemption for capital gains tax purposes. Further at the end of the 6 years you can move back in, then move back out and the 6 years clock starts all over again. TD 51 (www.ato.gov.au) lists the factors that the ATO takes into account when considering whether the house was your main residence during the time you are actually living there. These include where your personal effects are stored, the connection of utilities in your name, changing your address on the electoral roll etc. Neither the legislation nor the ruling specifies a time period that you are required to live there.

demolishing a rental property

The owner of a rental property wishes to demolish it and build a home she can live in on the site. She asks what valuations etc will he required to keep property records of the cost base for CGT purposes.

Answer: No need to get valuation. Both the original cost of the property, the demolition costs and construction costs of the new house will be included in the cost base for CGT purposes. This property will always be subject to CGT even though the portion will decrease over the time it is used as a main residence. Accordingly you need to keep very good records of all expenditure including rates, interest, R&M and insurance while it was your main residence.

References:
ID 2002/5 14 if the demolition expenses were incurred to enhance the value of the land, and are reflected in the state of the land when it is sold, they are included in the cost base, even when incurred to facilitate the construction of another dwelling. TD 1999/79 the demolition of the house is a CGT event. But it does not create a capital loss unless money is received for it (ie insurance). ID 2002/633 says that this is because the building has a zero cost base. Subsection 112-30(5) the original cost base is attributed to the remaining part (ie the land).

rental properties: switching property deductions as it suits

The age old question of property investors has been whose name should I buy the property in?

It's great to have it in the high income earner's name when it is negatively geared but bad when it becomes positively geared. When you make a high capital gain you wish you had more owners to spread the gain over. Just when you think you have made the right choice your circumstances change.

There is a legitimate way you can have the best of both worlds. This method allows you to share the capital gains between spouses, split the rent and depreciation but allows the highest income earner to effectively claim all of the cash flow expenses as a tax deduction. The arrangement is so flexible it can be adapted if the spouse who is the highest income earner changes.

This is very simply achieved by buying the property in joint names but the highest income earner salary sacrifices the cash flow expenses. There is a legal fiction in the FBT legislation that deems any benefit received by an associate (i.e. spouse) of an employee to be received by the employee. This extends to the otherwise deductible rule (FBTAA section 24). Accordingly, 100% of the expenses are considered otherwise deductible to the employee so the employer is not liable for FBT. Otherwise deductible expenses are exempt fringe benefits.

Sounds too good to be true doesn't it? Well the case it is based on is over 10 years old (NAB v FCT 1993). Unfortunately not many people are doing it because their employers baulk at the idea. You can't blame them since it is the employer who will have to pay the extra tax if the ATO disallow the arrangement yet it is only the employee who benefits. What the employer needs to do is get their own private binding ruling from the ATO so they can be confident of the arrangement. We already have a ruling so referring to our private ruling should make the process easier. Full details of this are available on our web site www.bantacs.com.au, click the Rental FBT button. There is also a calculator on the web site that will help you work out how much tax you will save every year by this arrangement. For example, assume the low income earner is in the 31.5% bracket, the high income earner is in the 48.5% bracket. The cash flow expenses such as interest are $20,000 and the arrangement does not change their relative tax brackets just their amount of taxable income. The tax saving will be $1,700 per year.

example of deductible expenses

Building depreciation for properties built after 17 July, 1985, more details on this in other articles.

- Motor Vehicle Expenses in relation to collecting rent, organising repairs, paying expenses, etc. There are various methods and requirements to calculate this claim, all of which I cannot list here. The most popular method is to claim a rate set each year by the tax office of approximately 60 cents per kilometre based on a "detailed and reasonable estimate" of kilometres travelled. In order to use this method you must not claim more than 5,000 kilometres in the year for all claimable purposes, note if the vehicle is owned by two people they get 5,000 kilometres each. You must own the vehicle, make the appropriate election and personally incur the costs associated with the vehicle. Note if you do more than 5,000 kilometres you can reduce your kilometres to 5,000 in order to use this method or use another method.
- Travel Expenses as above i.e. airfares and accommodation if the property is in another state. A travel diary and receipts meeting the substantiation requirements would be required if away for more than 5 nights.
- Agent's Commission to manage property.
- Telephone, Stamps, Stationery, Insurance, Advertising, Land Tax Secretarial, Bookkeeping, Tax Agent and Legal Fees regarding lease or rent recovery, not buying and selling.
- Borrowing Expenses. If more than $100 can be claimed over 5 years or term of loan whichever is the shorter period. If less than $100 can claim immediately.
- Depreciation on Curtains over 6 2/3 years, Blinds & Venetians over 20 years, Carpets and Vinyl over 10 years, Lawn Mowers, Furniture over 13 1/3 years. Hot Water Systems over 20 years, Air Conditioners room units over 10 years central over 13 1/3 years, Security over 20 years or Fire Systems but not doors, The Motor on Steel Roller Shutter Doors, Prefabricated Built-in Robes and Cupboards but not kitchen Cupboards; Ceiling Fans, Dishwasher, Electrical Meters & Switchboards, Insinkerators, Intercoms. Freestanding Electrical Appliances such as Fridges over 13 1/3 years, Microwaves over 6 2/3 years, Vacuum cleaners over 10 years, Washing Machines over 6 2/3 years TVs, etc, Satellite Dish, Sprinklers, Lifts, Lights and Free Standing Stoves over 20 years. Swimming Pools cannot be depreciated as plant in Australia Case 1102 1986.

repairs or improvements?

Repairs and Maintenance, not improvements are deductible. For example if the house needed painting when you bought it then painting it would be an improvement or if the house did not have a garden hose then purchasing one would be an improvement, therefore not deductible. On the other hand if during the time of your ownership the hose wears out and you replace it or the paint starts to peel and you repaint, these expenses would be a deduction. No deduction is available for your own labour.

Take care to perform repairs only when the premises are tenanted or in a period where the property will be tenanted before and after with no private use in the middle (IT18O). Do not make repairs in a financial year during which you may not receive any rental income (IT180). If a property is used only as a rental property during the whole year then a repair would be fully deductible even though some of the damage may have been done in previous years when the property was used for private purposes (IT2587). Note this does not apply if the damage was done in a period you did not own the property. If the state of disrepair the property was in at the time you purchased it is directly responsible for further damage when you own it, all the repairs relating to that damage are considered improvements (Law Shipping Co. UK). A repair can become an improvement if it does not restore things to their original state (case M60) i.e. replacing a metal roof with tiles. The whole cost of the tiled roof would be an improvement and no deduction would be available for what it would have cost you to put up another metal roof. But a change is not always an improvement. In ID 2002/330 the ATO states that the cost of removing carpets and polishing the existing floorboards is deductible. Yet in ID 2001/30 underpinning due to subsidence was considered by the ATO to be an improvement not a repair. It is not necessary to use the original materials to restore the thing or structure to its original state. Modern materials can he used even when these might be a slight improvement because they are more efficient. As long as the benefit is only minor or incidental it can still be considered a repair.

Work that replaces the whole thing or structure is an improvement not a repair. So don't pull down all of the old fence and replace it just replace the damaged area. TR 97/23 recognises that eventually the whole thing or structure may he replaced in a progression of repairs. These repairs are still deductible providing each repair is on a small scale, the progression is over a long period of time and that it is not just in reality a replacement done over time but individual repairs.

Tree removal is claimable if the trees have become diseased or infested during the time of ownership. Removal is also claimable if the tree is causing damage such as roots interfering with pipes and the damage was not present when you purchased the property. If a tree is removed because it may cause damage in the future or you are fed up with the leaf litter that has always happened since you bought the property, then you are making an improvement which is not deductible.

Note improvements that are still present when the property is sold can increase your cost base for CGT purposes.

warning if you decide to rent out your home

Section 118-192 of ITAA97 deems you to have sold and repurchased your home at market value if you first rent it out after 20th, August 1996. Most people thought section 118-192 was a concession to help out if they hadn't been keeping records because they never intended to rent it out. Very few people realised that this was not an optional election but binding on everyone. The depressed state of the property market when this provision was introduced has meant that some people are up for capital gains tax even when they sell the their home for less than they paid for it.

Imagine the situation where a person buys at $100,000 with a respectable 20% deposit but $5,000 is used up in stamp duty, legal fees, bank fees and searches so the bank loan is for $85,000. Very little is paid off the principle as at the start of the loan it just doesn't happen. He or she is then transferred so decides to rent out the house because the market has dropped and the house cannot be sold for as much as was originally paid for it. As it is now a rental property the logical move is to change the loan to interest only. The market recovers a little and he or she finally sells for $90,000 but the price had dropped by 20% (it happened around 1996) when the property was first rented out. He or she has made a notional capital gain of $10,000 less selling costs of say $4,000 equals $6,000 less the discount taxable income will be $3,000. This gain could push many people into the maximum tax bracket so tax could be as much as $1,455 (let alone child support and loss of Centrelink benefits and possible surcharges) on a loss! So out of the $90,000 the bank gets $85,000 the Real Estate and solicitor $4,000 and the tax man $1,455. Not only has he or she blown their $20,000 deposit (life savings) but they now have to find another $455 over the top of the selling price to pay the tax man. This is also a double tax because the original stamp duty paid on the purchase is ignored when setting the cost base on only the market value without acquisition costs.

depreciation rental properties

There has been considerable publicity lately about claiming building depreciation on rental properties by having a quantity surveyor calculate the original building costs and value of plant and equipment. A good reference regarding the building costs is ATO ruling TR 97/25 available from the ATO web site. There are a couple of little catches to relying on a quantity surveyor's report. The first one being that you can only rely on a quantity surveyors report if you have exhausted all other means of finding out the original building costs. The legislation even compels the seller of a property to provide you with this information Subsection 262A(4AJA) of the 1936 Act. The second catch is if the original owner was a spec or owner building the calculation cannot include their labour or profit.

Before you spend money on a quantity surveyor make sure you have exhausted all other means of ascertaining the original building price because the ATO will not permit you to use the quantity surveyors report if you can ascertain the original cost. You should also find out if the original owner was a spec or owner builder. Further make sure the quantity surveyor you use is aware of the changes in depreciation rates for plant and equipment since 1st January 2001. These are set out in detail in TR 2000/1 8C5, for example refrigerators are now to he depreciated over 20 years that is 5% prime or 7.5% diminishing value method, Carpets are 10% prime or 15% diminishing value method. The ruling covers most items including stuffed crocodiles that are considered to have the same life expectancy as a refrigerator.

are you making the most of building depreciation?

Some buildings qualify to be depreciated at 4% instead of 2.5%. Commercial buildings constructed after 26th February 1992 will qualify for the 4% depreciation rate if they are used mainly for Industrial activities or amenities or offices for workers and supervisors involved in industrial activities. Otherwise only 2.5% applies.

Industrial activities are:
1) The manufacturing of items or storage of manufactured items.
2) Processing of primary products
3) Printing, lithographing and engraving.
4) Preparation of foodstuffs in a factory or brewery.
5) Activities associated with the above such as packaging and cleaning.

For other Commercial buildings started before 26th February 1992 and after 16th September 1987 the depreciation rate is 2.5%. On Commercial buildings started before 16th September 1987 and after 21 August 1984 depreciation of 4% is allowed. Prior to 21 August 1984 only 2.5% depreciation is permitted. No depreciation is permitted on Commercial buildings constructed before 22nd August 1979. Buildings constructed after 26th February 1992 can be depreciated at 4% if they are used as a motel, hotel, guesthouse or short term traveller accommodation providing there is at least 10 bedrooms or apartments.

Residential properties on which construction first commenced after 18th July 1985 and before 16th September 1987 are entitled to be depreciated at 4% per annum. If constructed after 16th September, 1987 they are only entitled to 2.5% depreciation. Note, the above applies even if the current owner did not own it during that period.

claimable loans

Traditionally, the interest is only claimable on a loan where the actual money borrowed is used directly to produce income i.e. buy the income producing property. The Roberts and Smith case of July 1992 has changed this. In this case a firm of solicitors borrowed money to pay the partners back some of the original capital they had invested in the firm. The Commissioner argued as has been accepted in the past that the proceeds of the loan were not used to produce income but for the private use of the partners. The Federal Court ruled that such a simple connection is not appropriate the partners have a right to withdraw their original investment and as a result the business needed to borrow funds to finance the working capital deficit. It was irrelevant that the loaned money was paid directly to the partners, the purpose of the loan was to allow the income producing activity to continue. The tax office issued a ruling on this matter TR95/25. The ruling states the Roberts and Smith case cannot apply to individuals i.e sole owners of property because technically they cannot owe money to themselves. The ruling goes on to say: "The refinancing principle in Roberts and Smith has no application to joint owners of investment property, which are not common law partnerships. The joint owners of an investment property who comprise a sec 6(1) tax law partnership in relation to the property cannot withdraw partnership capital and have no right to the repayment of capital invested in the sense in which those concepts are used in Roberts and Smith. Accordingly it is inappropriate to describe a business, as a refinancing of funds employed in a business."

lT2423 states that people who own less than three rental properties are not in business and therefore not in partnership under general law. This means that couples wealthy enough to be purchasing their third rental property can rent out their home then borrow the money to build themselves a new home and maybe claim the interest on the loan as a tax deduction against the rent earned on their old home. Note there have been a few cases were taxpayers have unsuccessfully tried to argue they are in business. In Cripps V Federal Commissioner of Taxation 1999 AATA 937 the taxpayers owned 14 town houses and other properties at various time. The ATO was successful in arguing they were not in business but the foundation of the ATO's argument was that they had an agent managing the properties. So it is crucial that you run the properties as a business i.e. fully manage them yourself.

Regarding linked and split loan facilities. These loans link a loan for the rental home and a loan for the private home together so the bank will permit repayments from both rental and wages income to he paid off the private home loan with the interest on the rental home loan compounding. Accordingly in a short period of time the mortgage can be shifted from the private home to the rental home. As the rental loan was used to purchase the income producing properly and pay interest on that property, technically all the interest on that loan will be deductible. The Commissioner says in TR98/22 this is a scheme with the dominant purpose of reducing tax and he will apply Part IVA to deny a deduction for the interest on the interest. The High Court found in Harts' Case 27-5-2004 that it was an arrangement with the dominant purpose of avoiding tax and caught by Part IVA but the court did not rule that interest on capitalized interest was not deductible. More details of the High Court's decision in Hart's Case and ways of capitalizing interest appear later in this booklet.

line of credit facilities dangerous

It is dangerous to use a line of credit facility on a rental property loan when you will he drawing funds back out to pay private expenses. Based on the principle that the interest on a loan is tax deductible if the money was borrowed for income producing purposes, the interest on a line of credit could easily become non-deductible within 5 years. For example: A $100,000 loan used solely to purchase a rental property in financed as a line of credit. To pay the loan off sooner the borrower deposits his or her monthly pay of $2,000 into the loan account and lives off his or her credit card which has up to 55 days interest-free on purchases. The Commissioner now considers there to be $98,000 owing on the rental property. In say 45 days when the borrower withdraws $1,000 to pay off his or her credit card the loan will be for $99,000. However, as the extra $1,000 was borrowed to pay a private expense, via the credit card, now 1/99 or 1% of the interest is not tax deductible.

The next time the borrower puts his or her $2,000 pay packet into the account the Commissioner deems it to he paying only 1/99 off the non-deductible portion i.e. at this point there is $96,020 owing on the house and $980 owing for non-deductible purposes. When 45 days later, the borrower takes another $1,000 out to pay the credit card, there will $96,000 owing on the house and $1,980 owing for non-deductible purposes so now only 98% of the loan is deductible, etc, etc.

In addition to the loss of deductibility, the accounting fees for calculating the percentage deductible could be high if there are frequent transactions to the account. The ATO has released TR2000/2 which confirms this and as it is just a confirmation of the law is retrospective.

To ensure deductibility and maximise the benefits provided by a line credit you will need an offset account that provides you with $ for $ credit. These are two separate accounts one a loan and the other a cheque or savings account. Whenever the bank charges you interest on the amount outstanding on your loan they look at the whole amount you owe the bank i.e. your loan less any funds in the savings or cheque account. This type of account is offered by ANZ and Suncorp.

continuing to claim interest on a loan after business or investment sold

A reader has sold an investment property for less than the amount he borrowed. He wants to know if he can still continue to claim the interest on the balance of the loan. The ATO has lost a few cases in this regard lately so there is a good chance that the reader will qualify for a tax deduction. The ATO states the contrary to this in TR 2000/17 but in light of FC of T v Jones, 2002 ATC 4135 and FC of T v Brown, 1999 ATC 4600 this will have to be withdrawn. TD 95/27 has already been amended as the ATO recognizes that an employee using a car for work purposes that sells for less than the outstanding loan can continue to claim the interest.

Everything you can do to bring yourself into line with the positive points of the cases mentioned above should be done. Some of the relevant facts that you may be in a position to do something about are:

1) All the proceeds of the sale should be used to repay as much of the loan as possible.
2) Endeavour to appear to be unable to repay the loan from other assets other than the family home. This may mean as a couple if only one member owned the property sold at a loss the other member should hold any further investments.
3) Don't refinance the loan to extend its term or increase the interest rate. You must appear to be doing all that is possible to eliminate the loan. So refinancing to reduce the interest rate is ok. On the other hand if you have to change the loan from principle and interest to interest only because that is the only way you can afford the repayments you may be able to justify changing the loan.
4) If the loan is already fixed at the time the investment is sold, then you have an argument that you could not pay it out. This is a factor to consider if you are refinancing before the sale.

The above also applies if the investment was shares or if a business was sold for less than what is owing on it.

linked split loans

Hart's Case decided for the ATO

On Friday 27th May, 2004 the High Court handed down its decision on Linked Split Loans in favour of the ATO.

I do not find it too surprising that they found that these types of loans were a scheme with the dominant purpose of a tax benefit therefore caught by Part IVA. This case was a clay pigeon for the ATO and yet it still needed to go all the way to the High Court. It was a clay pigeon because the banks marketed these arrangements on the basis of the tax savings. Therefore it was difficult for the taxpayer to argue a different motive.

It is important to remember this case does not change the deductible nature of interest or for that matter interest on interest. Gleeson & McHugh specifically stated that the question of the deductibility of interest upon interest does not need to be addressed because the issue was already decided on the basis that there was a scheme to gain a tax benefit.

The moral of the story is not to get involved with mass marketed tax schemes unless they have an ATO ruling. This is because the ATO has no trouble proving your primary motive was a tax benefit as there is always an abundance of marketing propaganda to prove this.

On the other hand don't lose sight of the fact that you are not obliged to pay more tax than necessary. In IT 2330 the ATO states:

> "Notwithstanding that an arrangement may not he capable of explanation by reference to ordinary business or family dealing and even though ii may be entered into to avoid tax, it will not attract the operation of section 260 (now Part IVA) if its purpose is to take advantage of a specific or particular provision in the Income Tax Assessment Act and complies in every respect with the requirements of the specific or particular provision, i.e. the choice principle."

This approach is supported in Harts case where the judges stated:

> "If such a taxpayer took out two separate loans, and the terms of the loan for the investment property were different from the terms of the loan for the residential property in that they provided for a higher ratio of debt to equity, and for payments of interest only, rather than interest and principal, during a lengthy term, then ordinarily that would give rise to no adverse conclusion under [Part IVA]. It may mean no more than that, in considering the terms of the borrowing for investment purposes, the taxpayer took into account the deductibility of the interest in negotiating the terms of the loan. How could a borrower, acting rationally, fail to take it into account?"

Unfortunately the judges concluded that such a loan was not normally available so it was not reasonable to argue it was a normal arrangement apart from the tax benefit. Ultimately it was the linking of the loans that sunk them. This should not discourage investors seeking similar loans that stand on their own merits rather than being linked to a non deductible loan.

Fine tuning this theory in relation Part IVA we need to recognise that this test has two elements. Firstly there has to be a scheme and secondly it needs to have a dominant purpose of a tax benefit. In Hart's ease it was recognised that a scheme as per 177A(1)(b) can basically include any course of conduct. So there is no point in poking around here for a gap other than to say the legislators could not have intended this section to he so wide or it would catch everything.

So now let's look at the dominant purpose of a tax benefit test. Which must also be present for Part IVA to apply. No this does not mean that if you walk into a newsagency to buy an invoice book your dominant purpose was to gain a tax deduction for the book and as it was a "course of conduct" that is it no tax deduction because this is a tax scheme. We have to be more realistic than that. Nevertheless the High Court found that Hely J was correct in stating:

> "A particular course of action may be both tax driven, and hear the character of a rational commercial decision. The presence of the latter characteristic does not determine in favour of the taxpayer whether, within the meaning of Pt IVA, a person entered into or carried out a 'scheme' for the dominant purpose of enabling a taxpayer to obtain a tax benefit".

So finding another reason to justify the arrangement is not enough. lt is all about the dominant purpose. The simpler the arrangement the better, the more artificial it becomes the more it meets the definition of a scheme.

The court having disallowed the capitalised interest because it was part of a tax scheme did not have to rule on whether capitalised interest itself was tax deductible. I feel that the capitalised interest would normally he deductible providing it has not been created as part of a scheme with a dominant purpose to save tax.

Say for example you have a line of credit on your rental property and a separate loan on your home. Your tenant may pay you a couple of months rent in advance which you pay off your home loan as everything is up to date an cash flow looks good at the time. Over the next two months you have quiet a few personal expenses that take up all of your wages. Then the rates and some repairs are due on the rental property. You need to draw the funds to cover the rates and repairs from the line of credit on the rental property and due to lack of funds the interest that month has to he capitalised. Luckily you just manage to make the P&I payment required on your home loan. This scenario is not a scheme. Events just happened that way and it is not for the ATO to tell you how to manage your affairs. Linking the two loans or a systematic approach to the increase in the loan on the rental property may point towards a scheme. Just watch out for spare funds to make extra repayments on your home and don't prop up the rental property with your spare cash if you can use the equity in your rental property instead. This principle can also work with a business instead of a rental property.

reducing a capital gain

The withdrawal of CDS 10321 may mean that the ATO is attacking wash sales. If you make a capital loss on the sale of an asset that loss can only be offset against a capital gain made in the same year. It cannot be used to reduce other income. If there is no capital gain to offset the loss, the loss can be carried forward to offset against future capital gains. The tragedy is when a gain is made in one year and a loss the following year without any prospect of another capital gain in the near future. Another trap to watch out for is that the gain is taxable in the financial year the agreement to sell is entered into not when title transfers.

A reader had sold a property for a large capital gain. He also had some shares that were now worth less than he paid for them. He will need to actually sell the shares to be able to offset the loss on them against his capital gain. He does not want to sell the shares as he believes they will come good again. The obvious solution is to sell the shares and then buy another parcel of the same company's shares back immediately, hopefully at the same price. Thus crystallising the losses yet still holding onto the future potential. He wanted to know could the ATO use Part IVA to deem the transaction void as a scheme to reduce tax. Part IVA gives the ATO very wide powers to squash just about anything so we need to look to ATO commentaries on when it considers that it would not use Part IVA or section 260 (a predecessor to Part IVA). In IT 2330 the ATO states:

A simple disposition of income producing assets does not attract the operation of section 260.

Notwithstanding that an arrangement may not be capable of explanation by reference to ordinary business or family dealing and even though it may be entered into to avoid tax, it will not attract the operation of section 260 if its purpose is to take advantage of a specific or particular provision in the income Tax Assessment Act and complies in every respect with the requirements of the specific or particular provision, i.e., the choice principle.
In the situations where an income splitting arrangement survives the operation of section 260, it may he expected that it would not he affected by Part TVA.

As a practical matter, therefore, the views expressed earlier as to the impact of section 260 have broadly the same application in relation to Part IVA.

This point was further supported by CDS 10321 which states that Part WA will not be triggered by selling the shares to an entity owned by the seller as long as it is at market value as this is merely executing a choice. Strangely CDS 10321 has now been withdrawn. Leaving us with TT2643 which states that a sale and re-acquisition may be caught by Part IVA. A safer approach may be to sell the loss shares and buy shares in a mirror company. If you have faith in these shares in the future because of particular qualities they have, there is a good chance there is another company on the exchange that mirrors these qualities.

non resident for tax purposes

With Australian Rental Properties including Australian Citizens Working Overseas

It is a lot easier to become a non resident (for taxation purposes than it is for immigration purposes). If a non resident has a rental property in Australia they are still subject to Australian tax at non resident rates on it. If the property is rented and makes a loss these losses can be carried forward and offset against future Australian income. In order to carry these losses forward an Australian income tax return must be lodged for each year.

It does not matter which country the money is borrowed in, if it was used to purchase the rental property in Australia it will be deductible against the rent received.

A non-resident will also be liable for tax on a capital gain on the sale of the rental property.

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What does **APIN** offer ?

Seminars & Workshops

Why is that most people aren't taught how to be rich or happy? We are trained to do most things in our lives, in order to do them well enough to get by. We are taught how to read and write, how to cook, how to drive. We are taught how to do incredibly complex and challenging tasks like designing and building bridges over wide spaces, how to cure diseases, to fly airplanes, yet when it comes to creating personal wealth and happiness, we're left to find out for ourselves.

There's another, more subtle reason why most people don't achieve wealth and happiness. Deep down they don't believe that there is a choice to be made between being rich and being happy. They believe that somehow you can't have both, which is why in the end they don't get either.

The money that slips through your fingers could make you wealthy if spent more wisely.

Our free seminars and information evenings will provide you with leading edge valuable and up to date information. As a bonus you will be able to meet other like minded people who are either starting out on the road to success or are avid investors sharpening their investment knowledge. As a further advantage we encourage you to meet and freely talk with our alliance partners. These hand picked people both male and female are leaders in their own right, they are also licensed, qualified and independent.

These evenings are fun and informative plus you will have access to lots of support material in the form of e-books, books and cd's on a wide range of topics. Come and learn the many strategies used by successful investors NO SECRETS just sensible plain English techniques that really work in any market at any time.

Education

It's true what they say "*the difference between the rich and poor is what they know and what they do*". Property is more than houses and unit investing. Do you know how to buy a property using an option, how about knowing all the ins and outs of being your own "DIY Developer"?

There are many ways to make money in real estate and with the correct tools and strategies you too can play with the best.

TIME x INTENSITY = SUCCESS.

You can't expect to get results in life if you have all the information but fail to apply the principles needed to succeed.

Our programs, e-book, books and home study kits will give you the ability to learn and gather what you need at your own pace in your own time. We encourage you to learn from our expert alliance partners all that you can, so when you are ready to act you will have the education to get into your first investment or do your own JV building renovation makeover.

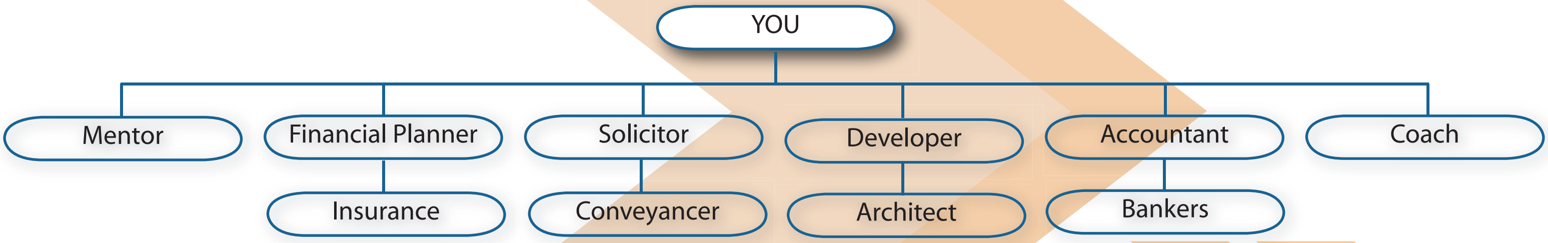
On going Support

Through APIN's Alliance Partners and Discussion Forums you can fortify your ideas and gain strength by exchanging information. Creating alliances generates business opportunities increasing your network and of course - your cashflow.

We have a mentoring service for those that are not quite ready to take those steps without guidance, extra information and some affirmation. Helping you to create a "*safe*" environment for your first steps.

Who is on your team?

When looking at people who are successful, you will notice they have a hand selected group of people to support and advise throughtout the journey to success.



Property Opportunities

Through our Australia wide network we select opportunities that "stack up". We use an independent Research company (Guardian) who are licensed financial planners and real estate agents to use our pre selection due diligence program. From investment properties, development sites, future land subdivisions, building makeovers to even golf course resort projects.

APIN also align ourselves with a select group of builders and developers where we negotiate wholesale purchasing, saving you 10% off the retail price. These opportunities are not available to the public but only members of the APIN site. We can introduce you to the key people who are experts in their fields, saving you thousands of hours of frustration and heartache. Very shortly APIN will also be offering FREE property advertising on our site through resisearch.com who are one of our alliance companies. APIN is fast becoming the most exciting site in Australia.