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NEWSFLASH BOOKLET

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Real Estate Agents

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Important

This booklet is simply a collection of Newsflash articles relevant to Real Estate Agents. The articles are transferred from Newsflash into this booklet so it is best read from the back page forwards to ensure you are reading the latest article on the topic first. Note that the information contained in this booklet is not updated regularly so it is important that you seek professional advice before acting on it.

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 23% 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.

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. 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

In Newflash 50 there were 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 20th 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.

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 be 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 2002/514 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).

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.

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) list 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.

RENTAL PROPERTIES

Switching property deductions as it suites

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

Its 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 46.5% 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 $1,500 per year.

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 surveyor's 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 2000/18C5, for example refrigerators are now to be 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.

Example of deductible expenses

Building depreciation for properties built after 17th 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, per car, 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, Incinerators, 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 T102 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, therefore not deductible. On the other hand if during the time of your ownership 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 (IT180). 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 (TR97/23). 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 be 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 be 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.

Reset of the cost base 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.

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 21st August, 1984 depreciation of 4% is allowed. Prior to 21st 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 traveler 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."

IT2423 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 mange 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 be 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 property 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 in our claimable loans booklet.

It is dangerous to use a line of credit facility on a rental property loan when you will be 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, viz 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 be 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 transaction 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.

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. FC of T v Jones, 2002 ATC 4135 and FC of T v Brown, 1999 ATC 4600 and TR 2004/4 are the references. TD 95/27 has 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) Endeavor 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. In the case of a business the ATO has issued a statement that division 35 cannot work to quarantine the interest in these circumstances as the taxpayer is no longer in business. Division 35 is discussed in Non Commercial Busineses booklet. But all you really need to know is that Division 35 will not stop you claiming the interest

Hart's case decided for the ATO – Linked split loans

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 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 (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 case 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 be 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 not a 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 bear 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. It 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 be 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 and 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 be 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.

Non resident 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.

More information is available in our Overseas booklet under free publications on www.bantacs.com.au

Motor vehicle expenses & substantiation

This is a summary of the Motor Vehicle Substantiation Bill of 1994. Areas of the bill that are not relevant to the average taxpayer have been omitted. Accordingly, it should be treated only as a basic guide to build on when you consult your accountant. These notes do not apply if a company owns the motor vehicle, in which case the Fringe Benefits Act applies.

Exempt Vehicles

To claim a deduction for the costs associated with the following vehicles, it is necessary only to keep a "record" of expenses:

a) A taxi or a vehicle designed principally to carry a load of less than one tonne i.e. a utility, panel van or Hiace van with only the front seats and some dual cabs, provided that vehicle is used only for business travel, travel to and from work and buying lunch etc. The vehicle would still be considered only used for business if the private use is minor and irregular.
b) Motor Cycles, Earthmoving equipment and Trucks designed to carry a load of more than 1 tonne.
c) Motor vehicles used as trading stock or used for hire or cars you hire.
d) Motor vehicles to which fringe benefits tax applies. Note there are other substantiation requirements in the Fringe Benefits Act that apply to these vehicles.

Note if you borrow a car (i.e. use a car that is in your spouse's name) you are not entitled to use the following methods of substantiation but are still required to prove your claim. You must own or lease the car to be able to use the following methods.
Owning a car includes hire purchase agreements.

Methods of Substantiation

There are 4 methods of substantiation available:

1) The flat 12% of the cost of the motor vehicle or market value when leased method which is available only to motor vehicles that travel more than 5,000 kilometres for business that year. Note – consult your accountant if the vehicle was more expensive than the average family car.
2) Claim a deduction for one third of the motor vehicle's expenses. The car must have travelled more than 5,000 kilometres for business that year. You will need odometer records and written evidence of all expenses.
3) If the motor vehicle travels less than 5,000 kilometres for business you may choose to use the cents per kilometre method. This method is also available for motor vehicles that travel more than 5,000 kilometres for business provided you reduce the claim to 5,000 kilometres only. You are required to keep a "detailed reasonable estimate" i.e. if you do the same number of kilometres per week, keep a record for one week and multiply by the number of weeks. If travel is irregular a list or diary entry of kilometres travelled is sufficient. Detailed means you cannot pull a number out of your head for the full year. According to TD93/177 it is the distance travelled by the taxpayer's car not the taxpayer that is relevant in calculating the kilometres travelled and each owner of the car is entitled to 5,000 kilometres. This means that if a car is owned jointly and both parties are travelling in the car together then you are still entitled to claim only up to 5,000 kilometres combined. On the other hand, if the car is owned jointly each owner is entitled to claim up to 5,000 kilometres each for business travel as an individual. For example, a husband and wife may own 2 cars and both cars are in joint names. The husband could use car one for 6 months and clock up 5,000 kilometres then swap with his wife and use car two for 6 months to clock up another 5,000 kilometres. The wife could do the same with the cars reversed. As a result, they would both be entitled to claim 10,000 kilometres, 5,000 kilometres for each car they own. If you change cars during the year, you can claim 5,000 kilometres for each car. For the 2005/06 year the cents per kilometre are: up to 1600cc 55 cents, 1601-2600cc 66 cents and over 2600cc 67 cents.
4) The log book method requires written evidence for all expenses and odometer records to be kept each year (refer definitions below). You may use the log book method if the car travels less than 5,000 kilometres for business but it is unlikely that this method will give you the best deduction. Log books

are required to be kept at least every 5 years. The log book is to be kept for 12 continuous weeks (or the period you own the car if less than 12 weeks). If you have more than one car using the log book method a log book must be kept for each car at the same time. The log book should include the following:

At each entry:

a) The date the journey began and the date it ended or for each day if journey longer than a day.
b) The odometer reading at the start and end of the journey.
c) The number of kilometres the car travelled on the journey.
d) The reason for the journey, a pedantic auditor may require the destination (MT2026 Archived).

In each log book:

a) The period the log book begins and ends.
b) The odometer readings at the start and end of the log book period.
c) The total kilometres travelled during the log book period.
d) The business kilometres.
e) The percentage of total kilometres that were business during the period.

Note – the actual percentage applied to the motor vehicle expenses is not necessarily that calculated in the log book because you are also required to take into account any other records including the odometer readings for that year, variations in the pattern of use and changes in the number of cars you own.

DON'T FORGET TO TAKE YOUR SPEEDO READING EACH 30TH JUNE

Written evidence

Both the log book and one third of all expenses methods require "written evidence" of all expenses except fuel which can be calculated based on the amount of fuel used per kilometre. Note – if you calculate your fuel this way for the one third of all expenses method, you are required to keep odometer records as defined below. Written evidence must be a document from the supplier setting out the following:

a) Name of the supplier
b) Amount of the expense
c) Description of goods or services
d) Date of incurring the expense
e) Date of document

Note - if the document does not show the date the expense was incurred, you can use a bank statement to support the claim. You may write the description of the goods or services on the document yourself. If the Commissioner considers it unreasonable to expect you to have written evidence (i.e. bridge tolls), you can just keep a record regardless of the size of the expense. If the expenses are for $10 or less you may just keep a record of these expenses providing the total does not exceed $200.

Odometer Records

Each year a record must be made for each car under the log book and one third of expenses methods containing the following:

a) The car's odometer readings at the start and end of the period.
b) Any nomination regarding a replacement car. If this is the case, Items a, c & d should be kept for both cars.
c) The car's make, model and registration number.
d) The cubic capacity of the engine.

Changing Cars

If you change cars during the year and the car would have done more than 5,000 kilometres for business if it had been used for a full 12 months, you may use the methods that require more than 5,000 kilometres business use. Careful, you may find you would be better off claiming the kilometre rate of 5,000 kilometres for each

car. If you own a car for only part of the year and choose to use the 12% of cost method, you must pro rata the 12% over the period of ownership. If you are using the log book method and the new car will be doing the same travelling as the old, you can nominate to use the old log book as the log book for the new car, subject to the 5-year limit. Note - you must record the closing odometer reading on the old car and the opening odometer reading on the new.

When to Begin a New Log Book

Log books must be renewed for a continuous 12 week period at least every 5 years.
Odometer records are required every year. You must keep a log book for an income year if, during that year, you get one or more additional cars for which you want to use the log book method for that year. If the business percentage increases you should keep another log book to support a bigger deduction.

When can real estate agents claim their vehicle expenses?

Basically the only trip a Real Estate Agent can't claim for is the trip from home to the office if he or she are not carrying bulky equipment. Bulky equipment would be items that weigh more than 20kg in total or are too bulky and awkward to carry on the train etc. Signs are worth considering here. Further if a Real Estate agent travels from home to an abnormal work place (such as a property he or she has listed for sale) and then on to the office the whole journey from the moment he or she left home is claimable.

Once the Real Estate Agent arrives at work any further travel undertaken for work purposes during the day is tax deductible. In order to claim the trip home from the office, if a property listed for sale is not visited on the way home, the bulky equipment claim mentioned above in regard to home to work travel needs to be considered. Note with the bulky equipment claim you must have a reason, for carrying the bulky equipment.

Employees Paying Wages to Their Family

TR98/6 is a ruling for Real Estate Agents. It recognises that even though the sales people are paid wages as an employee they are entitled to claim a tax deduction for any wages they pay to family members for helping them. The family member must do something significant, it is not enough to just answer the phone and a diary of the hours worked must be kept. The wage must be at market rates. If the sales person is paid at flat wage with no commission the ruling doubts that they would be entitled to this claim but invites the public to come forward and they will fund a test case to bring the matter before the courts.

This concept does not just apply to Real Estate Agents. It is applicable to all employees who's wages are on a commission basis. Section 26-35(1) says you can deduct an amount of a payment you make or a liability you incur, to a related entity. Section 8-1(1) ITAA 1997 states "You can deduct from your assessable income any loss or outgoing to the extent that it is incurred in gaining or producing your assessable income. This means that you do not need to prove that the payment was actually made. Only that the work was done therefore you have a liability to pay the family member. This is important when spouses run a joint bank account as it is difficult to prove the money has actually been paid.

Ryan's case decided in July 2004 by the AAT gives us the opportunity to take this one step further. Dr Ryan ran a computer consulting company that employed him and his wife. Ryan's wife only performed secretarial work for his company. She was paid at commercial rates for the amount of time she spent on company business. This was a relatively small amount but much, much more was contributed to superannuation on her behalf. The AAT found that Ryan was entitled to a tax deduction for these superannuation contributions.

Deductions for Commission Wage Earners

The definition of what is considered a cost of earning you income, is wider for employees whose wages are paid on a commission basis. TR98/6 is a ruling for Real Estate Agents but the concepts would apply to all wage earners whose income is based on commission. It recognises expenses not directly related to earning income would still be deductible because there is a prospect they will result in greater income in future years. These sorts of expenses include advertising properties, signs, letter box drops, sponsorship, property presentation costs, referral rewards, gifts and greeting cards.

Note even though taking someone out to lunch would have the same benefit it is specifically not deductible because it is entertainment. Buying them a beer would also be entertainment but buying them a gift of wine

or beer that has not been opened ie they can take it home, is not considered entertainment so would be deductible as would any other gift.

More Information

On the Tax Office web site www.ato.gov.au there is a ruling called TR98/6 which goes into great detail about what the ATO considers deductible to Real Estate Agents.

More on Real Estate Contract Clauses

Following on from Newsflash 261 where we examined the nightmare a GST clause can cause we now look at vacant possession and a going concern clause which can be equally as catastrophic, so never ever sign a contract without getting advice.

Going Concern:

If the sale of a commercial property qualifies as the sale of a going concern the seller will not have to pay the ATO any GST when they sell the property. The trouble with property is its market value seems to ignore the GST component. This means that the seller may well get the same price for the property whether they charge GST or not, the difference being whether they have to send 1/11th of the selling price off to the ATO, So sellers are always on the lookout for a way to avoid this. A going concern clause, is a dream come true for a seller of a commercial property. It pushes the GST obligation onto the unsuspecting buyer who has already paid full market value for the property.

A going concern clause only ever has a good outcome for the buyer if they just can't afford the funds up front to pay the GST and then wait for the ATO to refund it. Before a going concern clause can apply both the buyer and seller must be registered for GST. If the contract was subject to GST then the buyer would be entitled to claim it all back from the ATO anyway.

Say the market value of a property is $550,000 if the contract is subject to GST then the seller would have to send off $50,000 to the ATO and only end up with $500,000 in the hand. The buyer may hand over $550,000 but in the next BAS he or she will get $50,000 back as an GST input credit so is really only out of pocket $500,000. This means that if the sale is going to be subject to the going concern provisions the property should really change hands for $500,000. I don't like your chances of talking the seller into that when they know the valuation is $550,000. So just don't agree to the going concern clause, register for GST and pay the full $550,000.

The main reason you don't want to agree to a going concern clause is because if you ever de-register for GST or stop using the property in a business, for example as per last edition, the purchaser was eventually going to turn the professional offices back into a house, then you have to pay back the "notional" GST input credit you received. In the example above, that means effectively paying another $50,000 for the property. Notional, because you didn't actually receive it, it was just that the seller didn't have to pay it to the ATO, but the law is like this because the going concern exemption from GST is intended to make the property cheaper by the value of the GST. This is something that does not always happen unless the purchaser is well informed and a very good negotiator.

All this may lead you to decide to sell the property and cut your losses. That won't get you out of it either. Let's assume you decide this rather quickly so the property is still only worth $550,000 but what if your purchaser is not as gullible as you were? If the purchaser does not agree to use the going concern exemption (and they only should if you sell it below market value) you are going to give the ATO $50,000 of your sale proceeds even though you may still owe the bank the $550,000 you paid for it.

Vacant Possession:

This is a much more straight forward problem. It is only an issue if you intend to use the property as your home. If you don't move into the home as soon as practical after settlement then you will not be able to begin to cover the property with your main residence exemption until you actually move in. Sure it may be only a short time before the tenant moves out. It is not the portion of the gain that you will pay tax on that is the problem. It is the fact that you will need to keep records for the whole time you own the property in order to be able to calculate the whole gain to apply that small percentage to.

Going Concern Clauses In Real Estate Contracts

Interesting, fresh after our discussion on the horrors of a going concern clause in a real estate contract in the 1st February edition of Newsflash, the decision in MBI Properties Pty Ltd v FC of T 2013 ATC 20-372 was handed down on the 12th February. MBI had to pay back $215,000 in GST even though they had paid

full market price for the property. So please don't read the article on clauses and think it couldn't possibly be that bad.

In the MBI case they should not have agreed to the contract being one for a going concern because they intended to lease the apartments back to a hotel group. As it was the hotel group operating the business not MBI all MBI were doing was renting residential property to the hotel group. Residential property rents are not subject to GST. To qualify for the going concern concession you need to be making supplies that are subject to GST.

Please note that despite market price being paid for the property the purchaser had to then pay the ATO another 1/10th of the purchase price because they didn't use the property for the correct purposes. The ATO still considers them to have benefitted from a discount by not paying the GST. The unfortunately reality in most of these cases is that it is really the seller who has benefited by not having to send of 1/11th of the selling price to the ATO yet still managing to sell for full market value.

If you must enter into a contract to buy a property as a going concern make sure you pay at least 1/11th below the market value because if you ever stop using that property to make GST supplies you are going to have to pay the ATO back the GST discount that you supposedly received.

Don't be misled into thinking that a going concern sale avoids GST. All it does is remove the obligation from the seller to send 1/11th to the ATO and the ATO to send that 1/11th back to the buyer. This helps with cash flow at settlement that is all. The buyer is still considered to have received the GST input credit so must charge GST when they sell (or sell 1/11th below market value) and they must pay the GST back if they de register or stop using the property for GST purposes, for example change of use to a residential rental property.

In MBIs case they acquired apartments that would be leased to an entity that provided serviced apartments. Sure this is a commercial use of the apartments by the other entity but MBI was doing nothing more than renting residential property to that entity.

Fortunately, MBI is a related party to the seller so it will all come out in the wash but there are Mum and Dad investors also caught up in this. Their cases are yet to be heard by the courts.

Converted House Residential or Commercial For GST?

When is a house commercial premises? This is a very important question because if a house has been changed enough it will no longer qualify for the GST exemption that residential premises receive. If the property is considered to be commercial then the rent will be a supply that is subject to GST and the sales of the property will be subject to GST for up to 1/11th of the sale proceeds even when sold at market value.

This of course only applies if you are registered for GST. You must register for GST if your turnover exceeds $75,000 (exclusive of GST). Turnover does not include supplies that are input taxed such as residential rents and sales of capital assets. So converting one of your rental properties to offices is not going to force you into the GST arena if your only other income is wages and rent on residential properties.

Nevertheless, for owners of converted homes who are registered for GST (for example they may operate their own business from the premises through the same entity as the owner of the premises) it is extremely important to know whether GST applies when you sell. You will probably get the same price for the property, market value, but whether GST applies or not will determine whether you are required to send the ATO 1/11th of the amount you receive, so there are tens of thousands of dollars at stake.

Until the end of last year houses converted to commercial use would have been caught under paragraph 31 of GSTR 2000/20 which stated:

> *the purpose for which the premises are to be used will be evident from their form or fit-out. This is most clearly the case where premises have been fabricated, or altered, to accommodate commercial or professional activities.*

GSTR 20002/20 has been withdrawn and replaced by GSTR 2012/5 which elaborates on when a house would be considered residential premises. Paragraph 10 states:

> *Premises that display physical characteristics evidencing their suitability and capability to provide residential accommodation are residential premises even if they are used for a purpose other than to provide residential accommodation (for example, where the premises are used as a business office).*

Despite the differences between these paragraphs apparently the ATO has not changed their view only elaborated. Both rulings say it is all about the physical characteristics rather than the use to which the premises are put. GSTR 2012/5 points out at paragraph 36 that a shop that is used as a home is still commercial premises for GST purposes.

GSTR 2012/5 looks at the original intention of the design of the property and asks does it provide shelter and basic living facilities. Now you could say this was the case in many office blocks but the ruling differentiates by stating that they were not designed for that purpose. The next step is to consider whether the house has been modified to the extent that it is no longer residential premises. A significant physical modification that the ruling considers to have changed residential premises to commercial are a doctor's surgery where sealed car parking area, an operating theatre, hygiene facilities, industrial security, altering walls and additional lighting pushed it over the line.

Simply putting a sign out the front, fitting out an office and connecting the appropriate power and phone lines will not change a residence to commercial because it can still be used as a home without modification. On the other hand if you want to be sure the premises are considered commercial, remove the shower and bath. Anything in between get a ruling from the ATO because there is too much at stake.

GSTR 2012/5 has introduced a third scenario to the mix. You can be considered to have changed only part of the property to commercial so its sale or lease would be a mixed supply for GST purposes. In the doctors example GSTR 2012/5 found that the waiting room and store room were still considered residential premises because they had not changed in appearance (other than furniture) from the lounge and bedroom that they were in the original home. This means that on sale only part of the proceeds would be subject to GST. This is despite the GST Act at section 40-65 (1) on the sale of residential premises stating:

A sale of real property is input taxed (not subject to GST) *but only to the extent that the property is residential premises to be used predominantly for residential accommodation.*

If a property such as this, where some of the rooms still resemble residential property, is rented out then the rent also has to be apportioned, some of it subject to GST and some not. The same apportionment would apply to claiming GST input credits on expenses.

The worst consequence is that when you purchased it pre GSTR 2012/5 the sale may have been considered to be fully subject to GST because it had been "predominantly" modified to commercial purposes. Well now it seems that apportionment is necessary, you will have to pay some of that GST input credit back (even if you bought under a going concern clause).

Don't be upset about the advice you got at the time here is some extracts from the GST Act:

Section 195-1 – The term 'residential premises' means land or a building that:

(a) is occupied as a residence or for residential accommodation or

(b) Is intended to be occupied and is capable of being occupied as a residence or for residential accommodation

Yet the ATO make it clear in GSTR 2012/5 that whether the property is being used as a residence or not has nothing to do with the GST outcome ie a shop being used as a home is not residential premises. It is all about the design. That is what the word intended means, not the intended use by the buyer but what the designers intended it to be used for. This is how they can dissect up a house catching some rooms for GST and not others. They can look at the lounge room and say no real change since it was a house even though it is now being used as a waiting room but then look at one of the bedrooms and say it has now been changed, the last person who was involved in the design of that part of the property (ie modifying it) changed the intended use to a commercial purpose because a wall was removed, extra lighting, hygiene facilities and industrial security have been added.

Our advice is that if you are buying, selling or leasing a property that was originally a house that has undergone some modifications to make it suitable for commercial use but still has a shower or bath tub, apply to the ATO for a ruling on how much of it is subject to GST and let the ATO sort out its own mess. Unfortunately, you will need to do this before signing a contract and you will have to wait at least 28 days before receiving a reply. If you are the seller it would be sensible to apply for the ruling before you even have a buyer.

Note, in Newsflash 261 there was a story about a reader who purchased a house converted to a medical practice but intended to use it as her home. Under this new ruling GSTR 2012/5 the property may well have been considered residential premises rather than commercial or a mixed supply. Where taxpayers have relied on the wording of GSTR 2000/20 for any sale contracts they entered into before 19th December, 2012 they are protected from the findings in GSTR 2012/5 but that is not going to help you when you sell and if you are charging rent you need to get it right from 19th December, 2012 going forward.

Selling Your Business – Going Concern GST Concession

The Going Concern GST concession allows a business to be sold without having to charge GST. This can also include the building the business operates from if it is sold with the business. This is very relevant when a building is involved because the price will be lower so the stamp duty will be less. Of course reduced stamp duty only benefits the purchaser, so let's look at the risks on each side of the contract.

Firstly, a brief explanation of the requirements of a going concern clause: both the buyer and seller must be registered for GST and agree that the contract is the GST exempt sale of a going concern. The seller must also provide the buyer with all things necessary to continue the business and the seller must continue to operate the business up until the time of sale. If all these requirements are met the seller does not have to remit 1/11 of the selling price and the buyer is not entitled to claim GST input tax credits on the purchase. Accordingly, the property should be sold for $1/11^{th}$ less than the market price for sales of similar properties that are not subject to the going concern concession.

From the Seller's Point of View:

All is good if you can still get the market value for the property, you have nothing to lose. But a well-informed purchaser would expect to pay less than market value for a property under the going concern concessions for reasons elaborated on in the Purchaser's point of view below. Your biggest concern is that the ATO will come along and decide that the going concern concession did not apply to the contract, for example because you did not supply all things necessary to continue the business. This issue is addressed in GSTR 2002/5 which has just recently been updated. Don't underestimate the ATO here; they even consider that key staff members need to agree to work for the purchaser. If the ATO considers that the sale does not qualify for the going concern concessions it can ask for $1/11^{th}$ of the sale price in GST, which is totally unfair if you have sold for below market value because of the going concern clause. Solicitors will generally try to protect you from this outcome by putting a clause in the contract requiring the purchaser to pay you the GST if the ATO decide that the going concern concession does not apply. The problem may then be finding the purchaser and, if you do, then going through the court process of making them pay up.

From the Purchaser's Point of View:

The purchaser is considered to have received a GST input credit on the purchase even though no money changes hands. This means that should you change the use of the building to residential, de register for GST or just stop using it to make supplies that are subject to GST, section 135 requires you to pay back to the ATO the notional GST on the purchase. This of course is unfair if you have already paid full market value for the property, it could be as much as $1/10^{th}$ of the purchase price.

If the ATO come along and deny the going concern concession to the sale then the purchaser, if they can obtain a taxed invoice, may be entitled to an input credit for the amount of GST the seller has to pay. This is quite a bonus if the contract doesn't have a protection clause stating that the purchaser has to pay the GST amount to the seller should the ATO deny the going concern concession.

The Margin Scheme:

A seller can reduce the amount of GST they pay out of the sale proceeds of a property by making the contract subject to the margin scheme. The catch here is you can't apply the margin scheme to sales that are exempt under the going concern concession and the purchaser must agree to the use of the margin scheme before settlement. So choosing to use the going concern concession instead of the margin scheme may completely eliminate the GST rather just a portion of it under the margin scheme but if the ATO decides that it didn't qualify as a going concern then you are left with full GST rather than the reduction under the margin scheme. You can apply to the ATO for an extension of time to apply the margin scheme after the contract is completed but the purchaser has to agree. In the event of the going concern concessions being denied the purchaser is unlikely to agree to the margin scheme because this means they are not entitled to any GST input credits, something that they would qualify for if the ATO deny the going concern concession.

The Fine Print:

Quite often the business and its premises are owned by different entities (within the same family group) for asset protection purposes. To qualify for the going concern concession the building has to be part of a going

concern. This means it is either sold with the owners established business or it is leased out and the going concern business is considered to be the business of leasing out the building.

Getting back to the situation where the building houses the business, it is ok to sell say the business from your trading trust and the building from your holding trust and bridge the going concern concessions but only if both are sold to the same purchaser. This means that the purchaser cannot have the asset protection advantage of owning the building in a different legal entity than the business. The purchaser needs to consider whether this is really worth the risk just to save some stamp duty.

Winning Property Tax Strategies – The Book

By best selling authors Noel Whittaker and Julia Hartman, Winning Property Tax Strategies is a must-read for property owners and accountants alike. Residential property is Australia's favourite investment, yet many landlords fail to achieve their dreams of wealth because they get it wrong from the start. Winning Property Tax Strategies provides a unique insight into the many different facets of property investing. Primarily it addresses taxation issues, but the emphasis is that one size does not fit all. You can purchase it online by going to: www.bantacs.com.au/shopping.php. The cost is $29.95 plus $6.55 postage – tax deductible of course!

Ask BAN TACS

For $79.95 at Ask BAN TACS, www.bantacs.com.au/ask-bantacs.php, you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. We will include ATO references to support our conclusion. There is also a notice board where some askbantac users have generously allowed their question and answer to be published. Lots of good real life information.

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How to Make Sure Your Next Property Is a Good Investment

- Do you really know how much the property is going to cost you to hold?
- What name should the property be purchased in?
- Will this property fit your investment strategy and goals?
- What does the contract say about GST?
- How does the price compare with similar sales in the area?
- If it is negatively geared, how much capital growth is required before you breakeven?
- Do you know what records you need to keep and how?
- Are your financing arrangements maximising your tax deductions?
- What happens if interest rates rise?

.....and the list goes on!

To ensure you don't make a costly mistake with your next purchase make sure you see a BAN TACS Accountant before you sign