investors
booklet

Investors Booklet

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

©Copyright Australian Property Investors Network (APIN)

CONTENTS

Disclaimer	3
Deductibility of interest	4
To do before 30 June, 2003	4
Linking programmers, inventors and expanding businesses to investors and Government grants	5
Refund of franking credits	5
How to pay off your home sooner	6
Dollar cost averaging	7
Investment loans	8
Tax deductions for small investors	9
Bad habits	10
Tax minimisation schemes alert	10
Investors making PAYG instalments	12
Sold your business or investment but still have a debt?	12
Readers question	13
Self managed superannuation funds	13
Secret plans and clever tricks	13
Non-resident with Australian investments	14
Becoming a non-resident of Australia for tax purposes	15
Interest, dividends and rent when overseas	16
Non-residents and capital gains tax	17
Residents of Australia with overseas investments	18
Australian residents and foreign losses	18
Overseas summary	19
Warning when settling property on divorce	19
Capital protected loans – ATO loses	20
Budget report 2003	21
The 50% CGT discount	21
Realising capital losses to offset a capital gain	22
How franking credits affect investment yield	22
The financial services reform act	23
Arranging to make interest payments in advance	23
Children's investment income	24
Gearing – don't forget the franking credit	25
Reader's question – travel to AGM	26
CGT and shares or managed funds	26

©Copyright Australian Property Investors Network (APIN)

disclaimer

Australian Property Investors Network Pty Ltd is not:
a licensed investment advisor or planner
a licensed real estate agent
a licensed financial planner or advisor
a qualified or practicing accountant
a qualified or practicing finance professional

All information including materials referred to or provided to the recipient by Australian Property Investors Network Pty Ltd (APIN) has been developed by Australian Property Investors Network Pty Ltd solely from personal experiences and research as an investor and is referred to, or provided as, a typical model or framework which is referred to or provided by the way of example only and is not intended to be, nor is it accepted as, specific investment recommendations or advice to the recipient.

The laws relating to finance, property, investment and taxation are constantly changing and whilst all care is taken in the formulation, presentation, and dissemination of the information APIN does not warrant the accuracy of the information nor the appropriateness of the information for the recipient's specific investment requirements.

No investment decision should be made by the recipient based solely on the information provided by APIN and the recipient should obtain independent financial and legal advice in respect to special to specific investment.

Release: The recipient releases absolutely APIN from all and any responsibility or liability for any losses claims or demands that may be incurred as a result of the recipient using the information for investment or other purposes.

Restraint: The recipient hereby agrees that it may not (whether expressly or implies) represent or hold out to any person that the recipient is a representative, agent, employee, and partner or in any way connected with APIN.

Confidentiality: The recipient hereby agrees that the proposals, documents, concepts, ideas, calculations, formulae, intellectual property and any other materials or proprietary information (whether written or oral) given to the recipient are strictly confidential and remain the intellectual property of APIN. Proprietary information may only be used by the recipient within the scope of the material and may not be adopted or used for any other purpose, in particular to conduct any other promotional or marketing activity, without the prior written consent from APIN.

Privacy: APIN is bound by, and committees to, supporting the National Privacy Principles (NPPs) set out in the Privacy Amendment (Private Sector) Act 2000. Our Privacy Policy addresses any potential concerns you may have about how personal information you provide to us is stored, used, and accessed, this information can be accessed by applying in writing to: Australian Property Investors Network Pty Ltd, Suite 33, Level 3, 1-7 Jordan Street, Gladesville NSW 2111 (ACN 120 319 897).

©Copyright Australian Property Investors Network (APIN)

deductibility of interest

Interest on a loan is tax deductible when the money borrowed is used for income producing purposes. Case J54 (1958) 9 TBRD established the principle that interest is apportioned according to the ownership of the investment purchased. Accordingly, a couple can borrow money jointly for an investment that is held in just one name. The whole amount of the interest attributable to the investment will be deductible to the partner in whose name the investment is held.

Readers should seek professional advice before taking any action on specific issue in relation to any matter or information contained in this publication.

to do before 30th June, 2003

For Everyone:
Take the Speedo reading, for each car you want to claim for, as at 30th June, 2003.

Consider making superannuation contributions. Self-employed individuals only get a full tax deduction for the first $5,000 and a 75% deduction on the remainder up to the age based limit. Self employed individuals can only claim a deduction for their contributions if they do not receive wages income or if the wages income is less than 10% of their gross income. If you operate through a trust or company make the contributions as a salary sacrifice. If you are a wage earner you will need to enter into a salary sacrifice arrangement with your employer. Employers should consider making their employee contributions before the deadline as the obligation to pay superannuation cannot be accrued. A superannuation contribution can be included as part of an employer's obligations under the guarantee even if it is made up to 12 months in advance to the period of employment it relates to, subject to the age based limit. This amount can be claimed as a tax deduction even if you are not in the simplified tax system.

Consider spouse superannuation contributions if your spouse's assessable income is under $10,800 and you make a contribution of $3,000 for him or her, you will qualify for a rebate of $540. The rebate shades out between $10,800 and $13,800 Note the assessable income is the gross income before tax deductions but does not include exempt payments such as Centrelink's family payment.

If you have made a capital gain it is worth considering selling other assets (such as shares) that you know will create a capital loss on disposal and are unlikely to improve so that the loss can offset the gain. A loss in the future without a gain to offset it against may take a long time to recoup. If you are currently holding onto shares that, if sold, would realize a capital loss, but you want to hold onto them as you feel they have potential, simply sell them and buy them straight back.

Consider purchasing stationery and other deductible consumables that will be used up in the next 3 months.

Rental property owners and individual investors:
If your loan interest is calculated daily yet not entered on the bank statement until July ask the bank to advise in writing how much accrued at the 30th June.

Consider buying equipment under $300 (GST inclusive) i.e. light fittings or curtains for immediate write off. Note all identical items must total under $300 so it may be worth buying one curtain in this year and another next year. If the item is part of a set it is the value of the whole set that must be under $300. The item must not be predominantly used for business purposes. Items under $1,000 can go into a low value pool for accelerated depreciation. Note that is under $1,000 per owner i.e. $1,500 for a hot water system on a property held jointly by husband and wife can go into their individual under $1,000 pool as only $750 each.

Prepay the interest on the loan for the rental property up to 12 months in advance ID2002/939.

©Copyright Australian Property Investors Network (APIN)

linking programmers, inventors and expanding businesses to investors and government grants

The Queensland Government Department of State Development has compiled a huge network for this purpose. You are no longer alone the opportunities appear to be endless. For example:

Workshops to show you how to prepare your business and present your plan to investors.

Introductions to potential investors. For example Enterprise Angels is one of the many organisations that link businesses with investors. Their web site is www.enterpriseangels.com

Training to transform a technical person into a business person able to present their business to investors. This can be provided in Fortitude Valley by Achaeus Ltd., visit their web page at www.achaeus.com.au for more details. They provide training in preparing information about your business yourself, that would cost a fortune to have done professionally. Having prepared the plan yourself your personal presentation to potential investors will be much more professional.

Grants from ISUS up to $70,000 for start up at pre commercialisation stage. QIDS dollar for dollar assistance for business development e.g. business planning, trade shows etc. COMET for technology start-up grants. R & D Start grants and loans to assist research and development of innovation.

Mentors The Queensland Entrepreneurs Association provide mentors and network referrals.

Technical Assistance as well as funding is available through the Queensland Industry Development Scheme www.statedevelopment.qld.gov.au

Investors, these services provide a filtering system that helps ensure you make connections with legitimate businesses. For businesses this is an ideal method of funding before your business meets the criteria required by the banks. The first place to start looking is www.cbglobal.com.

refund of franking credits

On 22nd March, 2001 the Treasurer made a Press Release (No. 016) discussing the deferral of many areas of tax reform. He specifically stated that “refunds of excess imputation credits will be available upon assessment for dividends paid from 1st July 2000”. So the refund of franking credits will apply to tax returns for this financial year. This means that it may now be in the interest of many people who, received dividend income, to lodge a tax return even if their total taxable income is under the threshold, because they may get a refund of the imputation credits on the dividends.

We offer a free service to pensioners that we will check whether they need to lodge a tax return. They only have to pay if they decide to lodge the return. If there is no tax reason for you to lodge a tax return, a much simpler form can be filled out to claim back your franking credits.

©Copyright Australian Property Investors Network (APIN)

Investment Property Financing

Many people have heard the term "negative gearing" but are unsure what it means. Negative gearing is a tax effective investment strategy where your rental income from your property is more than offset by your interest and property expenses giving you a net tax loss to offset against your other income (e.g. salary income). Given a sufficient time period, your property price will (hopefully) be increasing in value so that in a sense you are making money whilst paying less tax. Investors traditionally prefer fixed interest only loans for budgeting and so that the whole repayment is tax deductible. There are several recent innovative loan products that increase this strategy's effectiveness and appeal.

Make triple the repayments

This may sound a little extreme but it emphasizes very dramatically the power of accelerating your repayments. For example $100,000 paid off over 25 years at 6.5% results in a monthly repayment of $675.24 which is a total amount repaid of $202,572! More than double. If the $100,000 was repaid over 5 years at 6.5% the repayments would be less than 3 times as much, $1,957 per month with the total amount repaid over the 5 years reduced to $117,420. The best part of this strategy is the banks only make $17,420 rather than $102,572, fight back and enjoy your $85,152 saving over the next 20 years.

This strategy may sound extreme but if you are a young couple intending to have children and live on one income for a while, why not start now and use the other income to pay off the house. This will make living a lot easier when you have children. With interest rates and deposits so low you could start early and own your own home completely by the time you are 25. This will give you an excellent start in life.

Hit the ground running and win.

©Copyright Australian Property Investors Network (APIN)

dollar cost averaging

On average over a reasonable period of time the value of a diversified portfolio will increase. The trick is not to try and pick the market but just go for the average, not too hard at all. Firstly you need a diversified portfolio. If you are buying direct shares this is very difficult to achieve as the minimum purchase, of any one parcel of shares on the stock market is $500. For a smaller amount you can buy units in a managed fund which will combine all the other unit holders' income and purchase a wide variety of shares. Generally the minimums of these funds are $500 up front and $100 per month but you can stop these monthly payments at any time. The idea of paying monthly is to further the averaging effect. While the share market travels in an upwards direction it has many peaks and troughs. By purchasing shares on a monthly basis you ensure that on average you do not purchase at a peak or trough but on the general upward curve over a larger period of time.

By investing in a master fund you can switch between high and low risk managed funds without entry and exit fees. High risk funds should only be invested in with a long term goal in mind. Again the averaging out of their returns over a long period will usually produce a better result.

Averaging is the key, the above strategy averages on time, on a wide variety of shares and on a wide variety of purchase dates.

Let's take as a practical example the couple in "How to Pay Your Home of Sooner" above. They have reached year 5 at 25 years of age and own their own home completely. All their friends are still making repayments of $675.24 per month, they are not. What if they placed this money each month into a managed fund for the next 20 years? The performance would be somewhere between the following, which is based on the performance of these funds over the past 5 years assuming on average it will continue.

Medium Risk Based on BT Wholesale Balance Returns. Average return of 12.14% over the last 5 years.

This performance over 20 years would result in $680,717 High Risk Based on Colonial First State Wholesale Imputation. Average return of 26.4% over the last 5 years. This performance over 20 years would result in $5,659,106.

Pretty impressive to have such a large sum invested and no debts by the time you are 45 years of age. The only time in their life that they borrowed money was between 20 and 25. Imagine the impact if they borrowed against their home to invest more. Note, this can be done on just an average income and the only time they live a little tighter than their friends in the same position was from 20 to 25 years of age when they lived off one income and paid off their house with the other. This is what I call hitting the ground running.

©Copyright Australian Property Investors Network (APIN)

Traditionally, interest is claimable only on a loan where the actual money borrowed is used directly to produce income i.e. buy the income producing property.

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 is 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 $96,020 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 it is retrospective.

To ensure deductibility and maximise the benefits provided by a line of 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 several banks.

A loan setup incorrectly will lose all deductibility within 5 years on average. If your loan is not set up correctly it is important that you act to change it immediately as every day erodes your interest deduction. The man to talk to about this is Don Sutherland as he understands what loans are appropriate, what loans you will qualify for and best of all his services are free. Contact our office or Don direct on his mobile 0414 246 821. Don can see you at our Ningi office or in your own home if you prefer.

The ATO has released practice statement PS2001/6 which reinforces the importance of keeping diaries to substantiate claims, whether you are a wage earner or in business. Diaries should be kept for one month every year. They are necessary when an item has both business and private use. The diary must record both the business and private use. Examples of expenses that this ruling could apply to are telephones, computers, photocopiers, etc. A record should also be kept as to the number of hours an office is used for business.

The ruling points out that a deduction is allowable only where additional running costs are incurred. For example if the family room is also used as an office there would be no deduction for the electricity to light the room if the room was also being used, at the same time, by family members to watch TV.

©Copyright Australian Property Investors Network (APIN)

investment loans

Claims for non variable expenses such as rent, mortgage interest and rates are only deductible if you business fits the definition of a place of business. Due to a recent case one of the main deciding factors is whether clients or customers regularly visit the premises. Note this is not decisive as you home can still be a place of business without seeing clients or customers there but you would have to be strong on the other points which are:

- Whether the area is clearly identifiable as a place of business
- Whether the area is not readily suitable or adaptable or use for private or domestic purposes
- Whether the area is used exclusively or almost exclusively for business purposes
- The essential nature of the area and the nature of the taxpayer's business

Note you may not wish to have your home considered a place of business, as this will make it subject to capital gains tax. So this is only beneficial if you are renting or purchased the house before 19th September, 1985. Claiming electricity, depreciation of equipment and telephone will not trigger capital gains tax.

tax deductions for small investors

Contrary to claims made by many Investment Advisers, the fee they charge for the initial drawing up of an investment plan is not tax deductible. Only ongoing fees for monitoring your portfolio are deductible according to TD95/60.

Fees paid to a registered Tax Agent in regard to taxation advice are always deductible under Section 69. But this does not include the preparation of an investment portfolio by a registered tax agent.

Travel expenses incurred in maintaining your portfolio are deductible (IT39) but if there is also a private motive the expense will need to be apportioned. This can include meals when away from home overnight, accommodation and transportation. If claiming less than 5,000km for a motor vehicle, it is most likely that the kilometre method will give you the best deduction. All this requires is a detailed reasonable estimate of the kilometres being claimed. But you must own the car.

Investment magazines and papers such as the Financial Review are deductible providing there is no private use (Case T96). Less specific publications such as the Courier Mail are less likely to be deductible because it is difficult to prove there is no private use.

Interest paid on a loan where the money borrowed was used to buy an income producing investment is deductible. It is a very strict condition that the money borrowed must have been used to purchase an income producing asset. It is not acceptable to use your own funds for the purchase then take out a loan because you want your "own funds" back for a holiday etc. Some banks offer offset accounts to help you overcome this problem. But be careful to check that the offset is dollar for dollar, not 3% interest on your savings offset against 5% interest on your loan. ANZ One is an excellent offset account. Borrowing costs are deductible over the lesser of 5 years or the term of the loan. This includes mortgage insurance when it is a condition of the loan.

Some financial institutions offer mortgage shifting accounts that link your investment loan and your house loan. Allowing you to concentrate all your repayments towards the housing loan, including income from the investments, while the investment loan interest compounds. In a short period of time the debt is shifted from the home loan to the investment loan on which interest is tax deductible. The Commissioner of Taxation has stated 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 compounded interest. This ruling has been partly validated by Harts case.

©Copyright Australian Property Investors Network (APIN)

bad habits

Did you know that, if, instead of consuming the following items over a 25 year period you invested the money on a monthly basis in a well diversified growth portfolio you would achieve the following returns plus tax credits depending on the performance of the portfolio:

Bad Habit	Avg 9%	Avg 12%
20 packets of cigarettes per month @ $8	$181,000	$304,000
A monthly subscription to cable TV @ $45	51,000	85,000
Buying your lunch on weekdays say 22 days per month @ an increased cost per day of $4 compared with bringing it from home	99,000	167,000

It is the small but regular expenses that really cost in the long run. Likewise a small but regular investment that compounds will really add up over time. If you expect your working life to be 40 years and you don't buy your lunch too often and invest the money instead you could have between $417,000 and $1,050,000 at the end of your working life. So by not buying your lunch and investing the money you could have over a million dollars when you retire if your portfolio averages 12%pa.

tax minimisation schemes alert

The ATO is investigating these schemes. More information is available on its web site:

ATO scheme investigation
The ATO has issued PS2001/15 which outlines the features of a scheme that would cause them to investigate the scheme, these are:

1. Artificial and contrived arrangements with little or no underlying business activity.
2. A significant part of the return on investment in the arrangement stems from tax benefits.
3. Little or no risk.
4. The transfer of a tax benefit in a contrived fashion.
5. Limited or non-recourse financing associated with a round-robin flow of funds.
6. Little cash outlay associated with borrowing of funds under a capitalising debt facility.
7. The investor can exit the arrangement or it is wound up before a profit is generated.
8. Assets over valued resulting in inflated deductions.
9. Use of tax exempt entities such as charities to launder income.
10. Use of tax haven countries.

This is a new segment for the lead up to the 30th June when all the tax minimisation schemes start to come out. Each month we will check the ATO web site for a list of the schemes the ATO is currently investigating and publish them. This month the ATO has listed home loan unit trust arrangements. Typically these would involve the family home being owned by a family trust and rented back to the family. The property would effectively be negatively geared by the family borrowing to invest in the units of the trust. The trust would use the proceeds from the sale of its units to buy the family home. After paying all the expenses associated with the home and claiming a deduction for depreciation the trust would distribute a profit to the unit holders against which they would be able to claim the interest on their loan, which would be more than the income. This loss can then be offset against other income, including wages income, of the family.

Please note, a scheme listed under the alert is only being investigated by the ATO they may still approve of the scheme. On the other hand just because a scheme isn't listed under the alert doesn't mean they have approved it. It is safer not to enter into any scheme unless it has a product ruling from the ATO.

©Copyright Australian Property Investors Network (APIN)

This month the ATO web site has list the following schemes it is currently investigating:

1. Arrangements to access superannuation before 55. For example, you roll your superannuation over into a self-managed fund which invests the money offshore and then lends it back to you. There are considerable fees involved in this arrangement and you still have to pay the interest on the money.
2. The movement of franking credits from one taxpayer to another. There are considerable fees involved and there are provisions in the Tax Act preventing the trading of franking credits which may catch this arrangement.

Please note a scheme listed under the alert is only being investigated by the ATO, they may still approve of the scheme. On the other hand, just because a scheme isn't listed under the alert doesn't mean they have approved it. It is safer not to enter into any scheme unless it has a product ruling from the ATO.

Franking Credit Trading

Taxpayers are offered shares that are cum dividend with an option to sell them straight back to the promoter once the dividend has been paid. Loans are also available to cover the cost of the shares and a transaction fee is charged (claimed to be tax deductible) to cover the cash portion of the dividend. The lender has control of the shares as security for the loan. The taxpayer declares the dividend and the franking credit as income but has a corresponding deduction for the transaction fee to offset the dividend. Therefore the only increase in taxable income is the value of the franking credit and the taxpayer gets the advantage of the full offset of that credit.

Prepaid Service Warrants for Wealth Creation Seminars

More information is available on www.ato.gov.au under Aggressive Tax Plan for investors, entitled: Prepaid Service Warrants for Wealth Creation Seminars

A taxpayer creates a loss for the current year by prepaying for service warrants that are redeemable for the provision of financial and wealth creation seminars or refundable if not used. Further, the prepayment is financed by a loan from the service provider. If the warrants are cashed in for a refund in the next financial year they are assessable income but this is a method of shifting income from one year to the next. To fully utilise this scheme you cannot be in business – refer prepayment rules in Newsflash 37 and the expense must be incurred in respect of investment income otherwise Division 35 could prevent loss from being offset against other income.

If the service warrants are cashed in I feel the ATO would have very little trouble applying Part IVA as it would become nothing but an artificial arrangement.

©Copyright Australian Property Investors Network (APIN)

investors making PAYG instalments

Many investors who know they will have to pay tax on their investment income that also have wages income have asked their employer to take more tax out of their pay packet to cover themselves against a tax bill at the end of the year. This worked well under provisional tax but will not work at all under the new PAYG regime.

Section 45-340 of the Tax Administration Act requires the ATO, when calculating how much tax you will pay on your wages, to look at the wages you earned in the previous year and work out how much tax would be payable on that figure. There is no provision in the calculation to take into account the fact you are making extra payments in your pay nor is there any way you can have that taken into account.

What is happening this year is that taxpayers have been paying the tax all year in their wages and when they make their annual PAYG instalment about this time of year they are paying the tax again. When they do their income tax return they will get the extra payment back as a tax refund but in the meantime things may be tight.

The best remedy is to stop your employer taking the extra tax out and put it aside for next year's annual PAYG instalment. If you really can't afford the double tax payment this year you will have to vary your PAYG instalment. This can be achieved by ringing the ATO on 132861. But be careful, if you are out by more than 10% you will be fined.

deductibility of interest

Interest on a loan is tax deductible when the money borrowed is used for income producing purposes. Case J54 (1958) 9 TBRD established the principle that interest is apportioned according to the ownership of the investment purchased. Accordingly, a couple can borrow money jointly for an investment that is held in the name of just one member. The whole amount of the interest attributable to the investment will be deductible to the partner in whose name the investment is held.

sold your business or investment but still have a debt?

Two recent cases (Namely Jones 2002 ATC 4135 & Brown 99 ATC 4600) opened the door for interest to be claimed on a loan after the business or investment it related to ceased to be owned by the taxpayer. Providing you use the proceeds of the sale of a business and all its assets or the sale of the investment to pay off a loan in relation to it, any further amounts are outstanding will continue to be tax deductible. The deductibility status will be compromised if the loan is acted upon in anyway that is seen to preserve it beyond reason. But it is ok to refinance the loan into repayments you can afford or in order to secure a lower interest rate.

Now, you may have realised that division 35 (non commercial businesses) may effectively quarantine this deduction anyway but, the ATO web site states that as the business has ceased and Division 35 only applies to businesses, it will not prevent this ongoing deduction. As the business has ceased the interest should be claimed at D13 rather than in a business schedule. Note Division 35 does not apply to loans for rental properties and shares if they are not considered to be a business.

©Copyright Australian Property Investors Network (APIN)

reader's question

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. 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 our Miscellaneous Small Business booklet. But all you really need to know is that Division 35 will not stop you claiming the interest.

self managed superannuation funds

If you have over $150,000 in superannuation, a self-managed fund can be a viable option. Not only does a self managed fund allow you to have more say in how your superannuation is invested but it also gives you considerable flexibility when you retire. For example, if you buy an annuity with your superannuation the amount invested in the annuity is not taken into account for the pension asset test. The problem normally with this strategy is if you die earlier than the statistics say you should, the superannuation fund holding your annuity gets a windfall and your heirs get nothing. There are some safeguards such as a residual pension going to your spouse if he or she out lives you and some annuities offer a safety net payout to your family if you die very early in the policy. A better solution to betting against your life expectancy is to setup the annuity through your own superannuation fund and make your heirs members of that fund. If you die early your heirs receive the residual as they are the only other members of the fund.

secret plans and clever tricks

The rebate for making super contributions for your spouse is $540 if you contribute $3,000, providing your spouse's assessable (not taxable) income is under $10,000 (shading provisions apply after that). If your spouse is retired from the workforce and over 55 years of age, he or she will be entitled to draw all that money straight back out. Effectively netting you an 18% return on an overnight investment. Note if your spouse has never held paid employment they will have to wait until they are 65 years of age. Spouse super contributions can only be made until the spouse reaches 65 years of age. The rebate is only available to offset tax so if your taxable income is too low to pay tax this will not benefit you.

©Copyright Australian Property Investors Network (APIN)

non resident with Australian investments

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 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.

The carried forward losses described above are reduced by any exempt income received (section 36-10) but section 36-20 states that this does not include income made exempt by Section 128B - refer next paragraph.

If a non resident has interest, dividend or royalty income with an Australian source it will only be subject to Australian withholding tax and as a result will be excluded from an Australian income tax return. Note dividend withholding tax rates are 30% for residents of countries with no double tax agreement and 15% for countries with a double tax agreement but if the dividend is franked the withholding tax rate is effectively zero. Section 128B.

Note if you are a non resident there is no point in negatively gearing any interest, dividends or royalties (other than considerations unique to your country of residence) as the withholding tax is calculated on your income before deductions and these deductions would not be claimable in your Australian tax returns as the corresponding income is excluded under 128B so there would be no link of cost of earning income under section 8(1) of the 1997 Act.

A non-resident may also be liable for tax on a capital gain arising from a CGT event that occurs in relation to an asset that is "connected with Australia", even if the gain does not have an Australian source. But shares in an Australian public company or units in an Australian public trust where your controlling interest is less than 10%, are not subject to CGT in Australia as they are not included in the definition of "connected with Australia".

©Copyright Australian Property Investors Network (APIN)

becoming a non resident of Australia for tax purposes

IT 2650 examines the relevant factors in depth. Generally if a person leaves Australia for more than two years and sets up a home in another country they will be considered not to be a resident of Australia for tax purposes right from the time they leave Australia. Note it is possible to become a resident of more than one country at the same time.

Upon becoming a non resident of Australia ITAA97 section 104-160 deems a capital gains tax event to have occurred. This is that you are considered to have disposed of all your assets that are not "connected with Australia" and acquired after 19th September, 1985, at their market value. Accordingly, you will be subject to capital gains tax on any increase in value over their cost base. The following is a list of assets "connected with Australia":

1. Land, buildings and structures in Australia
2. An interest or right in land in Australia
3. A strata title flat or home unit
4. A share in a company that owns 1, 2 or 3 above and gives the shareholder the right to occupy.
5. An asset that has been used by its owner at any time to carry on business through a permanent establishment in Australia.
6. A share in a private company that was a resident of Australia when the share was sold.
7. An interest in a trust that was a resident of Australia when the interest was sold.
8. A share in public company that was a resident of Australia when the share was sold and the non resident and associates had control over more than 10% of the shares at any time during the last 5 years.
9. An unit in a unit trust that was a resident of Australia when the unit was sold and the non resident and associates had control over more than 10% of the units at any time during the last 5 years.
10. An option or right to acquire any of the above.
11. Various provisions associated with rollover relief.

But Section 104-165(2) gives you the option of ignoring the capital gain accrued when you leave the country but this will effectively mean you are taxed on any gain while you are a non resident. The options offered by Section 104-165(2) are:

1. Defer the CGT and pay it when the asset is sold but the tax will be on the gain over the whole period up to the sale including when a non resident.

or

2. Defer the CGT on the basis you will be returning to Australian Residency before you sell it but when you do sell there will be no exemption for the gain made while you were a non resident.

So the choice is pay the tax when you leave and be free of Australian tax on any gain you make while a non resident or defer the tax but widen the period of time you are exposed to Australian capital gains tax.

As your home will be an asset "connected with Australia" you will not be deemed to have disposed of your home by 104-160 if you decide to keep a home in Australia to return to and go overseas for longer than 2 years and lose your residency for tax purposes. But note you will have to elect for it to be your main residence otherwise section 118-192 deems there to be a disposal anyway, if it is first rented out after 20th August 1996. If you elect for it to be your main residence but rent it out during you absence the exemption will only last 6 years unless you move back in again. You will qualify for another 6 years each time you move back in. If it is not rented out the exemption from CGT is unlimited. Section 118-145. Note the disposal deemed by section 118-192 does not trigger a capital gain if the house had always been your main resident during the time you owned it but it will start the clock ticking on any gain from that date forward.

You may also have trouble if you are the trustee of your self managed superannuation fund as the trustee needs to be a resident.

©Copyright Australian Property Investors Network (APIN)

interest, dividends and rent when overseas

This all revolves around whether you are a resident of Australia for tax purposes. Note you can be working overseas and being taxed on the wages you earn in that country by that country. But if you are still a resident of Australia for tax purposes Australia gets to tax your Interest, Royalties, Dividends and Rent from anywhere in the world. It is only your wages earned overseas and that meet the requirements of 23AG i.e. 91 days work, that are exempt in Australia. The interest on the overseas bank account, that your overseas wage is paid into, is taxable in Australia even if the wage isn't. Whether you are a resident of Australia for tax purpose is a question of fact but a big deciding factor is whether you have gone overseas for a period of less than 2 years.

If you are not considered a resident of Australia for tax purposes then you are not taxed by Australia (other than withholding tax) on your interest, royalty or dividend income that has a source in Australia but you are still taxed in Australia on your rental income if the property is in Australia.

Note if you make a capital gain on an asset "connected with Australia" you are subject to tax on that gain in Australia whether you are a resident or not.

©Copyright Australian Property Investors Network (APIN)
ebook-Investors Booklet
www.apin.com.au

non residents and capital gains tax

Non residents are subject to tax on capital gains made on assets that are "connected" with Australia ITAA97 Section 136-10 if the assets were acquired after 19th September, 1985. But if the Australian assets are actually owned by a non resident company the capital gains tax will not apply. Note the Ralph Review suggested closing this loophole. To be "connected with Australia" (section 136-25) the asset must be:

1) Land, buildings and structures in Australia
2) An interest or right in land in Australia
3) A strata title flat or home unit
4) A share in a company that owns 1, 2 or 3 above and gives the shareholder the right to occupy.
5) An asset that has been used by its owner at any time to carry on business through a permanent establishment in Australia.
6) A share in a private company that was a resident of Australia when the share was sold.
7) An interest in a trust that was a resident of Australia when the interest was sold.
8) A share in public company that was a resident of Australia when the share was sold and the non resident and associates had control over more than 10% of the shares at any time during the last 5 years.
9) An unit in an unit trust that was a resident of Australia when the unit was sold and the non resident and associates had control over more than 10% of the units at any time during the last 5 years.
10) An option or right to acquire any of the above.
11) Various provisions associated with rollover relief.

Accordingly, a non resident will not be subject to capital gains made on shares in Australian public companies or trust if they control less than 10%. But will be subject to CGT on the sale of a house or home unit unless they are utilising the exemption available under section 118- 145 because they have lived in it.

Note some double tax agreements can contradict the above and if so the double tax agreement has authority over Australian tax law.

A non resident is entitled to the 50% capital gains tax discount if they have held the asset for more than 12 months.

©Copyright Australian Property Investors Network (APIN)

residents of Australia with overseas investments

Note this also covers Australian Residents for tax purposes that are overseas at the time, even if they are working temporarily overseas and even if their wages income is exempt under section 23AG.

Dividend Royalty and Interest Income from Investments Overseas – Under our double tax agreements this should be subject to withholding tax in the country it is earned. Nevertheless, the full amount you have earned before the withholding tax was deducted should be included in your Australian tax return as foreign income with the withholding tax shown as foreign tax credits.

Rental Properties – If your net rent income is taxed in the country the property is located in you are entitled to a foreign tax credit for any tax paid. Your net rent income is determined according to Australian tax law and included as foreign income in your Australian tax return. Section 43 depreciation is available for buildings, alterations etc which began after 21st August, 1990 section 43-20(1) or 26th February, 1992 section 43-20(2).

The foreign tax credit can only be used to offset tax payable in Australia on foreign income of that particular class but unused tax credits can be carried forward and used to cover future foreign income of the same class. Interest income is in a different class to other passive incomes.

There is no point in negatively gearing any overseas investments (other than considerations unique to the country you have invested in) unless you have other foreign income the same class to offset the loss against.

Residents of Australia will be subject to capital gains tax on any assets acquired after 19th September, 1985 unless the applicable double tax agreement specifically excludes this. The 50% discount is available if the asset is held for more than 12 months. For the purposes of the tax return this amount is recorded as capital gains not foreign income. A capital loss is not quarantined as foreign income is, a foreign capital loss can only be offset against capital gains but they can be Australian or foreign. Capital losses have special offset rules refer IT2562. In short this allows foreign capital losses to be offset against Australian capital gains first thus maximizing any other foreign capital gain and so maximising the opportunity to utilise the foreign tax credits from the foreign capital gain. If you are entitled to a credit for foreign tax on your capital gain your tax return will need to be lodged manually with a note detailing this as there is no facility within a normal tax return to record the credit.

Australian residents and foreign losses

Foreign losses that cannot be offset against foreign income in the year incurred can be carried forward and deducted against foreign income of the same class in future years. The four classes are interest income, passive income that is not interest, offshore banking income and all other assessable foreign income.

A capital loss is not quarantined as foreign income is, a foreign capital loss can only be offset against capital gains but they can be Australian or foreign. Capital losses have special offset rules refer IT2562. In short this allows foreign capital losses to be offset against Australian capital gains first thus maximizing any other foreign capital gain and so maximising the opportunity to utilise the foreign tax credits from the foreign capital gain.

Unlike other partnership losses that are automatically transferred to the individual partner, foreign losses made by a partnership are quarantined to be offset against only foreign income of the same class only earned by the partnership (TD 92/113).

If you are offsetting a foreign loss against foreign income you are only permitted a tax credit for the amount of foreign tax that would have been payable on the net amount. But this is not the case with Capital losses which have special offset rules refer IT2562.

©Copyright Australian Property Investors Network (APIN)

Non Resident For Tax Purposes:

1) Subject to normal income tax at non resident rates on wages earned in Australia and investment income earned in Australia that is not subject to withholding tax or imputation credits.
2) Subject to capital gains tax on gains made on assets "connected with Australia"
3) If an Australian resident becomes a non resident they have 3 choices as to how they deal with their assets that are not "connected with Australia" and were acquired after 19th September 1985.
   a) Deemed them to have been disposed of when they leave and pay the CGT. As a result no Australian CGT will be payable on any gains while a non resident
   b) Defer the CGT and pay it when the asset is sold but the tax will be on the gain over the whole period up to the sale including when a non resident.
   c) Defer the CGT on the basis you will be returning to Australian Residency before you sell it but when you do sell there will be no exemption for the gain made while you were a non resident.

Residents For Tax Purposes That Are Overseas:

1) Under certain conditions overseas employment income exempt from tax in Australia but taken into account in determining tax bracket.
2) Subject to normal income tax at resident rates on interest, royalties, dividends and rental income no matter where in the world it was earn. But entitled to a credit for any foreign tax paid.
3) Subject to capital gains tax on any gains made on any assets anywhere in the world. But entitled to a credit for any foreign tax paid.

Note:: All of the above is written for the small investor not companies or trusts and there are more complex rules if you have a significant investment in a foreign entity.

warning when settling property on divorce

The following only applies if the assets subject to the settlement belong to a company. It is a horrible combination of Div 7A and the CGT roll over relief provisions. Section 126-5 applies rollover relief if there is a court order or section 87 maintenance agreement under the Family Law Act, corresponding foreign family law or a state or territory or foreign law relating to defacto marriage breakdowns. This is not an option but an unavoidable consequence unless you transfer the property before the court order.

The transfer of the asset out of the company into the hands of the spouse may create a debit loan account and if the transferee spouse is a shareholder, or not yet an ex spouse of a shareholder so considered an associate of a shareholder of the company division 7A would then apply. A dividend would be deemed to have been paid to the extent of the loan or the undistributed profits held by the company (note the legislation specifies undistributed surplus which has a much wider meaning than profits but I am trying to keep this simple).

The gravity of the ramifications varies depending how the company originally got its funds to invest. If the original investment was made by the shareholders loaning the company the money then there may still be a credit loan account to offset at least part of the debit loan account created by the transfer of the asset. How much is offset depends on whether all the assets originally purchased are transferred out. If the original investment was funded by buying a large number of shares in the company there would not be a credit loan account to offset and this is where there is more likely to be a large deemed dividend.

©Copyright Australian Property Investors Network (APIN)

A deemed dividend under Division 7A cannot be franked with imputation credits for the tax the company has already paid on the undistributed profits. So to keep the example simple lets say there was $70 in undistributed profits and the transfer of the property to a spouse who was also a shareholder created a debit loan account of at least that much. Because the undistributed profits are less than the debit loan account the deemed dividend is only the amount of the undistributed profits. To have that $70 in undistributed profits the company must have earned $100 and paid $30 in tax. Then as a deemed dividend to a shareholder in the maximum tax bracket the $70 would attract another $33.95 in tax. So the original $100 would have incurred $63.95 in tax. In reality this means you probably have had to sell the asset to pay your tax bill and only got close to half of the property settlement that the courts credited you with.

Some relief may be gained by declaring a dividend that reduces the undistributed profits to zero. All shareholders of the same class must received the same dividend.

There is much more than this. Section 126-15 deals with how the cost base of the company shares and any loans to the company are affected. Further there may be FBT concerns if either of the spouses have been employees of the company, for example having to pay interest on the debit loan account created by this nightmare. The legislation leaves more questions than it answers and unfortunately has not yet been tested in the courts.

I apologize that I have not been able to put the above into my usual user friendly form as it is a complex issue with problems specific to the facts of each case. I have printed this article because all too often property settlements do not take the tax ramifications into account and as a result one party can be considerably worse off than they expected. The main message I want to get across, is, that if you are settling property that is held within a company make sure a tax specialist is involved in the decision and refer them to the sections quoted above. Secondly think twice about investing through a company. If you are just doing it for the lower tax bracket a self managed superannuation fund maybe the way to go. Though they have their own set of problems which will be addressed in a future edition.

capital protected loans - ATO loses - Govt changes law

In Firth v Commissioner of Taxation the court ruled that additional interest charged on a loan because of the loans capital protection features was still deductible as interest. The ATO argued that protecting the underlying investment was a capital cost and only part of the interest was tax deductible. The ATO was refused leave to appeal to the High Court. So now the Government will change the law to ensure that only part of the interest will be deductible. This is not law yet but the Government has announced it will apply retrospectively to loans, that incorporate capital protection, entered into on or after 9.30am 16th April, 2003.

An example of a loan that the above would apply to, is a limited recourse loan facility used to purchase an investment but the investor would have the choice of giving the investment to the lender in full satisfaction of the outstanding balance of the loan regardless of the current value of the investment.

The ATO in the past has issued product rulings saying that the capital protection portion of the interest is not deductible. It would appear that those rulings may not be binding on arrangements made before 9.30am 16th April, 2003.

©Copyright Australian Property Investors Network (APIN)

budget report 2003

The following is a summary of the Income Tax parts of the budget report that would be relevant to our client base:

Low Income Rebate – has been increased from $150 to $235 and now it won't start to shade out until income exceeds $21,600. There is no entitlement to the rebate when income exceeds $27,475. This means that if your income is under $7,382 and you are a resident and not a minor you will not have to pay any income tax.

SATO- The Senior Australian Tax Offset will be increased so that single people over age pension age will not pay tax or Medicare if their income is under $20,500. Couples who are both over age pension age will not have to pay any tax or Medicare if their combined income is under $33,612. But note to achieve this both members of the couple must have exactly half of the $33,612 in taxable income each. Any unevenness will result in the higher income earner losing part of his or her low income rebate and their spouse being unable to utilize all of their's.

APSI – Taxpayers caught by the Alienation of Personal Services Income rules will be entitled to offset any losses left in their interposed entities, against their personal income. This concession is back dated to 1st July, 2000 when the APSI legislation first took effect. An abnormality with FBT has also been removed retrospectively to 1st July, 2000.

Medicare- The threshold at which a low income earner has to pay no levy for the 2002/03 year is $15,062 or individuals and $25,417 for families stepped up by $2,334 for each child. But note after this point it cuts in at 20 cents in the dollar.

Tax Thresholds – from the 1st July 2003 the resident income tax thresholds have increased (therefore tax decreases) as follows – note the rates do not include the Medicare levy:

0	to	6,000	No Tax Payable
6,001	to	21,600	17%
21,601	to	52,000	30%
52,001	to	62,500	42%
62,501	and over		47%

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.

©Copyright Australian Property Investors Network (APIN)

realising capital losses to offset a capital gain

A reader has made a large capital gain. He has made some paper capital losses on some shares but 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 wants 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 be expected that it would not be affected by Part IVA".
>
> "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."

In TD 95/4 the ATO states:

> "Of itself, the simple disposition of an income producing asset by a natural person to a wholly owned private company is not an arrangement to which the Commissioner will seek to apply Part IVA of the Income Tax Assessment Act 1936 (the Act)."

how franking credits affect investment yield

When you are considering the rate of dividend return you receive on an investment the franking credits should be taken into account. For example assume you purchased shares in A Limited for $100,000 with the expectation that the cash dividend you would receive would be 5.5% and you borrowed the $100,000 at 6.5%. Don't assume that you would have to top up an interest only loan for the other 1% over and above what you receive in dividends. If the dividends are fully franked the whole arrangement will be cash flow positive after you have completed your tax return. Let's assume you are in the 31.5% tax bracket. The dividend would be $5,500 in cash plus $2,357 in franking credits. Your tax calculation would be as follows:

Assessable Income	$7,857
Less Interest	$6,500
Taxable Income	$1,357 x 31.5% tax = $ 427
Less Franking Credits	$2,357
Tax Refund	$1,930

If you are getting a 5.5% cash dividend return that is also fully franked you are really getting a 7.857% return before tax.

the financial services reform act

©Copyright Australian Property Investors Network (APIN)

You have probably heard that the Financial Services Reform Act was going to restrict the activities of Accountants. Little by little the Accounting Profession has been whittling away at these restrictions but the government wouldn't budge on one area. The Act still prohibited Accountants to advise their clients whether they should set up their own Self Managed Superannuation Fund (SMSF). If Accountants wanted to give this advice they would have to be registered under the Act. This wasn't a great problem in itself it was just that once they became registered under the Act they were required to prepare a financial plan for the client before they could give any advice. This would mean that clients were looking at a bill of about $500 to be told whether or not they should have a SMSF.

The government has relented and permitted Accountants to advise clients whether they should have a SMSFs but they are not permitted to advise on how the funds should be invested. This is fair enough as at that stage of the decision making process it is worth paying for a financial plan.

arranging to make interest payments in advance

Investors who pay the bank next year's interest before 30th June, 2004 can claim the amount as a tax deduction this financial year.

The deductibility of prepaid interest, paid by an individual taxpayer in respect of a rental property for a period not exceeding 12 months is not subject to special timing rules under section 82 KZM of the ITAA 1936 according to ID2002/939.

Taxpayers who have a loan for a rental property or shares can make up to 12 months interest payments in advance and qualify for a tax deduction at the time the repayments are made. Be careful that the ATO cannot argue that it was really a repayment of capital. Make sure the arrangement with the bank is that the payment is interest. Simply putting the money into the loan account will not work as the bank will treat that as a repayment of capital. You must not make an advance payment for a period in excess of 12 months or the whole amount will only be able to be claimed in the period the interest is applicable to not when paid. Businesses do not qualify for this concession unless they elect to enter the simplified tax system. If your business is in the simplified tax system you may want to consider making 12 months lease payments in advance also.

As this arrangement is only moving tax deductions from next year into this year it could work against you if you are in a higher tax bracket next year than this year.

©Copyright Australian Property Investors Network (APIN)

children's investment income

Last month the ATO released a fact sheet on dealing with Children's investment income. It is very important to know the ATO's policy on this one because the law is such that parents or grandparents are technically liable for the tax on their children's investment income if they are trustee. In most cases they are trustee because the children being under 18 are not allowed to hold shares in their own name.

Accordingly, the parents can only rely on the ATO's guidelines as to when they will not exercise their absolute power to tax the parents.

Children are taxed on any passive income over $416 though they do qualify for the $235 low income rebate to offset some of that tax. When their passive income exceeds $416 but is less than $1,446 it is taxed at 66%. Any further income the child has over $1,445 is taxed at 47%.

Note there are concessions for income from the investment of an inheritance, compensation etc.

Considering the hefty tax rate applied to children's passive income it might be more important to find out how to arrange your affairs so that the parent is the one taxed on the children's income anyway.

The fact sheet is in regards to shares and basically states that the person who controls the shares and proceeds, is the person who should pay tax on them. So if the proceeds of the shares are held for the child then the child pays the tax and must lodge a tax return if their passive income exceeds $772 if there are no franking credits, or $416 if there are franking credits. A tax return will also need to be lodged if TFN tax has been withheld. If there are franking credits on the shares and the child's income is under $416 they can complete an application for a refund of franking credit form rather than lodge a tax return.

The ATO's opinion as to who is taxed on bank account interest can be found in IT2486, which examines where the money in the account came from and whether the parent uses the money. This is basically the same as the fact sheet on shares. Children with only interest income need to lodge a tax return if their income exceeds $772 or they have had TFN tax withheld.

Note both the fact sheet and the ruling make it clear that the more money in the account the more likely they are to consider it the property of the parent.

©Copyright Australian Property Investors Network (APIN)

gearing – don't forget the franking credit

The objective of negative gearing is to run an investment at a loss by the expenses associated with it such as interest exceeding the income, while you are in a high tax bracket. During this time the investment should be increasing in value but you do not sell until you are in a lower tax bracket. The 50% CGT discount also makes capital growth more attractive than income.

The trouble is some people investing in shares and managed funds are not doing their sums right because they forget that the franking credit is taxable. Generally if the investment is negatively geared it should be held in the name of the high income earner but if it is positively geared it should be held in the name of the low income earner. Another factor to consider is that if the negatively gearing is not that great, inflation may soon see it become positively geared, if all goes well. On the other hand there is the possibility of interest rates increasing but you would not expect this to be as great as inflation. If the investment becomes positively geared you are going to wish you purchased the investment in the low income earner's name but cannot transfer it across without incurring a capital gains tax bill. This scenario is not just a possible outcome but the outcome you are investing with the intention of achieving, so do not be short sighted when deciding whose name the investment should be in. You can't blame the average shareholder for misunderstanding as the rate of dividend return quoted always ignores the franking credit, at best you hear plus tax credits.

Crunching the numbers for $1,000 worth of positively geared shares that pay a fully franked dividend borrowing 100% of the purchase price:

Dividend @ 5% $50.00 Plus Franking Credit (Dividend/70x30) $21.40 Equals $71.40 Assessable Income

Less Deduction for Interest of $1,000 x 7%	70.00
Taxable Income	1.40

Owner Taxed at 48.5%		Owner Taxed at 31.5%	
Tax Calculation 1.40 x 48.5%	.68	Tax Calculation 1.40 x 31.5%	.44
Less Franking Credit	21.40	Less Franking Credit	21.40
Tax Refund	20.72	Tax Refund	20.96

On the other hand if the shares are negatively geared because they are only producing a 4% return:

Dividend @ 4% $40.00 Plus Franking Credit (Dividend/70x30) $17.14 Equals $57.14 Assessable Income

Less Deduction for Interest of $1,000 x 7%	70.00
Tax Loss to Offset against other income	12.86

Owner Taxed at 48.5%		Owner Taxed at 31.5%	
Tax Calculation 12.86 x 48.5%	6.24	Tax Calculation 12.86 x 31.5%	4.05
Plus Franking Credit	17.14	Plus Franking Credit	17.14
Tax Refund	23.38	Tax Refund	21.19

While the rate of return on the share price at the time might not change, inflation should increase the return in relation to the original amount borrowed. So if the investment is positively or slightly negatively geared but the dividends are expected to increase and the shares will be held for a long time it is better to hold the shares in the name of the low income earner. This will also be helpful when realising a capital gain.

©Copyright Australian Property Investors Network (APIN)

reader's question – travel to AGM

An investor can claim the costs associated with travel to an AGM. Including meals, accommodation, air fares and motor vehicle expenses. This is verified by the ATO in ID 2002/948 but with the condition that if the costs exceeded the dividend income the motive would be questioned and apportionment of the expenses maybe necessary unless it is clear that the sole purpose of the travel is in regard to the AGM.

capital gains tax and shares or managed funds

While capital gains tax (CGT) is not a death tax, it does impose a huge headache on the beneficiaries of your estate to find necessary information when you are not around to help them. The transfer of your assets to your heirs will not trigger CGT but when your heirs eventually sell the assets they need a cost base in order to calculate any CGT payable. The ATO can fine them if they do not have the appropriate records and they could end up paying a lot more tax than necessary.

To keep it simple!! I will just consider the costs base for shares and units in managed funds. The cost base is the original purchase price plus any reinvestments of dividends or distributions, brokerage fees and initial financial advice costs less tax deferred distributions or returns of capital. The capital gain or loss is the difference between the cost base and the selling price. It is helpful if you record the number of units or shares as any discrepancy between this total and the quantity sold will detect an error in the records. Documentation explaining any tax free distributions should be kept safe as they may also affect the cost base. If you have sold some of the parcel, your records should show how the cost base was calculated as this is relevant to determining the cost base of the remaining shares or units. In my experience you cannot always rely on your fund manager to keep for you the information you need to calculate your cost base. If the fund has been taken over the relevant records may no longer be available. The funds are under no obligation to provide this information. It is the owner of the asset, namely you or your heirs, that is required to keep the records necessary to calculate the cost base and liable for a fine from the ATO.

If the thought of having to dig up this information gives you the horrors imagine how difficult it will be for your heirs.

So what can you do to leave your estate in good order? Firstly acquire a big box and then start to do what I have been planning to do over the last 10 years. Include in this box a folder for each investment containing all correspondence. Just because some of the information provided on the taxation statement each year has been included in that year's tax return does not mean that is the end of it. Keep all statements and explanatory information, even if the fund claims the distribution is tax free.

©Copyright Australian Property Investors Network (APIN)

INVESTMENT NETWORKING

FOR YOUR
BUSINESS AND YOU

some **work** others **network**

learn how to
drastically advance **your financial future**
through property and personal investment

Australian Property Investors Network (APIN)

www.apin.com.au

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.

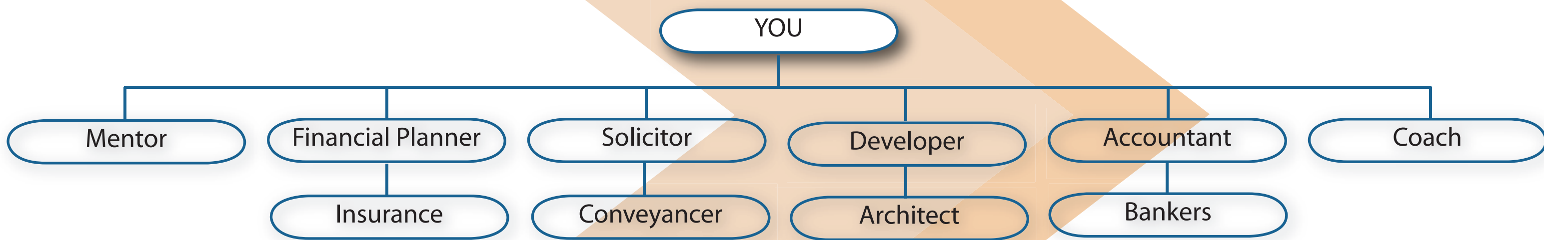
On going Support

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.