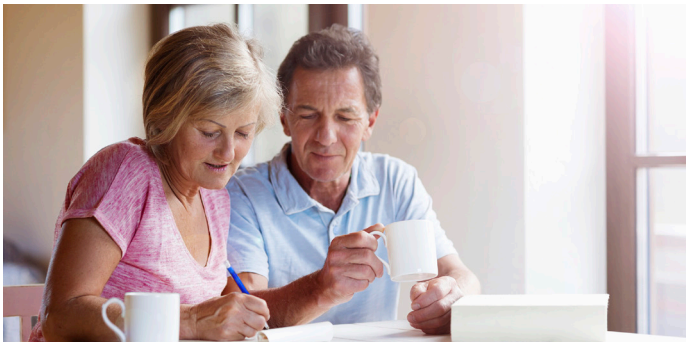


TAX MATTERS

TAX STRATEGIES FOR YOU AND YOUR BUSINESS

EDITION
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• How do franking credits work?



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ATO warns pre-retirees on SMSF tax schemes

The Australian Tax Office has its sights set on individuals participating in an increasing number of aggressive tax avoidance and retirement planning schemes in self-managed superannuation funds.

The ATO has launched Super Scheme Smart, an initiative designed to help inform individuals and advisers about illegal retirement planning schemes. The program is a result of an increase in schemes designed specifically to target those approaching retirement.

The Tax Office has noted individuals approaching retirement are most at risk, in particular, those aged 50 or over, looking to put significant amounts of money into retirement. Self-managed super fund (SMSF)

trustees, self-funded retirees, small business owners, company directors and individuals involved in property investment are also particularly at risk.

The schemes targeted typically involve a lot of paper shuffling; are complex and usually connected with a SMSF; are designed to leave the taxpayer with minimal or zero tax, or a tax refund, and aim to give a present day tax benefit by adopting the arrangement.

The ATO is targeting three schemes including:

- Dividend stripping: where shareholders in a private company transfer ownership of their shares to an SMSF so that the company can pay dividends to the SMSF. The purpose being to strip profits from the company in a tax-free form.
- Non-arm's length limited recourse

borrowing arrangements: when an SMSF trustee undertakes limited recourse borrowing arrangements (LRBA) established or maintained on terms that are not consistent with an arm's length dealing.

- Personal services income: where an individual (usually at pension phase) diverts income earned from personal services to an SMSF where it is concessionally taxed or treated as exempt from tax.

The ATO is urging individuals and SMSF trustees to come forward if they believe they are at risk or are already involved in an illegal scheme. In addition to severe penalties, individuals caught using an illegal scheme may risk losing some of their retirement nest egg and their rights as a trustee to manage and operate a self-managed superannuation fund.

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ATO crackdown on work-related expenses

The ATO is currently targeting work-related expenses by taking a closer look at unusual deductions and claims that are higher than expected.



The Tax Office will be looking for expense claims that are much higher than others who are in the same occupation and will be contacting employers to validate these claims.

When claiming work-related expense deductions, taxpayers must ensure that the expense is related to their job; they were not reimbursed for the money spent and have a record to prove it.

Here are some things to keep in mind when claiming deductions:

Car expenses

You can only claim a deduction if you use your own car in the course of performing your job as an employee. You cannot claim the cost of travel between home and work as it is considered private.

The ATO is focusing on the transportation of bulky tools as carrying unnecessary equipment is not a legitimate claim if equipment is already supplied.

Self-education expenses

You may be able to claim a deduction if your study is work-related or if you receive a taxable scholarship. A deduction cannot be claimed if a course does not have a sufficient connection to your current employment.

Internet and mobile phone expenses

If you use your own mobile phone or internet for work purposes, you may be able to claim a deduction. If you also use them for personal use, you will need to apportion the percentage that reasonably relates to work use.

Tax tips for property investors

Property investors can access a wide range of tax deductions and items subject to depreciation for their rental property yet many miss out on unknown tax breaks, foregoing an average of \$20,000 a year on a \$1 million house.

Here are five ways to maximise your tax deductions while complying with the tax office:

Use a quantity surveyor

Registered quantity surveyors can establish the value of purchased items and building construction costs by preparing depreciation schedules to maximise an investor's claim.

Items as diverse as kitchen equipment, bathroom fittings, outdoor furniture, air conditioning and swimming pools are all legitimate claims. A quantity surveyor will ensure valuations of the items in the building are at market value, avoiding the need to explain any valuations that are higher than expected to the ATO.

The cost of using a quantity surveyor is also tax deductible.

Apportion expenses

It is common for investors to bundle a mix of properties under one single loan, i.e. the family home and a rental property may be funded by the same mortgage and expenses apportioned accordingly. However, having separate loans can increase deductions as the non-deductible debt can be paid down or even better linked to an offset account, with the deductible loan having full interest paid and claimed.

Claim travel expenses

Travel to your rental property for management purposes can be claimed as an expense. If you combine your property inspection with a holiday, the tax office will require you to apportion the expenses between non-deductible private expenses and the costs that can be claimed.

Immediate write-offs

An immediate write-off applies to items worth less than \$300 and can be claimed in the current income year. Items such as garden gnomes, kitchen cutlery, ironing boards and irons are easily forgotten and all can be written off in the first year.

Depreciation

Construction costs can generally be depreciated at 2.5 per cent each year over 40 years for residential properties built after July 1985. This entitlement passes from one owner to the next whenever the property is sold. A quantity surveyor can provide an estimate if information is not available.

Many high value household items are now deducted using the "diminishing value method", which means the most depreciation happens in the first few years. For example, ducted heating worth \$4941 would have a first-year deduction of \$493, totalling \$2022 over the first five years.

Adding items such as solar lights, garbage bins, garden sheds, intercoms systems and closed-circuit television systems to a low-value pool can open up ways to depreciate items at a higher rate, therefore, increasing immediate returns.

How do franking credits work?

Franking credits are a kind of tax credit that allows Australian companies to pass on the tax paid at company level to shareholders.

Franking credits can reduce the income tax paid on dividends or potentially be received as a tax refund.

Where a company distributes fully franked dividends (and those dividends are included in the taxable income of the taxpayer) the taxpayer can claim a credit against their taxable income for the tax that has already been paid by the company from which the dividend was paid.

For example, an individual who owns shares in a company receives a fully franked dividend of \$700 from the company. The dividend statement says that there is a franking credit of \$300 (the tax the company has already paid). This means the dividend would have been \$1,000 (\$700 + \$300) before company tax was deducted.

At the end of the financial year, the individual must include \$1,000 (the \$700 dividend + the \$300 franking credit) in their taxable income.

The tax for an individual is calculated through their marginal tax rate; i.e. if their rate is 19 per cent they would have to pay \$190 tax on the dividend. But because the company has already paid \$300 in tax, the individual receives a refund of the difference, which is \$110.

Where the individual's tax rate is higher than the company rate, i.e. 32.5 per cent, the individual will not receive a refund but will receive a credit of \$300 against the additional \$325 in tax payable.