

"In Brief with Elite"

Vol. 7 - September 2006



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Welcome to the Spring 2006 edition of our quarterly newsletter. Contained inside this edition is information on superannuation changes with the proposed budget, capital gains tax implications, the importance of having a will and the child care rebate.

BAS time is here again and we ask you to collate your documentation and send it through to your client manager in order to have your BAS completed and lodged by the due date.



IMPORTANT DATES

August 2006 Monthly BAS/IAS

21 September 2006

September 2006 quarter BAS/IAS

Self Prepared 28 October 2006

EFS Prepared 11 November 2006

September 2006 Monthly BAS/IAS

21 October 2006

October 2006 Monthly BAS/IAS

21 November 2006

NEW STAFF

We would like to introduce the newest staff members who have joined the team at Elite.

Nathan Bolling - Accountant
Cassandra Bennie – Office/Financial Planning Assistant.

MARRIAGE BREAKDOWN – CGT IMPLICATIONS OF TRANSFERRING ASSETS

Are you involved in the transfer of assets as a result of a marriage breakdown?

There are special Capital Gains tax (CGT) rules that apply when assets are transferred between spouses in the unfortunate event of a marriage breakdown.

A CGT 'marriage breakdown rollover' may be available where assets are transferred between spouses when a marriage breaks down.

Where you transfer the asset [or a share of a jointly owned asset]:

- a. The capital gain or loss will be disregarded if the asset was acquired before September 20, 1985; or
- b. The marriage breakdown rollover will enable you to disregard the capital gain or capital loss you make if the asset was acquired on or after September 20, 1985.

Where the asset or a share of a jointly owned asset is transferred to you, you are also taken to have acquired the asset before September 20, 1985, if your spouse acquired it before that date.

The capital gain or loss will, therefore, be disregarded when you eventually sell the asset.

If, however, the asset or a share of a jointly owned asset was acquired by your spouse on or after September 20, 1985, you are taken to have acquired the asset at the time it was transferred from your spouse.

This is important in determining whether you may be able to use the indexation method or the discount method when calculating your capital gain or loss.

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The first element of the cost base of the asset will be the same as your spouse's cost base at the time of the transfer.

There are additional rules that apply in relation to:

- a. The main residence exemption
- b. Acquisition of a dwelling from a company or trust upon a marriage breakdown; and
- c. Superannuation interests.

MAIN RESIDENCE CGT EXEMPTION

A person's main residence will generally be exempt from CGT upon disposal.

A Tax Office fact sheet indicates that, in certain circumstances, the full exemption may not apply and only a partial main residence exemption may be available. This will occur when the taxpayer's partner and/or dependants have separate homes, part of the property has been used to produce assessable income, or the land area is more than two hectares.

As a general rule, a person is only entitled to the exemption on one property for any particular period. However, where a person purchases a new home before disposing of an old one, both dwellings may be treated as the person's main residence for up to six months.

DO YOU OWN OVERSEAS REAL ESTATE?

If you own real estate that is situated outside Australia, you must include the

rental income derived from the property in your Australian tax return.

The rental income is included in the foreign source income and foreign assets or property item on your tax return.

You may also be entitled to certain deductions on the property such as:

- a. Interest;
- b. Insurance;
- c. Real estate agent fees;
- d. Depreciation and deductions for capital works; and
- e. Rates

In addition, you may be entitled to a foreign tax credit if you paid foreign tax on the income you received from the property.

If you sell the overseas real estate, any gain or loss on disposal will be subject to Australian capital gains tax.

The capital gain or loss is included in the Capital gains item on your tax return.

You may be again also entitled to a foreign tax credit if you paid foreign tax on the capital gain.

CGT AND FOREIGN RESIDENTS

On 22 June 2006 the Taxation Laws Amendment (2006 Measures No. 4) Bill 2006 was introduced into the House of Representatives. The main amendment the Bill introduces is the treatment of capital gains tax (CGT) in the hands of foreign residents. The Bill aims to narrow the range of assets on which a foreign resident will be subject to Australian CGT, namely:

- Australian real property; and
- Business assets of a foreign resident's permanent establishment operating in Australia (not including Australian real property).

As an integrity measure, the Bill also applies CGT to the non portfolio interests of foreign residents operating through interposed entities. This is where more than 50% of the interposed entities' assets are attributable (whether directly or indirectly through one or more interposed entities) to Australian real property).

HAVE YOU INHERITED A DWELLING?

A capital gain or loss that you make on the disposal of a dwelling you inherited

is generally disregarded for Capital Gains Tax if you inherited the dwelling before September 20, 1985.

However, major capital improvements made to the dwelling after September 20, 1985, may be considered to be a separate CGT asset, and therefore taxable. Where a pre-CGT dwelling is used to derive assessable income, major capital improvements made to the dwelling after September 20, 1985, may be considered to be a separate CGT asset.

These improvements may, therefore, be subject to CGT in their own right when the dwelling is eventually sold.

An improvement is taken to be 'major' if the original cost [indexed for inflation] of the improvement is:

- a. Greater than 5% of the amount you receive when you dispose of the dwelling; and
- b. Greater than the 'improvement threshold' for the income year.

For the 2005-06 and 2006-07 income years, the improvement thresholds are \$109,447 and \$112,512 respectively.

The capital gain or loss on the major improvements is calculated by subtracting the cost base of the improvements from the proceeds of the sale that are reasonably attributable to the improvements.

WHY LEASE?

It is important that a business retains working capital and unused lines of credit for investment or other business opportunities.

Although Lease and Asset Purchase represent another type of financial commitment, in most cases additional security is not required.

Benefits of leasing

Cash-flow benefits

100% finance is available. Equipment that may not reach its full earning potential in the early years or generates

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income on a seasonal or irregular basis can be accommodated with a suitable repayment structure.

Known and fixed costs

Most Lease and Asset Purchase transactions are written on a fixed rate and fixed term basis, thus ensuring that the future borrowing costs will be known in advance. This permits more accurate profit planning and cash flow forecasting. Many business enterprises have been caught in the situation of making major capital equipment purchases using lines of credit or overdrafts that are not guaranteed to be available for any length of time.

Avoid inflation and currency risks

Fixed repayments/rentals provide a hedge against inflation and unfavourable exchange rate movements, allowing the purchase of equipment at today's prices.

Convenience

Most financiers have standardised documentation and a quick approval/documentation process to allow funds to be raised in a matter of days.

Partnerships/Joint Ventures

Leasing is a convenient way to share costs of equipment acquisition in a partnership or joint venture, thereby minimising the capital contributions of the partners. It can also simplify the accounting and taxation aspects of a partnership/joint venture.

What can be financed?

Assets used at least 51% of the time for business purposes ie to earn an assessable income.

Earthmoving equipment, fixed equipment, computers, printing press etc.

Furniture & Fittings: Professional office fit outs, demountable partitions, desks, and chairs

Vehicles includes passenger vehicles and small commercial vehicles which are able to carry less than a tonne

Vehicles (trucks, buses)

Planes

Type	Payments	Depreciation benefit
Finance Lease	Tax Deductible	Claimed by financier
Novated Lease	Tax Deductible	Claimed by financier
Rental Finance/Operating Lease	Tax Deductible	Claimed by financier
Asset Purchase	Interest portion is tax deductible	Claimed by you
Chattel Mortgage	Interest portion is tax deductible	Claimed by you
Fully maintained vehicles Operating and novated	Lease payments tax deductible Running costs pre tax nil FBT	Claimed by the financiers

What cannot be included in a Will

- Family Trusts - The trust deed of a family trust will be ultimate determinant of where assets will be distributed on the death of a trustee or beneficiary.
- Superannuation - Superannuation proceeds cannot be directly distributed via a will, as like a family trust the trust deed will make the determination.
- Life Insurance
- Exclusion clauses
- Testator Family Maintenance Claims

This can be the bane of any estate plan. Recently the laws relating to the concept of family maintenance have been significantly widened. Now anyone who has a relationship with you, be it financial, personal, blood or platonic can make a claim on your estate when you die if the Court considers you have not made adequate provision for them in your Will. A court order can significantly diminish the value of the estate. Through careful planning, these can be avoided to some extent as illustrated below.

Example

George and Jane are married with four children. George has been unfaithful having an affair with Judy.

As such Judy will have a claim over the estate should George exclude her or not offer her a reasonable amount.

Strategy

If George used his superannuation, as well as a family trust he would be able to effectively shield his assets, in order to protect the assets of his family.

What is intestacy?

Dying without a valid will. This can cause serious and unnecessary problems for your family or intended beneficiaries as legislation sets out how your estate will be distributed. In such cases the order of distribution may be completely contrary to what you would have specified if you had drawn up a will.

The absence of a will inevitably delays and increases the cost of the administration of your estate. A person mak-

WHAT IS A WILL?

What is a will?

A will is a legal document, which ensures that your assets are distributed after your death according to your wishes. It nominates the executor you have chosen to handle this distribution. If you are over the age of 18 (or any age if married) you can and should have a Will.

What can be included in a Will

Provisioning for children's education
Investment instructions - in cases where the willmaker is not confident in the investment ability of the executor, they can install their own investment strategy for the funds. This could include setting an asset allocation or funds or determining assets which cannot be purchased or sold.

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ing a will can assess the suitability of potential executors and can choose the most appropriate person to administer the Estate. The right to choose an executor is lost without a will. By making a valid will you have peace of mind knowing your estate will be distributed according to your wishes.

A MAJOR DISASTER

Tom and Anna are the owners of a company that operates four very successful cafes. Three of the cafes operate from strata retail premises owned by the company. The company has been built up to this stage over 12 years by the reinvestment of virtually all profits at the expense of Tom and Anna's personal lifestyle.

After years of living in rental accommodation Tom and Anna recently decided to purchase their own home, since they have negligible personal assets (other than their shares in the company). Their bank manager told them he would approve a loan for the required \$545,000 only if the company provided a guarantee for this personal borrowing. Tom and Anna agreed to this condition when he pointed out that no stamp duty cost would be involved since the assets of the company were already charged in favour of the bank to secure the company's small overdraft.

Tom and Anna went ahead with the purchase of their dream home.

Disaster! If Tom and Anna default on the loan they will be deemed to have received an unfranked dividend of \$545,000 from their company, resulting in a tax liability of \$253,425. To add insult to injury, the company's franking account balance will be reduced by \$545,000, possibly resulting in a franking deficit tax liability.

Believe it or not, this is the consequence of Division 7A of the [Income Tax Assessment Act 1936](#). Under Division 7A, a company guarantee in favour of shareholders is treated as a deemed dividend to the extent the

guarantee is called upon. It does not appear possible to undo the tax mischief that can be unwittingly created by the giving of a company guarantee.

Once again, neither ignorance of the provisions nor a lack of tax avoidance motives can be used to get Tom and Anna off the hook.

COMMON MISTAKES IN CLAIMING RENTAL PROPERTY DEDUCTIONS

The Tax Office has recently released a guide to help taxpayers claim deductions on a property they lease. The guide outlines common mistakes made on income tax returns, some of the more common of which are outlined below:

- Claiming the cost of improvements such as remodelling or adding sections to the property as repairs when these should be claimed as capital works deductions;
- Over-claiming deductions of interest where a loan was taken out for both private and income producing purposes.
- Claiming deductions for items that have been incorrectly identified as depreciating assets; and
- Claiming deductions on a property that is only available for rent for a portion of the year (ie a holiday house).

2005/06 MV CENTS PER KM RATES

The rates at which taxpayers may claim income tax deductions for the 2005/06 income year for car expenses, where the car does not travel more than 5,000 "business" kilometres during the year are as follows:

Description	Engine capacity of car not powered by a rotary engine	Engine capacity of car powered by a rotary engine	Rate per Kilometre (cents)
Small Car	Not exceeding 1600cc	Not exceeding 800cc	55.0
Medium Car	Exceeding 1600cc but not exceeding 2600cc	Exceeding 800cc but not exceeding 1300cc	66.0
Large Car	Exceeding 2600cc	Exceeding 1300cc	67.0

DO YOU UNDERSTAND THE CHILD CARE REBATE?

For taxpayers who receive the Child Care Benefit and meet the work/study/training test, the Government's Child Care Rebate will cover 30% of out of pocket child care expenses up to a maximum of \$4,000 per child. That is, for approved care, it will cover 30% of your fees less your Child Care Benefit.

Please note that:

- you can only calculate your out of pocket expenses once you know what is the correct amount of your Child Care Benefit.
- the claim for the rebate is made in the succeeding year's tax return.
- Your rebate for 2004-2005 will be claimed in the return for the 2005 – 2006 year.

If you do not have a sufficient tax liability to absorb the whole rebate you will be given the option of transferring any unused amount to your spouse. This will mean you have the opportunity to gain the maximum benefit possible.



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This means that it is important to keep your receipts for child care expenses paid in this current tax year ie 2004 – 2005. You should also check with your child care provider to see if they can provide you with an annual statement of expenses paid.

PROPOSED SIMPLIFIED SUPERANNUATION – FINAL DECISIONS

Subject to any applicable work test people will be able to make up to \$1 million of post tax contributions between 10 May 2006 and 30 June 2007 which will allow people to who were planning a large contribution under the existing rules to do so.

The \$150,000 annual limit on post tax contributions will commence from 1 July 2007. People aged less than 65 will be able to bring forward two years of contributions, enabling \$450,000 to be contributed in one year, with no further contributions in the next two years.

In addition to the above \$150,000 limit on undeducted contributions, people planning to make undeducted contributions still need to satisfy the relevant contribution rules, ie the age/work test for these aged 65-74.

For persons aged 65-74 years, a fund can only accept personal undeducted contributions in respect of a member who is 'gainfully employed' to at least a 'part time basis' during the financial year in which the contribution is made. An individual will be gainfully employed on a 'part time basis' where he or she has worked at least 40 hours in a period of not more than 30 consecutive days in the financial year in which the contributions are made.

Therefore, those approaching retirement should consider working at least the first 40 hours of a new financial year before retiring. This will effectively enable them to get an extra year's work of undeducted contributions (up to \$450,000) into the superannuation system.

The transitional provisions also require those approaching retirement at age 65 and over to carefully manage the way they use the three-year averaging provisions. When making the \$450,000 contribution you must meet the work test in the following two financial years.

In addition to the annual cap, people can contribute:

- a lifetime limit of \$1 million from the sale of small business assets which have been held for 15 years;
- and settlements for injuries resulting in permanent disablement.

The concessional amount of lump sum benefits from an untaxed source will be increased from \$700,000 to \$1 million.

Employer ETPs

From 1 July 2007 the Employer ETPs must be cashed out. However there is a transition payment for clients with employer ETPs specified in existing employment contracts at 9 May 2006, provided payment of the employer ETP is made prior to 1 July 2012, transitional rules apply.

Under the transitional rules, the ETPs can still be rolled into superannuation.

Treatment when taken as cash: exempt component will not be taxable. First \$140,000 of taxable component will be taxed at 15% (30% if under 55) between \$140,000 and \$1 Million will be taxed at 30%, and any amount over \$1 million will be taxed at the top marginal rate plus Medicare Levy (46.5%).

Rollover treatment: taxable amounts less than \$1 million will be a taxable contribution (15%) but will not count against the deductible contribution limit. Any taxable amount over \$1 million will be taxed at the top marginal rate plus Medicare Levy (46.5%) on rollover.

Please speak with Christine Hallows to ensure you take full advantage of proposed superannuation changes before its too late!

QUOTE OF THE QUARTER

"A cynic is a man who knows the price of everything but the value of nothing"

FINAL THOUGHTS

At Elite we thrive on minimising tax and maximizing our clients investments all under the one roof. We want our clients to succeed whether it be in business, in employment or in retirement.

Are you 50 years or older and planning to retire soon? Superannuation legislation is ever changing and currently there is a small window of opportunity to increase your superannuation. Take advantage of this now and speak with Christine. You too could be looking forward to a comfortable retirement.

We are passionate about helping our clients to achieve and maintain their financial and lifestyle goals. We believe in delivering this objective to every client that walks through our doors no matter how big or small.

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