Tax Things you can do …

Planning to keep tax at a minimum is an exercise that should be carried out throughout the year and not rushed at the end.

However to maximise your tax position for the 2014 year taking advantage of any benefits, below are some of the issues involved and some tax tips to help property investors save some more tax by better planning.

Contents

Rental Property Expenses- What you can and can't claim

It's not uncommon for landlords to be confused about what they can and can't claim for their rental properties. What often seems to make perfect sense in the real world does not always make sense for the Australian Tax Office (ATO).

In general, deductions can only be claimed if they were incurred in the period that you rented the property or during the period the property was available for rent. This means a tenant needs to be in property or you are actively looking for a tenant. If, for example, you don't put a tenant into the property so that you can renovate it, then you might not be able to claim the expenses during the renovation period if it was not rented or available for rent during this time (there are some exceptions to this general rule).

There needs to be a relationship between the money you make and the deductions you claim. Here are a few common problem areas:

Travelling to inspect your property

You can claim the cost of travelling to inspect your rental property. For example, if you fly interstate to inspect your property, stay overnight then fly home, you can claim the full cost of the trip. If however, the purpose of the travel is a holiday and the inspection is incidental to it, the trip is non-deductible except direct expenses and a reasonable portion of your accommodation.

Interest on bank loans

Only the interest on repayments for investment property loans, and bank charges, are deductible - not the actual loan itself.

Repairs & Maintenance

Expenses you incur for repairs and maintenance are deductible if the expenses relate to wear, tear, damage through rental activities.

If the repair improves function or if it replaces an entire structure (e.g. a whole fence as opposed to repairing damaged palings), it's unlikely to be deductible but will be capital and depreciated over time.

Rental income from overseas

If you are an Australian resident, the ATO looks at your worldwide income. This means that if you own rental property overseas, you have to declare any income earned in your tax return - even if you have lodged a tax return and paid tax on the rental income in the country where the property is located.

The risky business of dying

Why the death of your business partners can have dire consequences

Imagine this scenario…. Michael, James, and Nadine are shareholders in a successful business, MJN Solutions. The shares in the company are fairly evenly split reflecting the contribution that each has made to the business, with Michael and James each holding 35% and Nadine holding 30%. They have been working together for years to build the business to its current level. The business is now worth around $4 million and is still on a growth path. While no one is related to each other, everyone is close. They have had their disagreements but they trust each other and respect each other's ability. It's a fairly common scenario.

But one morning Michael and Nadine are shocked by a call from James' wife Monica, telling them that James has died in a car accident.

If you are in business with shareholders, your business faces a major potential threat and its shareholders unexpected personal costs, if one of your fellow shareholders dies or becomes permanently disabled. And, the situation can be exacerbated where the shareholders are not related.

Good planning through buy/sell agreements and appropriate insurance can make all the difference.

For many businesses, if no pre-existing arrangements are in place, the death of a shareholder can mean having an unknown person (the beneficiary of the shares) actively involved in the business or an unwilling shareholder. The alternative is for the original shareholders to find the cash, then and there, to buy back the shares. Think about the value of your company…do you have enough cash to quickly fund the buy back for another shareholder?

<u>What does a buy/sell agreement do?</u>

Many companies do not have a plan in place that contemplates the untimely death of its shareholders or a break-up of the shareholders, and as a result, do not have buy/sell agreements in place.

Buy/sell agreements are legal documents that define what happens in an event that may trigger the disposal of a shareholder's interest in a company. Amongst other things, the agreement determines how the company will be valued, and how shares can be disposed of in a series of scenarios including death.

<u>Outcome 1 – Nothing Planned</u>

Michael and Nadine have a problem beyond dealing with the demise of a close friend and trusted professional in the business. While everyone knows that the unexpected can happen, nothing was planned or put in place to manage a worst case scenario.

James' shareholding and the rights that come with it, transfer through his estate to his wife Monica. Monica however wants nothing to do with the business that consumed so much of her husband's time. She just wants to cash out the shares and get on with her life.

MJN Solutions is still on a growth path and does not have the cash available to buy back James' shares. This means that Michael and Nadine now need to personally fund the purchase of Monica's shares (assuming they can come to an agreement about what the company is really worth). If they are unable to come up with the money, then Monica will become an unwilling shareholder.

<u>Outcome 2 – Pre Planning</u>

Michael, James and Nadine worked with their accountants to put a buy/sell agreement in place to manage succession and unplanned events, such as the death of one of the shareholders. The buy/sell agreement defines how MJN Solutions will be valued and how the equity will be managed. In this scenario, the buy/sell agreement states that James' shareholding will be purchased by Nadine and Michael if James dies or becomes permanently disabled.

During the planning process, the funding arrangements necessary were put in place should the buy/sell agreement be triggered. In this scenario, Michael, James and Nadine opt to manage the funding through an insurance policy taken out in their own names (another way would be to fund the policy through a self managed superannuation fund - although there may be changes in this area with the ATO flagging that they will soon release their position on insurance held through superannuation for buy/sell agreements. Whichever way you go, it will be important to get current, structured advice in this area).

When James dies, the insurance proceeds are used to purchase James' shareholding. As a result, neither Michael nor Nadine are out of pocket or take on debt, they own an increased share of the business, they avoid having an unplanned shareholder running the company, and they can get on with business.

Accountants templates & Annual rent statement from the agent

Most agents now send out Annual rent statements summarising the rental revenue collected and expenses paid on behalf of the landlord. These save a lot of time.

Make these available to your tax agent.

Take care when using these statements to prepare your 2014 tax returns. Real estate agents do not always pay for all rental expenses including land tax and insurances. Landlords usually do that. Also many landlords pay for rates.

Tax Tip – Use your accountant's rental templates to summarise all expenses and present a complete picture of each property's situation.

Clients of ***Property Tax Specialists*** get these rental templates and others as part of their year end package.

Tax Tip - Scan your original documents and send to your accountant. This ensures you have access to original documents to check on reports produced by the accountant and in case of a tax audit.

Vary your PAYG Withholding

This can help with your cash flow where you are expecting a large refund due to rental losses in 2015.

This can be done by lodging an application to vary the 'Income Tax Withholding' using a form from ATO. This can be done electronically on line or you can download the form, prepare and lodge it manually.

If you need help, contact your accountant. ***Property Tax Specialists*** provide this service.
www.propertytaxspecialists.com.au

Tax Tip – Depending on your personal circumstances the additional refund from negative gearing may not be substantial. If the savings are small you should consider saving the cost of preparation and claiming the deductions at year end when lodging the tax return.

Tax Tip – When lodging electronically ensure you keep a copy of the electronic receipt or make a record of receipt reference number. It helps when chasing up ATO.

Refinancing – alliances with brokers

With interest rates at below 5% for fixed term loans, refinancing may result in a savings for some clients. Financing new projects with these lower rates may make some projects feasible.

So to help clients analyse their situation and determine whether there is a benefit for them, we have created alliances with brokers who are able to deliver these low fixed rates. Call us on 02 9411 8133 for details.

Medical Expenses Tax Offset

The medical expenses tax offset is being phased out as announced in budget in may 2014.

If you received the offset in 2013 tax assessment you will be eligible to receive it for 2014 year. If you were eligible to receive in 2014 then you will be eligible to receive it in 2015 year.

Maximising the Medical Expense Tax Offset may mean you need to visit the dentist this week instead of next week.

Where medical expenses for a family group exceeds $2162, you are entitled to a tax offset of 20% on the excess. For example if the un-refunded out of pocket medical expenses are $5162, then a $600 tax offset is available – calculated as follows $5k-$2k=$3k x 20% = $600

The offset for Higher income earners is only 10% of the excess over $5100 - $88k for singles and $176k for families.

Tax Tip – once the year ends on 30 June 2014, contact Medicare and your private health fund to send you a summary of the claims made and what amount was refunded. This saves you time. Also keep a record of payments made for all your prescription drugs or ask your regular chemist for a report

The 2012 budget has used income testing to limit the rebate for Singles with an *adjusted* taxable income above $84k or $168k for a couple or family. For people in these categories, a rebate will only be available where their out of pocket medical expenses exceed $5k per year.

Financial Planning with your Tax Planning

Tax planning should ideally form part of your overall financial planning, as it may well have an impact on your overall financial situation.

As we are not licenced to give investment advice, we have created alliances with licenced Financial Planners and Advisers as an additional service to clients. To get an overall perspective of a client financial situation, we have persuaded them on arrangements to attend a tax advice meeting with us and you .. when requested at no cost to you. Call the office on 02 9411 8133 for more details.

Checklists and Templates

To make the compilation & reporting task for 2012 tax returns easier, clients of **Property Tax Specialists** receive checklists and templates to facilitate the process ... **saving them time and money** ... the 'write' way is having clear documentation. ATO way means time/money wastage with audit investigation.

Two heads are better than 1? Discuss your plans? Call to chat ...

Contact us if you would like to

- review & discuss your current property & tax situation ... maybe the next deal or
- whether or not to sell a property, which one in the portfolio should be sold
- your asset protection strategy. What is your risk profile? High ..medium ..low
- structuring your next investment property. In whose name should it be?
- planning to legally minimise your tax position or just to explore the possibilities
- Subdividing a block or your Main Residence … Capital Gain or Main Residence
- Capital Gains on selling a previously Main Residence .. estimate tax
- Is your Self Managed Super Fund ready to acquire a property
    1. with limited recourse loans
    2. from lending institutions or yourself
- prepare your next tax return or application to reduce your PAYG

We look forward to being of service. We also look forward to your **referrals**.

To improve our service we welcome all constructive comments on this newsletter and other materials.

Call/email **Shukri Barbara** at Property Tax Specialists at Shukri@propertytaxspecialists.com.au

Shukri Barbara
Winner
2014 - **Property Tax Adviser of the Year**
2012- **Property Tax Specialist of the Year**
2011- **Property Tax Specialist of the Year**
Readers Choice Awards Your Investment Property Magazine
Tax Columnist – Smart Property Investment magazine
Tax Contributor – 'Your Investment Property' magazine

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