

TAXWISE® INDIVIDUAL NEWS

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MORE ON RENTAL PROPERTIES

Domestic rental property investment remains popular and continues to attract the ATO's attention.

There tends to be some confusion about how rental property ownership can impact on your tax. With that in mind, here is a checklist of some common tax issues for you to consider (especially before you commit to buying a rental property).

If I own a rental property, am I in business?

The answer to this question usually surprises people. If you simply own or co-own an investment property or even several properties, you are usually regarded by the Tax Office as an investor who is not carrying on a rental property business, either alone or with the other co-owners.

However, even if you are not carrying on a rental property business, this does not mean that you escape the tax net.

How can a rental property affect my tax?

- Acquisition and disposal costs generally are not immediately deductible (e.g., cost of purchasing the property, stamp duty on the transfer, conveyancing costs). Some of these costs may be relevant for capital gains purposes.

- When you rent out a property, the rent you collect and other rent related income (e.g., if you are entitled to retain rental bond money) is assessable for tax purposes. Against this income, you can claim deductions for a range of expenses you incur whilst this property is rented out (or available for rent).
- Where the total rental income exceeds the total allowable deductions, you will have a net assessable amount, which is added to your other taxable income. Where the total allowable deductions exceed the total rental income (this is a negatively geared property), you will generate a loss that may be off-set against your other taxable income.
- When you sell a rental property, you may need to pay capital gains tax on the net sale proceeds. You may also need to pay tax on gains made on the sale of any depreciated items that are sold with the property (e.g., where the property's fixtures and fittings have been depreciated).

What happens if I own the property with someone else?

If you own a property with someone else (co-ownership), your legal interest in the rental property determines your share of rental income and deductions.

The best place to look to work this out is the Title Deed to your property – this will usually identify what sort of legal interest you have:

- if you are a **joint tenant**, each of you holds an equal interest in the property (e.g., two joint tenants will each hold a 50% interest); or
- if you are a **tenant in common**, each of you may agree to hold unequal interests in the property (e.g., you may agree for one

of you to hold a 70% interest and the other a 30% interest)

How does this type of ownership impact on my tax?

If you are a co-owners who are not carrying on a rental property business, you must divide the income and expenses for the rental property in line with your legal interests in the property:

- **joint tenants** always equally share income and expenses - you cannot vary this for tax purposes with some other agreement; or
- **tenants in common** share in the income and expenses in proportion to their respective legal interests as set out in the Title Deed.

EXAMPLE

John and Mary own a profitable rental property as joint tenants (a 50% interest each) and are not regarded as being in business.

Mary earns no other taxable income, so Mary and John decide it would be a good idea for Mary to receive most of the net income from the rental property and any profit on its eventual sale, so they enter into an agreement to that effect (e.g., Mary 70% and John 30%).

Because John and Mary are joint tenants, this agreement has no effect and Mary and John will still each receive 50% of the net rental income and the net proceeds on any sale of the property.

However, if John and Mary owned the property as tenants in common and the Title Deed indicates that Mary holds a 70% interest and John a 30% interest, then these proportions will usually be applied for tax purposes.

Do I have to pay PAYG on my rental income?

Once you earn business or investment income (and this includes rental income), the ATO may notify you that you have to start paying your income tax in instalments (Pay As You Go (PAYG) instalments).

According to the ATO, as a general rule this instalment system will apply to individuals who have shown gross business or investment income of \$2,000 or more in your latest income tax return and the debt on your income tax assessment is more than \$500.

PAYG instalments are usually made at the end of each quarter, but in some cases you may be able to pay an annual PAYG instalment if the tax you would have paid on your business and investment income (excluding any capital gain) is less than \$8,000, based on your last income tax assessment.

GIFTS OF SHARES

There are some changes impacting on making gifts of shares that you might find interesting.

From 1 July 2007, you can deduct the market value of a gift of shares in the income year in which you make the gift if the shares:

- have a market value of \$5,000 or less on the day they were gifted;
- were acquired in a listed public company;
- are gifted to an authorised deductible gift recipient; and
- were acquired at least 12 months before you made the gift.

SOME WORDS OF CAUTION

A deduction for a gift of shares:

- cannot add to or create a tax loss for you as the donor; and
- can trigger the capital gains tax rules, so you will also have to work out whether your gift of shares gives rise to a capital gain or capital loss.

Fund raising events

Some people contribute shares as part of the cost of attending a fund raising event. If you do this, you may also be entitled to a deduction for the shares if:

- the GST inclusive market value of the right to attend the fundraising event does not exceed the lesser of 20% of the value of the shares and \$150; and

the shares:

- have a market value of \$5,000 or less, but more than \$150, on the day they were contributed;
- were acquired in a listed public company;
- are gifted to an authorised deductible gift recipient; and
- were acquired at least 12 months before you made the gift.

HELP FOR THE TERMINALLY ILL

The Government announced on 11 September 2007 that lump sum superannuation benefits paid to members with a terminal illness will be exempt from tax.

However, this proposal is not yet law.

Nevertheless, at the time of the announcement the Assistant Treasurer also asked the Commissioner to consider changing the rate at which superannuation funds are required to withhold from payments to people in these situations in anticipation of these changes.

The good news is that the Commissioner of has introduced *temporary* measures to remove any unnecessary hardship for terminally ill superannuation funds members.

What are these temporary measures?

The Commissioner has varied the rate of withholding (to "nil") on all superannuation lump sum benefits paid to eligible terminally ill members of the fund.

The Commissioner has also removed the requirement for payers to give payment summaries to eligible terminally ill members when they receive a superannuation lump sum benefit.

When do these temporary measures take effect?

These temporary measures take effect from 12 September 2007 and cease on 1 July 2008.

When will a member be taken to be terminally ill?

You should be aware that a member of a super fund will be taken to be terminally ill:

- if two medical practitioners (at least one of whom is a specialist) certify that the member is suffering from an illness; and
- in the normal course this would result in death within a period of 12 months.

TIP

There are a number of eligibility factors that need to be taken into account in accessing this concession, so it's best get advice about any potential eligibility.

ANNUAL COMPLIANCE CHECK-UP

It's time for your annual tax compliance check-up and although 30 June 2008 seems light years away, it's best to be prepared.

Here is a check-list of some of the current hot spots highlighted in the ATO's Compliance Program 2007-08 for individual taxpayers that you may want to have a look at.

Funding superannuation contributions

Prior to the start of the new simpler super regime on 1 July 2007, there was a rush by many people to make considerably large contributions to their superannuation funds before the new contribution rules kicked in.

SOMETHING NEW ...

For the first time in the ATO's Compliance Program, the ATO is specifically targeting compliance risks where taxpayers may have tried to fund contributions to superannuation from income sources that have not been properly taxed.

What is the ATO looking for?

Some of the problem spots already identified by the ATO include attempts to fund super contributions by:

- applying the undeclared proceeds from the sale or disposal of assets that might be subject to capital gains tax (e.g., there was a lot of activity in the property market up to 30 June 2007 that has attracted the ATO's attention;
- by using in-specie contributions (e.g., assets are assigned or transferred into SMSFs at less than their market value, with a risk that the transaction may not have been properly treated for capital gains purposes); and
- borrowing funds to make contributions into a superannuation fund and incorrectly claiming the interest cost on these borrowings as a tax deduction (according to the ATO this is a relatively common problem).

Capital gains

This year the ATO is again targeting a range of capital gains from the sale of assets and property (e.g., rental properties, vacant land, holiday homes and the sale of shares and managed investment funds).

You should be aware that the Tax Office is getting smarter in the way it targets people and determines whether or not they are correctly reporting these types of gains.

To give you an idea of what the ATO is now doing to track down transactions, this year it will be:

- working more closely with land titles offices, State revenue authorities, commercial service providers and the Australian Valuation Office to understand the overall market and to get information about your property sales if there are any;
- examining share registries and other public data sources for information on share sales if you have sold shares; and
- matching information reported by managed funds with information lodged on your tax returns to check that your return is correct.

Work related expenses

The ATO continues to be touchy about what it regards as being a dramatic increase in the value of work-related expense claims (which at present seems to increase in total value by over 9% annually).

If you are going to claim work-related expenses for things like cars, travel, uniforms, laundry and self education expenses in your return, the ATO may want to look closely at what you are claiming. The Tax Office is also likely to take a particular interest in your 2007 tax return if you are a:

- tourism worker, travel consultant and guide;
- fitness and sporting industry employee;
- construction industry employee;
- guard and security employee; and
- mining site employee.

A WORD TO THE WISE

Whatever fears the ATO has about the escalation in work related expense claims, be absolutely clear there is nothing wrong with making a valid claim for a work related expense.

Rental properties

This continues to be a significant problem area as in past years.

If you have a rental property and want to make sure that there is nothing for the ATO to be concerned about, here are some tips to follow:

- do not overstate interest deductions (e.g., by including amounts related to borrowing expenses);
- only claim deductions for a property that is genuinely available for rent;
- be careful with claims for repairs and maintenance (things like renovation costs are generally not deductible as repairs and maintenance – they are usually part of the capital cost of the property);
- always apportion deductions where there is a private non-deductible element (e.g., as sometimes occurs when you incur travel costs to visit a rental property);
- be careful if you pay any legal costs in relation to your property – they may be capital expenses and not deductible against your rental income; and
- declare all rental income.

SIMPLER SUPER AND YOUR TFN

This is just a reminder to make sure your super fund has your tax file number (TFN).

From 1 July 2007, employer contributions made to new super accounts without a tax file number (TFN) will be taxed an additional 31.5%. This is on top of the 15% tax paid by the fund.

For existing accounts, the additional 31.5% will generally be payable on all contributions once the contributions for the year reach \$1,000. For accounts created after 30 June 2007, the additional 31.5% will be payable regardless of the amount contributed. Also, superannuation funds will not be able to accept certain contributions if you have not provided your TFN.

The ATO has started imposing these penalties already, so to avoid this make sure your super fund has your TFN.

A note on the terminally ill concession and TFNs

The ATO has advised that tax is not required to be withheld from superannuation lump payments paid to eligible terminally ill members even where they have not quoted their TFN to the fund.

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