NEWSLETTER

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This newsletter is written to assist in recognising issues and developing strategies so as to maximise profits and minimise and / or defer taxes payable in the current and future years.

Taxes, superannuation, dividends, equities and properties all need to be considered, because they are all (including taxes) an integral part of your Family's wealth creation and can be designed to provide substantial tax savings if correctly structured and managed.

If the strategy is to work, all of the elements must be considered and kept in balance. It does not have to be in writing but the elements should be clear and understood.

You need to have wealth and tax strategy that deals with*:*

- *lowering tax rates across the family's income spectrum;*
- ***increasing your return on investment;***
- *paying off your home with pre-tax dollars; and*
- ***freeing up cash to invest and by such means increasing your wealth****.*

The strategy should be understood by the owners, operators and their advisors.

For additional copies of this newsletter and what we specialise in please refer to [***www.goodco.com.au***](http://www.goodco.com.au) or contact our office on +612 9232 1588.

Strategies for your Wealth Creation, Financial Protection and Business Success.

Paying corporate tax at the lower rate of 27.5% or 25% - cause and effect

As detailed in our August 2017 Newsletter the Federal Government has announced that corporate tax rates **for companies in business** will be reduced under the following program.

Year ended	Aggregated turnover threshold	Tax applicable to entities below the threshold	Tax applicable to all other companies
	$	%	%
30 June 2017	10,000,000	27.5	30.0
30 June 2018	25,000,000	27.5	30.0
30 June 2019	50,000,000	27.5	30.0
30 June 2020	100,000,000	27.5	30.0
30 June 2021	250,000,000	27.5	30.0
30 June 2022	500,000,000	27.5	30.0
30 June 2023	1,000,000,000	27.5	30.0
30 June 2024	All corporate entities	27.5	27.5
30 June 2025	All corporate entities	27.0	27.0
30 June 2026	All corporate entities	26.0	26.0
30 June 2027	All corporate entities	25.0	25.0

The new company tax rates will only affect you if you are running a business and you have generated a turnover in that business up until 30 June 2024. Until then the Corporate tax rate for non-business passive Companies will be 30%.

After the year ended 30 June 2023 all companies will be taxed at the same rate of 27.5% irrespective of whether they are in business or are passive companies.

People invest in companies for running a business or for capital growth and a return on investment. That return comprises an increase in the value of the company on an annual basis by the company retaining profits and increasing its profitability and paying to the shareholders a dividend which in the majority of cases is franked. I.e. it has tax paid credits attached to the dividend so that those franking (imputed) credits can be offset by the shareholder when that shareholder pays its annual tax bill to the Australian Taxation Office. The decrease in the tax rate decreases your return on investment.

From the investors' point of view if you earn more than $37,000 a year (the point at which your personal tax rate increases from 19% to 32.5%) you will have to pay the 2.5% in your personal tax as there has been no decrease in the personal tax rates for individuals to compensate for the reduced imputed credit. The 2.5% is the decrease from the current 30% tax rate applicable to non-business companies to the 27.5%.

Equally, ***passive companies*** *(i.e. companies not conducting a business)* ***receiving those dividends will no longer receive dividends on which no tax is payable but they will be obliged to pay the 2.5% as their tax rate will remain at 30% until 30 June 2024.***

Should any of that tax saving be used to pay the shareholders then that 2.5% or 5% will be recouped by the Government levied on the shareholder if their income is greater than $37,000 per annum.

Companies earning profits pay taxes but at the end of the day those profits are returned to shareholders in the form of dividends so the perceived saving is in fact nothing more than a deferral of tax and not in fact a saving at all.

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Do I want to sell my business - pitfalls and mistakes?

If you are buying a business or have bought a business and you own that business in a Company then that was probably a bad mistake if you are ever going to sell the business. You also more than likely issued $2.00 in shares to yourself or to yourself and your partner and lent the company the money to set up and fund day to day expenditure. Effectively you have a very minimal cost base should the shares in the company be sold.

Unless you can convince the buyer to buy your shares in your company (which is normally very unlikely because of the inherent tax issues in non-audited private companies) then YOU HAVE A BIG PROBLEM and it's all about the tax you are going to have to pay.

There is some relief to companies but those benefits can be onerous and expensive to achieve and will lock up the proceeds in structures that may not work for you.

If you use the roll over provisions then according to the Australian Taxation Office if you don't come to them for help before selling the business and / or lodging a return then you are more than likely going to get it wrong and they will be forced to tax the taxpayer accordingly.

Let's get down to basics. ***You should only buy an investment or a business to derive a capital gain***.

Hopefully that investment / business will also pay a dividend to the owner as part of the annual return on investment and if you work in a business pay the working proprietors a commercial remuneration while annually increasing in value through retained earnings and greater goodwill through market penetration and product awareness.

If you start the business in the incorrect structure then you will pay dearly for the bad advice when you sell the investment/business. Individuals in most circumstances get a 50% discount on the taxable capital gains derived.

Companies:

- DO NOT get any discount on the capital gain;
- have to pay tax on the gain at the 27.5% rate;
- have to pay a fully franked 27.5% dividend on all the retained profits and goodwill sold; and
- then the shareholders get taxed on all this at the shareholders highest marginal tax rates less any imputed credits.

If the acquiring structure does not facilitate access to the discount then the so called great price for the business may not be so attractive after the taxes on the sale proceeds are paid.

Good sound long term advice may not be cheap in the short term but may well be a fabulous investment in the long term if taxes on capital gains can and are minimised particularly across family members. It is never too late and if you are contemplating selling today or in 5 years it would pay you to invest in some strategic advice before the business is put up for sale.

When buying or investigating a business one of the classic tricks is to bombard the seller with questions and watch what happens to the day to day business when the principals are distracted assimilating information for the purchaser because most of the time you want the business and not the Principal or Principals as the assessment of goodwill should exclude personal goodwill attached to the Principal.

Depreciation dilemma: Is it better to buy new or old properties?

By Paul Mazoletti of *Napier & Blakeley*

Depreciation (capital allowances) can be a valuable tax deduction for any property investor and a great way to reduce your taxable income. However, the question of old versus new does come up a lot in discussions with investors. So, who is right and who is wrong? With effect from 9 May 2017, if you are focusing on capital allowances deductions, new property is the better way to go. We could also suggest that neither is the 'best' way, as there are advantages to both. However, the changes will certainly lean you towards buying new.

The benefit of newer properties

The main benefit of buying a new investment property is that this will provide a higher total base tax deduction entitlement, when considering the combined value of fixtures and fittings the building structure's value. Deductions through the depreciation of fixtures and fittings under Division 40 may now only be available on any new investment property asset acquisition made after 9 May 2017. Deductions through the depreciation of the building structure under Division 43 are also available on both new and older assets; we'll explore this further later in the article. The Australian Taxation Office introduced capital allowances in 1985 for the residential sector, coincidentally at the same time as Napier & Blakeley opened its first office in Australia and launched its capital allowances business.

Since then, a few of the fundamentals of capital allowances have changed in regard to what you can claim on a property. What remains the same is the question of what provides the biggest deductions, and which properties provide the most value, particularly with regard to new and old properties.

Every situation is different, and certainly newer properties are now looking very attractive, as outlined below. Deductions under 'Capital Allowances' are categorised into two main divisions:

- Division 43 Capital Works (Building)
- Division 40 Capital Allowances (Depreciating Assets – Plant)

Division 43 Capital Works (Building) – Old vs new

Division 43 relates to the calculation of the construction expenditure on both building and structural improvements. To calculate the construction expenditure for building allowance deductions as defined in Section 43-70 ITAA 1997, you require a suitably qualified person (a quantity surveyor) who can certify the cost of constructing a building, in addition to structural improvements such as driveways, fences, etc., as at the date they were installed and completed. This cost is then apportioned over the tax life of the building (usually 40 years or 2.5% per annum) and can be claimed as a tax deduction.

Second-hand residential deductions commence from when an investment asset was completed. For example, if in 2017 you purchased a 10-year-old house built in 2007, you need to determine the construction cost as at 2007 and start claiming an allowance per annum for the remaining 30 years, as 10 years have already passed. This is all you can claim now, in accordance with the proposed new legislation.

If you recently purchased a new house, you have the next 40 years to claim this allowance per annum. The construction expenditure and size of the house will determine what you can claim in the year you buy or build, and how far into the future you can claim deductions is dependent on the age of the building. This also applies to low-rise townhouses and high-rise apartments.

Another consideration is that if the property is within a body corporate you will also be able to claim an additional portion of the building's common property. This allowance depreciates the same as the building, but is apportioned in accordance with your interest entitlement. On a second-hand property you are allowed to claim any recent refurbishments and/or extensions as well. This can sometimes be attractive to buyers as they can claim for something old as well as new.

Example: If you purchased a large house built 10 years ago it may have cost $200,000 to build the structure and so you could claim this at 2.5% or $5,000 per annum for the next 30 years. If you purchased the same large new house today it may have a building structure cost of $300,000 and you could therefore claim at 2.5% or $7,500 per annum for the next 40 years. This is an example of how you can get more deductions for a new building than you do for an old building. If, however, you purchased the large house built 10 years ago and then refurbished / extended it, and these structural costs were an additional $100,000, then you could claim another 2.5%, or $2,500 per annum, for the new works for 40 years, plus the $5,000 for the next 30 years on the original structure. This would give you a total annual deduction of $7,500 per annum for at least 30 years.

Could items previously considered to be plant and equipment … now simply form part of the building and therefore become deductible as part of the building?

Rules of Depreciation

- Depreciation of fixtures and fittings under Division 40 is always available on any new investment property (to be confirmed by legislation shortly);
- You can generally claim 10–20% of a new property's construction cost under Division 40;
- For instance, a new property costing $400,000 to construct could generate $40k–$80k in capital allowance deductions over 10 years; and
- High-rise new apartments may attract more Division 40 deductions due to more communal amenities (e.g. lifts, pools)

If the property is within a body corporate, you will also be able to claim additional deductions from the building's common property.

Division 40 Capital Allowances (Depreciating Assets – Plant)

This part of the Act covers the principle of 'decline in value' of a depreciating asset. The definition of a depreciating asset is a separate topic that can't be covered here. However, with the proposed new legislation as of 9 May 2017, Division 40 Capital Allowances (Depreciating Assets – Plant) are available only for the purchase of new properties, although at this stage we are not sure of the exact details until legislation is passed. But will this mean, for example, that items previously considered to be plant and equipment (and therefore deductible under Division 40) could now simply form part of the building and therefore become deductible as part of the building and included under Division 43 Capital Allowances deductions?

Some examples of depreciating assets are curtains, air conditioning, fire services, lifts, carpets, dishwashers and hot water units. The effective lives of these items were previously considered to be lower than the general building structure and therefore they could be depreciated more quickly, giving a higher write-off value per annum.

The Australian Tax Handbook 2017, at page 2,508, lists all the capital allowances items you can claim and their respective effective lives. The 'effective life' determined by the Australian Taxation Office is its estimate of how long an item will last before it needs to be replaced, and this therefore determines the percentage depreciation rate.

For instance, the effective life of curtains and drapes is six years, a ceiling fan lives for 20, an electric or gas hot water unit lasts 12 years and a solar hot water system lasts 15 years.

The cost base for depreciating assets was based on the principle of reasonable apportionment that is defined in Subdivision 40-195 of the ITAA 1997.

The opening value of any depreciating asset is now the new purchase price and is not necessarily based on the age of the asset but on its income-producing capability and condition. This part of the Act will apply to all the depreciating assets of income producing buildings.

In simple terms, say a quantity surveyor inspects your property and determines that you have paid $2,000 for the curtains and drapes and these have an effective life of six years, the opening cost for depreciation will then be $2,000 and the taxpayer can claim an annual tax deduction of $333.

There are as yet no details on how these plant and equipment items' values will need to be treated during a taxpayer's ownership, but they will likely have to be calculated the items' written-down values at the time of purchase.

There are also no details as to how costs for post 9 May renovations, refurbishments and extensions to investment assets will be treated or whether an investor can or cannot depreciate these items going forward.

On a positive note, this may influence a boost in residential development as investors may be drawn to the higher deductions they can achieve by acquiring assets in new residential developments that are currently underway or planned for the future.

In summary, new property may now have the greatest edge in terms of total deductions available, as shown in the table.

Depreciation allowances changes from 9 May 2017 budget announcements - Typical house purchase					
	10 years old pre 9 May 2017	10 years old post 9 May 2016	2 years old pre 9 May 2017	2 years old post 9 May 2016	Brand new post 9 May 2017
Year	Total deductions	Total Division 43 deductions	Total deductions	Total Division 43 deductions	Total deductions
1 – 2018 (365 days only)	$14,106	$5,392	$16,151	$7,703	$17,474
2 – 2019	$14,148	$5,392	$16,193	$7,703	$17,516
3 – 2020	$11,507	$5,392	$13,552	$7,703	$14,886
4 – 2021	$9,693	$5,392	$11,738	$7,703	$13,079
5 – 2022	$8,427	$5,392	$10,472	$7,703	$11,817
6 – 2023	$7,526	$5,392	$9,572	$7,703	$10,920
7 – 2024	$6,876	$5,392	$8,921	$7,703	$10,272
8 – 2025	$6,397	$5,392	$8,442	$7,703	$9,796
9 – 2026	$6,040	$5,392	$8,085	$7,703	$9,440
10 – 2027	$5,769	$5,392	$7,815	$7,703	$9,170
Total cumulative	$90,490	$53,923	$110,941	$77,033	$124,369

Family Trust Elections Revisited

We are seeing more and more when we are giving advice or take over a new client that the Discretionary Trust has not made a Family Trust Election. A Family Trust election is required if a Discretionary Trust wants to utilise either income or capital losses incurred in prior years or wishes to distribute franking (imputed) credits to beneficiaries.

If that election is not made then the Australian Taxation Office can disallow the use of the losses and deny the beneficiary the franking credits attached to distributions to the beneficiary claiming those franking credits as tax paid.

The issue involves several areas of Trust Law which are very complex and require expert opinion prior to and through their application. The issues here may have severe consequences on your Family and therefore their application and execution should not be considered without first consulting your Lawyer.

The trust loss measures are intrusive in the way in which they are intended to affect the taxation treatment of losses incurred by trusts and the availability of imputation credits attaching to fully or partially franked dividends paid in respect of shares held by trust entities.

The legislation to implement the trust loss measures is, however, not new. It was introduced in 1997 with an intended effective commencement date of 9 May 1995.

In this context, we reiterate that:

1. the Government's entity taxation proposals indicated that if a trust was not to be taxed as a corporate entity, then it would be necessary to file a trust taxation return in which the trustee consciously determines to make a family trust election under the trust loss measures;

2. if this election is made, it has two consequences:

    (a) a trust would continue to be treated as it had previously been treated for taxation purposes, namely, the beneficiaries who received distributions from that trust would be taxed at their respective marginal tax rates and have the franking credits made available to them; and

    (b) the consequence of making the family trust election was that for the purposes of the trust loss measures, there would be a resulting restriction of the potential class of beneficiaries who could receive distributions from the trust, being persons designated by reference to a defined "test individual".

What is the current situation that now confronts trustees?

The general consensus seems to be that if at all possible, trustees should not make the family trust election unnecessarily. If this is a valid assertion, then when is it necessary for a trustee to decide whether or not to make the election?

A decision has to be made when a trust either receives dividends to which is attached an imputation credit or the trust incurs a net loss for taxation purposes.

The important thing to realise is that this decision has been required to be made by trustees since 9 May 1995, being the date from which the legislation was determined to be effective.

What has happened since then?

For clients of Goodman & Co., a decision was taken to deal with trust income such that the income derived, including any income derived in the form of dividends, was distributed to beneficiaries who were assessed on that distribution at their own marginal tax rates. Consequently, the tax that was required by the Tax Office to be paid on the distributions was paid and no liability remains outstanding in respect of those distributions.

What does this now mean?

If, a trust has, since the 1995 income year, received dividends to which imputation credits are attached or it has incurred a net loss for taxation purposes, then the trustee will need to determine whether it makes the family trust election.

If the trustee does not make the election, then the imputation credits claimed by beneficiaries against the income returned by them in the form of franked distributions received could be deemed to be not available. Further, to the extent that a trust has incurred a net taxable loss, that loss will not be available to be offset against future trust income.

However, if the trustee does make the family trust election, then that election will mean that the trust will only have to satisfy a more limited number of tests to ensure availability of the imputation credits and / or the ability to offset net trust losses against future trust income.

This will come at a cost because the consequence of the election is that there will be a material restriction on the potential class of persons who can be beneficiaries under the trust, whose eligibility ultimately will be determined by reference to a “test individual” and whose identity will be chosen by the trustee.

There are issues for a trustee in even choosing a test individual, which decision has to be taken very carefully and after receipt of appropriate advice.

The trustee’s decision in this regard will be substantially curtailed if in fact dividends have been received since 1995 and beneficiaries have claimed the benefit of the imputation credits attached to those dividends. Similarly, if trust losses have been incurred which have subsequently been recouped, then the trustee’s decision-making discretion will be materially restricted.

Depending upon what the decision of the trustee is, there will also need to be consideration of how the decision of the trustee can best be implemented and supported by the provisions of the Trust Deed. Whatever decision a trustee reaches in respect of the need to make a family trust election, we believe that it should do so in consultation with the trust's appointor if one has been designated in the trust deed.

The role of an appointor in a discretionary trust is a precautionary function which often focuses primarily on decisions made by a trustee that effect the entitlement of beneficiaries and persons who might become beneficiaries. We suggest that it would, at least, be prudent for a trustee making a decision which has such far reaching consequences as a family trust election to involve the appointor in that decision making process.

Property Owning Discretionary Trusts – ALERT the game has just changed

If you own or are about to own a residential property in a discretionary trust or if that trust has a direct interest in a residential property via another trust then there are stamp duty and land tax issues that have recently come into play that **will affect you.**

If a beneficiary of the trust is a non-resident citizen then the purchase will be subject to higher stamp duties and the annual land tax bill will cover an additional loading. This is applicable to most States and Territories in Australia and applies to residential properties.

Most trusts because of the definition of general beneficiary have or potentially have a non-resident beneficiary and as such by the Trustee and Appointers inaction will create a situation where the trust will pay additional stamp duty on the purchase and a loading in the annual land tax assessment (both issued by the Office of State Revenue).

It appears that the fix is simple in that if your trust owns a residential property directly or indirectly via a unit trust owned by the discretionary trust then you should review the Deed of Settlement to ascertain the definition of excluded parties.

A simple paragraph should be drafted by the Trusts lawyers when drafting the Deed or by a Deed of Variation stating in essence and at least that the Excluded Parties should also include any person who is a 'foreign person' within the meaning of the Foreign Acquisitions and Takeovers Act 1975 (Cth), but not including any such person who is a citizen of Australia.

Tax Losses incurred by a Business. Can they be utilised going forward?

Historically there has been two tests under which business losses can be utilised in future years.

If a business continues to have the same owners then the “Same Ownership Test” prevails and no other test is required. Should the business be sold or the shareholding materially change then there was a second test that was used and enforced with strict application and that was the continuity of a business known as “Same Business Test”.

The government has now introduced a “Business Continuity Test” which seems to retain the “Same Business Test” but adds a further test being a “Similar Business Test” under which a company will be able to utilise tax losses made from carrying on a business against income derived from carrying on a similar business following a change in ownership or control. On this issue readers are urged to seek expert advice.

Claiming self - education expenses

It is accepted that further learning in this day and age is all part of earning income. Attending CPD (continuing professional education) conferences where professional bodies insist that to maintain your registration that this must be undertaken and recorded so it can be audited.

Employers are today strongly suggesting in many industries that to progress you need higher education such as speciality courses covering your or their area of expertise or in many cases paying for staff to undertake these courses. Many staff are openly encouraged to get an MBA if they want to progress within their firm or the employee wants to progress in the industry in which they work.

To be eligible there must be a sufficient connection between the taxpayer’s present employment and the course they undertake for the self-education expense to qualify as a work-related tax deduction.

If there is no nexus between the self-education and either your current employment or qualifications then the expense will not be allowed as a work related self-education tax deduction.

Generally deductions are disallowed where the self-education expense is designed to obtain new employment or to branch into a new area of expertise that is not a direct nexus to your current income earning. If you cannot show ***while working and studying*** that your education expense has or will lead to a higher income the expense will be disallowed. If this area affects you go to the Australian Taxation Office website and read TR98/9 and TR92/8 the latter covering travelling, accommodation and meals involved in self-education.

