

Investors: Beware ‘mortgage management’ plans

Investors contemplating an arrangement which is being marketed as a ‘mortgage management’ plan should be wary. Under this scheme, split loan arrangements – that is, the combination of an investment loan, a home loan and a credit facility – are being promoted as providing tax-effective financing and therefore have attracted the attention of the Tax Office.

The schemes generally involve a person taking out one loan for their ‘principal place of residence’ (the family home) and an additional loan for an investment property. The investor then establishes a line of credit facility. The Tax Office says taxpayers often partake in split loan arrangements to pay off their home mortgage sooner.

In response to a surge in such schemes, the Tax Office has issued a recent tax determination – known as TD2012/1 – to alert taxpayers to the fact that the general anti-avoidance provisions may be applied to deny interest deductions.

How the scheme works

Under the mortgage management plan arrangement, an individual owns at least two properties:

- their residence
- an investment property.

The individual has:

- an outstanding loan used to acquire their residence (home loan)
- an outstanding loan used to acquire the investment property (investment loan), and
- a line of credit with an approved limit (line of credit).

The home loan, investment loan and the line of credit are each secured against the individual’s residence and/or the investment property. The line of credit is drawn down to fund the interest payments on the investment loan as they fall due.

Typically, the taxpayer’s cash inflows (including that which the taxpayer might reasonably be expected to use to pay the interest on the investment loan) are deposited into their home loan, which reduces the non-deductible interest otherwise payable on the home loan.

The diagram on the following page illustrates how the scheme works.

All three loan products are typically provided by a single lender. The interest rates on the home loan and the investment loan are also generally the same whereas the interest rate on the line of credit is marginally higher.

The investment loan is typically an interest-only loan for a specified period with principal and interest repayments required thereafter while the line of credit has no minimum monthly repayment obligations provided the balance remains below the approved limits.

If the line of credit reaches its approved limit before the home loan has been repaid, the individual may apply to increase the limit on the line of credit in conjunction with a corresponding decrease in the available ‘redraw’ amount in the home loan.

Warning: The Tax Office warns that split loan schemes are likely to be considered a tax avoidance scheme as the dominant purpose of the arrangement is to claim tax deductions that would not otherwise be available.

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About this newsletter

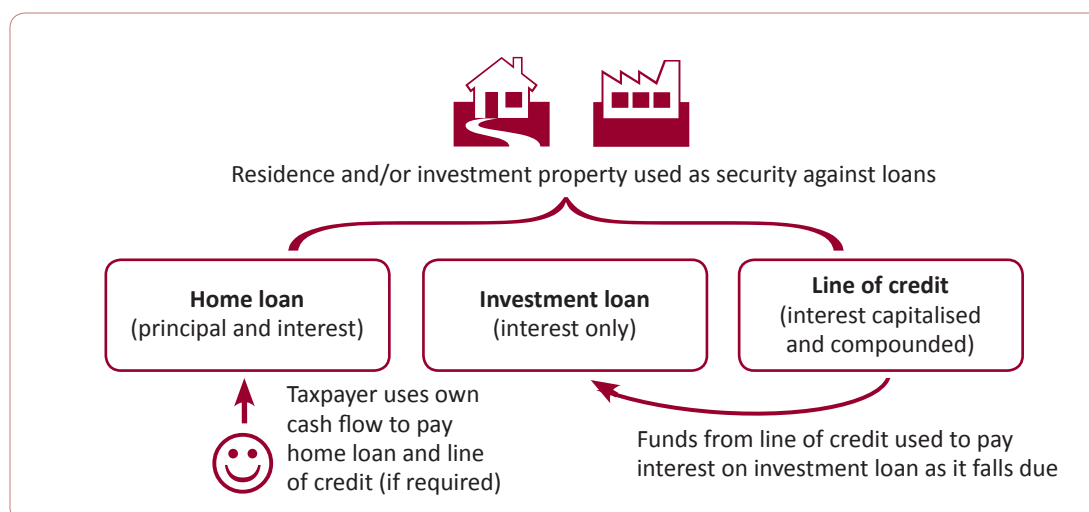
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Tax Office's approach

The determination highlights the Commissioner of Taxation's power to cancel a tax benefit, or part of a tax benefit, that has been obtained in connection with a scheme to which the general anti-avoidance provisions apply. The Commissioner concludes that this is the likely outcome for participants in the mortgage management plan arrangement. However, this must ultimately be decided on the basis of the facts in each case.

In the Tax Office's view, an individual's purpose of 'paying their home loan off sooner' or 'owning their home sooner' is not in itself an adequate defence against the application of the general anti-avoidance provisions.

The Commissioner identifies the following factors:

- The manner in which the scheme is entered into or carried out is generally explicable only by the tax consequences.
- The interest rate on the line of credit is typically higher than the interest rate payable on the home loan.
- Apart from the alleged availability of additional tax deductions, the taxpayer's financial position under the scheme is generally no better (and possibly worse) than if they had not engaged in the split loan scheme.
- A key feature of the scheme is the use of the line of credit to pay the interest on the investment loan. This results in most of the interest on the investment loan, in effect, being deferred. The deferral has the economic effect of allowing the taxpayer to repay the home loan at a faster rate than what would otherwise be possible: the taxpayer is able to pay an amount equivalent to the deferred investment loan interest on the home loan.
- A scheme can only have a limited lifespan. The scheme will only last for the period during which the taxpayer has non-deductible interest expenses (home loan interest) and once that debt is repaid,

the taxpayer is likely to revert to making the payments on their investment loan out of their cash flow instead of using a line of credit.

- If the taxpayer's residence is used as security for either the investment loan or the line of credit, the taxpayer will not actually own an unencumbered home any faster than if they had not engaged in a split loan scheme.

How to protect yourself from tax avoidance schemes

Anyone involved in a split loan scheme who voluntarily tells the Tax Office about their involvement in such a scheme, may be eligible for a reduction in any penalties they may face.

Before committing to an investment arrangement, ensure you understand the ins and outs of the arrangement and are certain that the promised tax benefits are legally available. Check with our office on the steps that can be taken to avoid involvement in what may be considered a tax avoidance scheme, such as:

- **Step 1: Conduct research on the creator of the investment arrangement:** Investigate the origins of the party that has created the investment arrangement offered as this can be an indication as to whether the investment arrangement is lawful or not.
- **Step 2: Obtain a product disclosure statement (PDS) from the arrangement creator/promoter:** If the arrangement constitutes a public offering, you must be given either a PDS or a prospectus when an arrangement is recommended or offered.
A PDS must set out important information about an investment arrangement, including details of fees and commissions, outlining the benefits and risks of the investment and other information to help you and your adviser make an informed decision.
- **Step 3: Obtain a product ruling:** If uncertain about the tax-related consequences of the arrangement,

there may be a product ruling that has been issued in regards to the arrangement. It is crucial that the arrangement is implemented exactly as it has been outlined in the ruling because a product ruling only provides you with legally binding assurance that the tax deductions set out in the ruling are available when the scheme is carried out as described.

Before considering a tax-effective investment, run through the quick checklist which follows:

Quick checklist

- ☒ Conduct research on the originator of the investment arrangement
- ☒ Have you been given a product disclosure statement or a prospectus for the investment?
- ☒ If uncertain, ascertain whether there is a product ruling pertaining to your investment arrangement.

For more detailed information on this ruling please contact our office.

End of financial year tax planning tips

Although the May Federal Budget could introduce some new considerations into your tax planning strategies, there remain many tactics you can consider to ensure you pay not one cent more tax than is necessary.



Remember the best tax planning should commence in July; that is, as early as possible in any financial year, not right near the end of it. Proper tax planning is more than just finding bigger and better deductions — and the best tips are those that set your tax affairs in better order for future income years.

A central fact to remember of course is that after July 1, 2012, all individual tax rates will be changing due to the introduction of the price on carbon. The tax-free threshold will rise from \$6,000 to \$18,200. From there the marginal rates will be 19% up to \$37,000, then 32.5% to \$80,000, 37% up to \$180,000, and 45% after that.

Not all of the following tips will suit your circumstances, but as a list of possibilities they may get you thinking along the right track. Of course check with this office if you need further information.

Make use of your tax agent

No-one knows your affairs better than yourself, so you will recognise if any of the following tax tips applies to your circumstances. But no-one is better informed as to what is appropriate to your situation than your tax agent. Also, a tax agent's fee is an allowable deduction in the year it is paid.

Every individual taxpayer is required to lodge their return before October 31, but tax agents are given more time to lodge, which can be a handy extension to the payment deadline. Of course, if you're sure you are going to get a refund it's no use delaying, so in these cases it is worth getting all of your information to your tax agent as soon as you can after July 1.

Pre-pay investment loan interest

See if you can negotiate with the lender of your investment property or share loan to pay interest on borrowings upfront, thereby giving you a deduction this year. Most taxpayers can claim a deduction for up to 12 months ahead, and make sure your lender allocates the payment correctly, as the deduction is only allowed against the costs of financing income producing investments, such as interest charged on borrowings.

Bring forward expenses, defer income

Try to bring forward any deductions (like the interest payments mentioned above) into the 2011-12 year. If you know, for example, that next fiscal year you will be earning less (maternity leave, going part-time etc) deductible expenses that can be brought forward into the present financial year will provide more financial benefit.

An exception will arise if you expect to earn more next financial year. In that case, especially as some tax rates after the tax-free threshold are going up slightly, it may be to your advantage to delay any tax-deductible payments until next financial year, when the financial benefit of deductions could be greater.

And by legally deferring income into 2012-13, you may take advantage of the higher tax free threshold arising out of the carbon tax package (of course these tactics depend very much on your personal circumstances).

A strategy that can take advantage of this area of tax planning is to place money into a term deposit that matures after June 30, where interest will accrue to you in the 2012-13 tax year. It's probably leaving it a bit late to adopt this strategy now, but is one to keep in mind for later years, should circumstances and tax regimes suit.

Investment property

Many expenses stemming from owning a rental property are claimable, so it can be helpful to bring forward any expenses before June 30 and claim them in the present financial year.

Use the CGT rules to your advantage

If you have made and crystallised any capital gain from your investments this financial year (which will be added to your assessable income), think about selling any investments on which you have made a loss before June 30. This way the gains you made on your successful investments can be offset against the losses from the less successful ones, reducing your overall taxable income.

Of course, tread carefully and don't let mere tax drive your investment decisions – but check with your tax agent whether this strategy will suit your circumstances.

Put as much as you can into super (and the rules change after July 1)

If you are aged less than 50 you can put up to \$25,000 (pre-tax) into your super fund, and those aged between 50 and 74 can generally contribute up to \$50,000 pre-tax. But after July 1, 2012, the cap will be \$25,000 for everyone – so make the most of it while you can. Only over-50s with balances of less than \$500,000 will be able to make contributions of \$50,000 a year (based on current government announcements).

But be aware of how much you are putting in, as exceeding the limits can see tax levied at punishing rates. And if you salary sacrifice into super tread carefully, as in some income years (and 2011-12 is one of them) there are 27 fortnightly pay periods instead of the usual 26.

Some relief was legislated during the year however, so that in some cases up to \$10,000 in excess concessional super contributions can be withdrawn and treated as assessable income, (and so be taxed at marginal rates) rather than incurring excess contributions tax (however you are only allowed one such re-allocation).

You may also like to take advantage of the government's co-contribution policy while it lasts at its present level. Under the current rules, the government pays dollar-for-dollar (up to \$1,000) from incomes of \$31,920, reducing up to, and phasing out at, \$61,920. After July 1, 2012 the matching rate will be reduced to 50%, with a maximum co-contribution of \$500 for people with incomes up to \$31,920 in 2012-13 (phasing out at \$46,920).

Split super contributions with your spouse

Most concessional super contributions – salary sacrificed, compulsory, and personal contributions for which you can claim a tax deduction – can be split between members and spouses. So some super contribution amounts can be directed to a spouse's super fund.

A smart use of the strategy, if your circumstances suit, will be for a spouse whose super savings are under \$500,000 to direct contributions to the spouse who may have more than \$500,000. This will help the lower-balance spouse stay under the threshold for longer, and boost the family's retirement savings.

In the same vein, if both partners have funds under the threshold, contributions can be directed to the lower-balanced fund so that both stay under the threshold longer. But remember, the contribution cap applies to the member making the contributions, even where these are directed to the spouse's fund.

Children still at school?

If you have school age children, you should investigate the education tax refund scheme. You may qualify for a refund of 50% of expenses, up to a maximum of \$409 for primary school children and \$818 for secondary students.

The refund is available for items like laptops, educational software, textbooks and, for the first time, uniforms (included from July 1, 2011). School fees are not covered. And if you've been pestered to get an iPad, these are treated like a laptop for the purposes of the education tax refund.

R&D Tax Credit

The new Research & Development Tax Credit provides a 45% refundable offset to businesses with an annual turnover under \$20 million for eligible R&D expenditure, and a 40% non-refundable offset to all other eligible entities. The new rules narrow the definition of eligible R&D but allow for holding intellectual property offshore, and businesses must separate their 'core' and 'supporting' R&D activities.

Final reminders

You can claim up to \$300 of work-related expenses without receipts, provided the claims are for outgoings related to earning assessable income.

A couple of tax reforms have been deferred. The 'standard' deduction (\$500 for first year of operation, and \$1,000 thereafter) for work related expenses has been deferred until July 1, 2013, as has the 50% tax discount for interest income.

And remember, the above tax tips are not exhaustive nor will they suit every taxpayer's circumstances. It is essential that you talk to your tax agent for more tailored advice.

Tax deductions: What you can't claim

Here are some deduction ideas that many commonly believe to be claimable, but are typically rejected by the Tax Office. While some may appear obviously not allowable, they have all been genuinely attempted to be claimed. Other disallowed claims, however, may surprise. But while the Tax Office may reject the following in the first instance, taxpayers who believe they have a 'reasonably arguable position' may have a case, and should consult this office for more advice.

Driver's licence

Vehicle expenses made while earning assessable income are allowable – repairs, tyres, servicing, interest on a car loan etc. But the cost of a driver's licence is not – even if having one is a condition of employment. Any extra on the cost of a 'standard' licence could be allowable. The costs of defending a driving charge, even where one's job is conditional on holding a licence, are not deductible.

Vaccinations

A deduction is generally not allowable for vaccination against diseases that an employee may come into contact with in the course of work; for example airline employees. Some disease protection, for example for cattle-borne Q fever, may be allowed.

Child minding expenses

Expenses for having someone care for children during working hours are not deductible, even when this is necessary to secure job advancement. There is however the child care rebate and the child care benefit.

Commuting to and from work

Travelling between home and work is not generally deductible, even where incidental work tasks are performed on the way. Certain circumstances may allow a deduction, such as carrying bulky equipment, but not if there is secure storage at the workplace or carrying tools is done for convenience, not practicality.

Grooming costs

Even though a high standard of appearance may be required, expenses such as hairdressing or cosmetics are not usually deductible. Not even Defence Force personnel get a deduction for grooming, although required to meet military regulations. Anyone constantly exposed to chlorinated water (such as a hydrotherapy assistant) could have a case for claiming moisturisers and conditioners.

Relocation expenses incurred by an employee

Expenses from changing employment, such as costs of moving house or meeting an employment agreement, are not generally deductible. The reason given is that

the expense comes 'at a point too soon' to be regarded as having been incurred in gaining assessable income. The same reason has been used to deny taxpayers on unemployment benefits a deduction for expenses such as relocation to secure a job.

Police clearance and record checks

Any expenditure that is required to meet prerequisites to securing particular employment, such as a police clearance certificate or record check, is not deductible. The reason given here is much the same, that these costs are made 'at a point too soon'.

Telephone 'silent number' fee

While the work-related portion of telephone costs can be deductible, the cost of maintaining a 'silent' number for privacy (for example, to protect a police officer's home and family members) is not allowed as a deduction, as it is considered a private expense.

Eviction of a tenant

Expenses incurred by a rental property owner in raising eviction proceedings against a tenant is not generally allowed as a tax deduction to the property owner.

Meal costs

In general terms, the cost of a meal is not deductible as it is a private expense. Meals consumed by truck drivers over a normal working day have been denied as not having sufficient connection to income production (even though they had no meal allowance). But there are provisions to allow meal costs if it can be shown these are tied to employment, such as when away from home for a job, or for work-related entertainment.

The cost of buying your own business

Costs of buying or establishing a business are also regarded as having been made 'at a point too soon' to be connected to generating assessable income. Likewise, preliminary costs (feasibility studies etc) cannot be claimed. Expenses made very early in a business however, even before income is realised, may be deductible if these costs are of a usual kind made with that type of business.

Insurance cover through your SMSF can be tax deductible

Buying insurance within an SMSF can give access to deductible expenses that would otherwise not be available, as some insurance premiums, such as for life insurance (which typically cannot be claimed as deductions by individuals for income tax purposes) may be available as tax deductions for the SMSF.



The same concession applies for any super fund, but the deductibility is available to the fund itself — therefore previous members of retail or industry funds who subsequently set up their own SMSF may not be aware of the deductibility of insurance premiums.

On top of this, life insurance payouts made to death benefit dependants of the deceased via a super fund are *tax-free*, regardless of whether a tax deduction for premiums has been claimed or not. Note however that insurance benefits paid to a non-dependant may attract tax at a rate of 16.5% or 31.5%.

The forms of insurance open to trustees to buy via an SMSF are:

- life insurance
- total and permanent disability insurance (TPD)

- temporary disability-based income stream support (up to two years)
- terminal medical condition benefit.

The rules about the deductibility of premiums for life insurances distinguish between premiums paid to provide a benefit and premiums that have a savings element — as is the case with certain variable life policies that build a cash value. No deduction is available for the proportion of the premium that supports this investment element.

The one essential however is that policies must be held in the trustee's name, and the fund must be the sole beneficiary of the policy. And it is prohibited from transferring existing life insurance policies of related parties to the SMSF — the law prohibits a super fund from acquiring an asset from a 'related party', and an insurance policy is a financial asset.

Note that other forms of insurance, such as health insurance, may not fit with the 'sole purpose test' and therefore it would be inappropriate to hold such policies in an SMSF. However the Tax Office has ruled that trauma insurance is consistent with the sole purpose test (although the cover must be held for trustees/members only). Please seek advice from this office for more details.

Did you know... FBT 'odd spot'

The 2011-12 fringe benefits tax year-end has come and gone, and the FBT lodgement deadline is on the horizon (May 28). With this in mind, here are some 'left field' FBT facts that employers may find useful, both now and to keep in mind for the 2012-13 year.

- Shopping centre car parks that provide free parking for an initial period (the first two hours, for example), and thereafter charge a fee based on time (to discourage all-day parking), are not considered by the Tax Office to be 'commercial parking stations' for the purpose of determining if there is a car parking fringe benefit
- Where a mobile phone or similar item is treated as an exempt work-related item, and the monthly call costs are exempt, the exemption will extend to internet data usage fees
- The Tax Office released a ruling during the 2011-12 FBT year that clarifies the 'base value' of a car. Where an employee contributes to the purchase price of a car, either by cash or by making their own vehicle available as a trade-in, the base value of the car benefit will be the amount paid by the employer/lessor, (that is, an amount net of the employee's contribution)
- Where a loan is made in respect of employment to an employee who is also a shareholder of a private company, there will be no loan fringe benefit if the loan amount (or residual un-repaid balance) is deemed to be a dividend made to the borrower (even if the private company had 'nil' distributable surplus).

Regulatory Round-up

\$1,000 bonus to take on older workers

Employers who take on an over-50 job seeker for at least three months will receive a \$1,000 bonus as part of the federal government's efforts to combat age discrimination and encourage businesses to employ older Australians. The Job Bonus initiative, set to begin on July 1, 2012, is part of the government's final response to a report entitled *The Economic Potential of Senior Australians*.

R&D guidelines now available

Small businesses floundering with the new Research and Development (R&D) Tax Incentive have received assistance in the form of AusIndustry's guidelines – including advice on how to complete applications. The R&D Incentive replaced the R&D Tax Concession and applies to expenditure incurred in a financial year commencing on or after July 1, 2011. Despite reports the application form will be available in May, a spokesperson confirms it will be available in June instead.

Tougher liabilities for delinquent tax bills

Directors of companies that are more than three months in arrears on certain tax bills may become personally liable for the outstanding payment if planned legislation is tabled in Parliament later this year. This means directors risk losing personal property and face possible bankruptcy in more extreme cases. For misdemeanours such as missing a deadline to file annual reports, company directors may face increased jail terms up to one year in custody.

SMEs over-burdened by tax compliances

Small businesses spend on average \$28,000 and nearly 500 hours – equivalent to 20 days – a year complying with tax obligations according to a study conducted by two professors from University of NSW and University of Tasmania. The research surmised that small businesses spend too much of their time and money on tax compliance and paperwork while concessions designed to cut their tax headaches are actually adding to the burden.

EFTPOS fee switcharound hits SMEs

Smaller retailers are calling on the Reserve Bank to review changes to the EFTPOS payments system which will see small retailers pay more per transaction. The relevant changes mean businesses are charged an interchange fee for every EFTPOS transaction valued at more than \$15. Previously, the consumer's bank paid a fee to the retailer's bank. Now, the retailer's bank must pay the consumer's bank – with fees ranging from 5c to 18c per transaction. Major banks at the time assured retailers that the new changes would not be passed on in full but have backtracked on this claim and are intending to do just that.

Business limits on credit card surcharging

The Reserve Bank is set to rein in on businesses that penalise consumers with excessive fees when they use credit cards to pay for goods and services as a study revealed that many businesses were using surcharges to generate income rather than simply recover the cost of transactions. Under the Reserve Bank's proposal, credit card companies such as Visa and Mastercard will be able to place a cap on the credit card surcharge that businesses impose on customers. The proposal is in its final stages of consultation.

SMEs in the dark on registration and licences

As the Small Business Support Line commemorated its 50,000th call in early April 2012, analysis of past calls revealed that registration and licences are the top concerns of businesses and constituted 37% of all calls received by the service since its inception in 2009. Other topics discussed in the calls are government initiatives, grants and assistance, starting a business, legal, accounting and taxation services followed by business planning and diagnostic services.

Construction activity shrinks

Australian construction has been in contraction for almost two years, says a report by the Australian Industry Group and the Housing Industry Association. According to the report, residential and commercial construction have showed significant weakness, with house building registering its lowest level in six months. House building showed a reading of 30.3, while apartments were 30.5 and commercial construction was 35.5. Any reading of less than 50 indicates contraction.

Tax Freedom Day

Australians effectively worked 95 days this year to pay off their taxes, research by The Centre for Independent Studies (CIS) shows.

As part of its annual research, independent public policy think tank CIS says April 5 is 2012's Tax Freedom Day – the day when Australians clear their tax bills of the year and start working for themselves rather than the government.

Although this year's Tax Freedom Day is earlier than a decade ago – good news as that effectively means Australians had to work less than before for the government – the unusually early date may be due to the global financial crisis and a subsequent fall in tax revenue rather than reduced Government spending. Conversely, the tax burden in the 1920s was comparatively lower – causing the Tax Freedom Day to fall in January.

Private health insurance rebate update

During April, the government released updated figures for the private health insurance rebate. The latest figures mean that singles earning more than \$130,001 and families earning more than \$260,001 will lose access to their private health insurance rebate under the new means test coming into effect on July 1, 2012.

The measures also mean the Medicare surcharge for the groups above will increase from 1% to 1.5% if they do not take out private health insurance. That

translates to \$1,950 pa for high-earning singles and \$3,900 pa for high-earning families.

The income test is based on the total sum of the taxable income, reportable fringe benefits, reportable super contributions and total net investment losses, less other taxed elements depending on a person's age and circumstances.

Below is a breakdown of the private health insurance tiers for 2012-13:

Tier	Income	Private health insurance rebate			Medicare levy surcharge
		Below 65 yrs	65 to 69 yrs	70 yrs or over	
No tier	Singles: \$0 - \$84,000 Families: \$0 - \$168,000	30%	35%	40%	nil
1	Singles: \$84,001 - \$97,000 Families: \$168,001 - \$194,000	20%	25%	30%	1%
2	Singles: \$97,001 - \$130,000 Families: \$194,001 - \$260,000	10%	15%	20%	1.25%
3	Singles: \$130,001+ Families: \$260,001+	0%	0%	0%	1.5%



Upcoming key lodgement dates

The following deadlines are for lodgement with the Tax Office. Please make sure to get your documentation into this office in plenty of time to allow proper processing.

15 May 2012	<ul style="list-style-type: none"> Income tax return for all other entities not required earlier (including all other consolidated groups), and not eligible for the 5 June concession.
21 May 2012	<ul style="list-style-type: none"> Monthly activity statement for April 2012.
26 May 2012	<ul style="list-style-type: none"> Quarterly activity statement, quarter 3, 2011-12 -electronic lodgement (ELS, ECI, Tax Agent Portal or BAS Agent Portal).
28 May 2012	<ul style="list-style-type: none"> Fringe benefits tax return - lodgement and payment. Superannuation guarantee charge (SGC) statement - quarterly for quarter 3, 2011-12 (if required contributions were not made by the due date).

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