



# “The Not-Quite-Bottom-Line” SIMMONDS LE-FEVRE

Tax & Super Information that's Important to You

September 2019



Photo by Silvia Brazzoduro on Unsplash

## Property development and tax

The ATO seems to be always looking over the shoulder of property developers to make sure they are complying with their tax obligations.

### About this newsletter

Welcome to your tax and super update from Simmonds Le-Fevre. This newsletter is aimed at keeping you on top of the issues you need to know about and changes as they happen. If you have any queries don't hesitate to contact us.

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The considerations facing the ATO can include whether an agreement to develop and sell land is a “mere realisation” or a disposal either in the course of a business or as part of a profit making undertaking or plan.

A “mere realisation” is a sale on capital account to which the capital gains tax (CGT) rules will generally apply. Landholders will usually seek this treatment if they can access CGT concessions (for example, applying the appropriate CGT discount or the small business CGT concessions) or the property is a pre-CGT asset.

A sale that is more than a mere realisation will be on revenue account and the proceeds will generally be

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## Property development and tax *cont*

assessable as ordinary income. The two most common scenarios where the proceeds are income are:

1. where the land is sold in the course of a business or as an incident of business operations, or
2. where the land has been acquired and sold as part of a profit making undertaking or scheme.

Whether a sale is a mere realisation or something more is determined by examining and weighing the facts and circumstances taken as a whole.

Outside of the capital/revenue discussion (more below), the ATO must also consider timing issues relating to the recognition of income and deductions, property development agreements, and land banking activity.

A relevant discussion can be found in the Taxpayer Alert *Trusts mischaracterising property development receipts as capital gains*. This alert focuses on the recognition of profits from property developer activities as a mere realisation of capital rather than an allocation of ordinary income to trust beneficiaries.

Also note for completeness that Taxation Ruling *Income tax: whether profits on isolated transactions are income* and Miscellaneous Taxation Ruling *The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number* provide public advice relevant to this issue.

Ask us for links to the above documents should you want to read more.

## CAPITAL VS REVENUE CHARACTERISATION

The ATO has stated that it is important to weigh all the facts and indicia together, and not make any decisions or take any actions in isolation. The test the ATO applies is whether, on the balance of probabilities, it is more likely than not that the relevant tax provisions apply to the facts of the particular case.

The ATO says it is not simply a matter of tallying how many indicia point in each direction (for example, that a taxpayer acquired land with the requisite profit-making intention or purpose). Some factors will be more influential than others, and some will, because of the particular circumstances, point more strongly to a particular conclusion.

The ATO has provided the following list of indicia, but says this is not exhaustive and may change over time:

- Whether the landowner has held the land for a considerable period prior to the development and sale
- Whether the landowner has conducted farming, or other non-development business activities, on the

land prior to beginning the process of developing and selling the land

- Whether the landowner originally acquired the property as a private residence or for recreational purposes
- Whether the landowner originally acquired the property as an investment, such as for long term capital appreciation or to derive rental income
- Whether the land has been acquired near the urban fringe of a major city or town
- Where the property has recently been rezoned, whether the landowner actively sought rezoning
- A potential buyer of the property made an offer to the landowner before the landowner entered into a development arrangement
- The landowner was unable to find a buyer for the land without subdivision
- The landowner applies for rezoning and planning approvals around the time or sometime after acquisition of the property, but before undertaking further steps that might lead to a profitable sale or entering into development arrangements
- The landowner has registered for GST on the basis that they are carrying on an enterprise in relation to developing the land
- The landowner has registered a related entity for GST that will participate in (or undertake) the development of the land
- The landowner has a history of buying and profitably selling developed land or land for development
- The operations are planned, organised and carried on in a businesslike manner
- The landowner has changed its use of the land from one activity to another (such as from farming to property development)
- The scope, scale, duration and degree of complexity of any development
- Who initiated the proposal to develop the land for resale
- The sophistication of any development or other pre-sale arrangements
- The level of active involvement of the landowner in any development activities
- The level of legal and financial control maintained by the landowner in a development arrangement
- The level of financial risk borne by the landowner in acquiring, holding and/or developing the land
- The value of the development or other preparatory costs relative to the value of the land. ■

# Tax and the kids' savings

If a child is under the age of 18, and they earn income on their savings account, remember that the ATO considers that the person who “owns” the interest depends on who uses the funds of that account (no matter what type of account it is or the name of the account holder).



Photo by Limor Zellermayer on Unsplash

The ATO says you need to consider who provides the money, such as the initial and ongoing deposits into the account, and who decides how the money is spent, regardless of who it is spent on. In other words, if you provide the money and spend it as you like, you must include the interest in your own tax return.

If the person who owns or uses the funds is the parent, and so acts as a trustee for the child but there's actually no formal trust arrangement in place, the ATO will expect that the parent's TFN should be used. But if a formal trust exists, you should quote the trust's TFN.

If you hold a joint account, interest earned is divided equally among all account holders, who each declare their share of the income in their tax return.

## TAX RATES

Residents under the age of 18 pay tax at different rates to adults. The tax free threshold is only \$416. Between that and \$1,307 the rate is 66%, and over \$1,307 it is 45%. These higher rates are there to discourage adults from splitting their own income and diverting some of it to a child's account.

Note however that those rates mostly apply to non-PAYG income. If the minor concerned is an “excepted” person, all income is taxed at the same rate as if they were an adult. This may apply if the minor:

- has finished full-time study and is working full time
- has disabilities
- is entitled to a double orphan pension.

## AGE AND TFNS

A child can apply for a tax file number (TFN) – there is no minimum age. Children are not exempt from quoting a TFN. When deciding whether to quote a TFN, you need to consider your child's age and the amount of interest they receive.

If your child is less than 16 years old, special rules apply to their income from a savings account. (And just so you know, the ATO treats a child as being under 16 years old until the end of the calendar year in which they turn 16.)

If your child is:

- any age and they earn less than \$120 per year from savings accounts, their financial institution will not withhold tax

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# CGT exemption on inherited homes



Photo by Gus Ruballo on Unsplash

Inheriting a home or a legal interest in one could be the largest windfall gain that many Australians ever experience. From a tax law perspective, when someone dies a capital gain or loss does not apply when a property passes:

- to the deceased person's beneficiary
- to the deceased person's executor or other legal personal representative (LPR), or
- from the deceased's LPR to a beneficiary.

While generally no CGT applies when assets are distributed to beneficiaries, there may be CGT implications when the executor or beneficiary sells the inherited asset to a third party (see flowchart overleaf).

## SELLING AN INHERITED PROPERTY

There are different factors that influence whether CGT will apply, including whether the asset was a pre-CGT asset or not. Assets acquired before 20 September 1985 (when CGT was introduced) are considered pre-CGT assets.

For the most part, if the beneficiary sells a dwelling within two years of the deceased's death, then CGT does not apply (more below).

For dwellings acquired after 19 September 1985 to be exempt from CGT, the beneficiary must generally satisfy that the dwelling:

- was the deceased's main residence at the time or just before their death
- was not used to produce assessable income at the time of death, and
- is sold within two years of the deceased's death.

Note that there can be exceptions regarding whether the dwelling was a main residence before death. This includes where the owner, say, was in a nursing home before their death and the main residence was rented out. (This is known as the "absence concession".)

## THE TWO-YEAR RULE

When assessing this two-year period, where the property is sold under contract, the settlement (rather than exchange of the contract) must occur within two years of the date of death.

Note that there are some circumstances where an extension to the two-year rule may be granted. These include (but are not limited to):

- if the ownership of a dwelling or a will is challenged
- the complexities of estate delay the completion of its administration
- a trustee or beneficiary is unable to attend to the deceased estate due to unforeseen or serious personal circumstances, and

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### CGT exemption on inherited homes *cont*

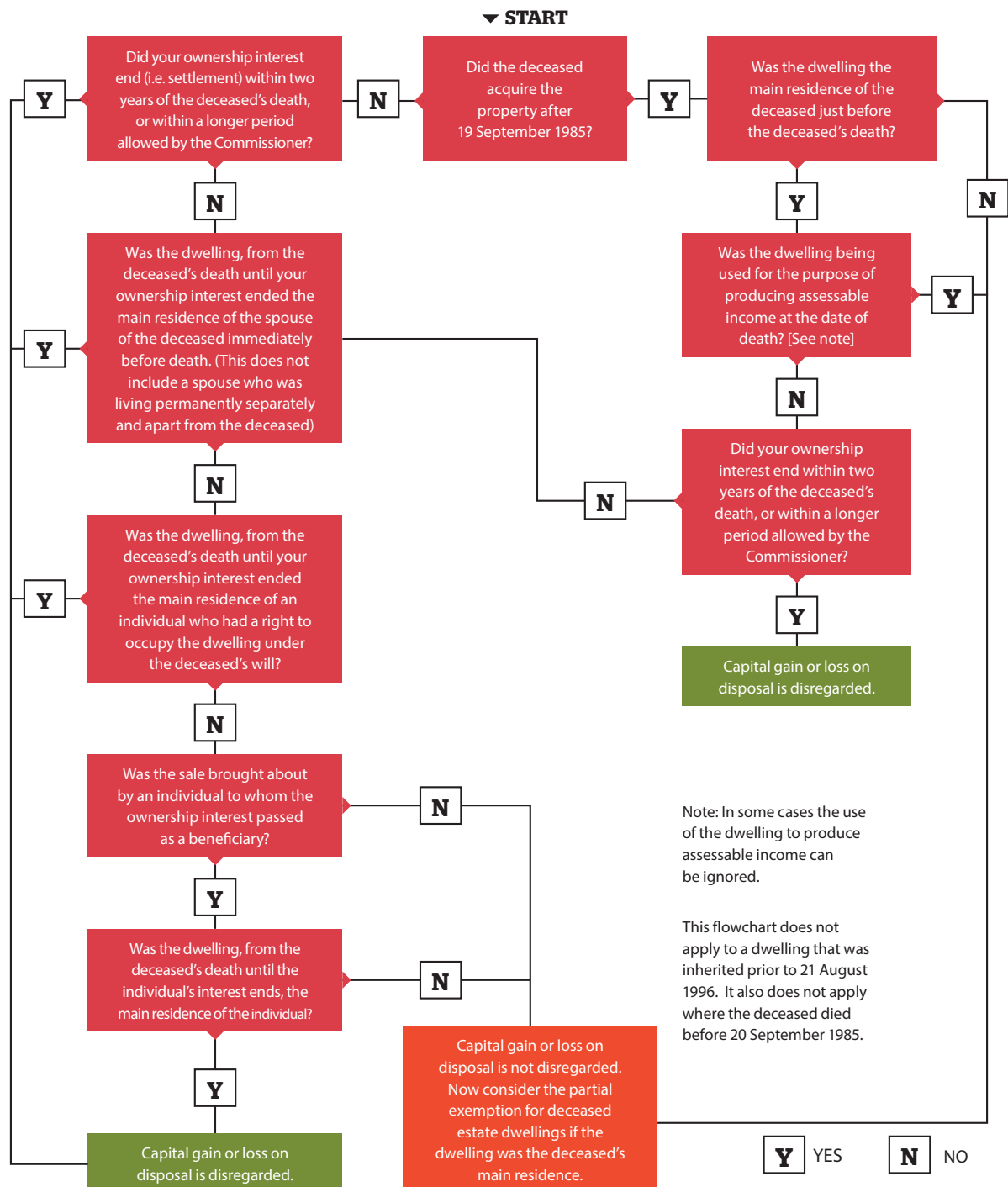
- the settlement of a contract of sale over the dwelling is unexpectedly delayed or falls through due to circumstances outside the beneficiary or trustee's control.

Further, if the deceased has given someone, eg a spouse or family member, a lifetime right to reside in the property, then the beneficiary may be exempt from the two-year rule. There are other circumstances where a gain can be exempt and the two-year rule has not been satisfied.

### PARTIAL EXEMPTION

Note, if the two-year deadline is not met, it doesn't necessarily mean that the entire capital gain on the property will be subject to CGT. It may be that only part of the gain is subject to CGT, and this amount may not be significant.

Each case needs to be dealt with on an individual basis, and is generally best discussed with this office. ■



# SMSF trustees: Operating expenses you can deduct

Operating expenses that are incurred by an SMSF are mostly deductible, however there can be exceptions to the extent that these relate to the gaining of non-assessable income (such as exempt current pension income) or are capital in nature. The following are examples of the types of operating expenses that are typically deductible for SMSFs under the general deduction rules.

## ASIC ANNUAL FEE

ASIC charges an annual fee to special purpose companies, whose sole purpose is to act as a trustee of a regulated superannuation fund. While about half of SMSFs operate under an individual trustee structure, many choose to use a corporate trustee arrangement.

Corporate trustees pay an initial ASIC registration fee but are also required to pay an annual fee. The ASIC annual fee is payable where an SMSF has a corporate trustee and, as such, this expense is deductible.

## MANAGEMENT AND ADMINISTRATION FEES

These are costs associated with the daily running of the fund such as preparing trustees' minutes, stationery and

postage fees. Such costs must be apportioned if the fund earns both assessable and non-assessable income. No apportionment is necessary for costs that are wholly incurred in collecting and processing contributions (for example, costs associated with obtaining an electronic service address [alias] to meet data standards requirements). An SMSF may incur other more specific management and administrative costs in running the fund, and it can pay to keep evidence.

## AUDIT FEES

An SMSF is required by the super laws to ensure that an approved SMSF auditor is appointed to give the trustee(s) a report of the operations of the entity for each year of income. Audit expenditure that relates to meeting obligations under super laws is deductible but must be apportioned if the SMSF gains or produces both assessable and non-assessable income.

However any administrative penalties that can be levied on a trustee under the super laws are not deductible to the fund as they are incurred by the trustee of the fund (or director of the corporate trustee) and must not be paid or reimbursed from the assets of the SMSF. ■

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## Tax and the kids' savings cont

- less than 16 years old and earns between \$120 and \$420 from savings accounts per year and
  - provides either their date of birth or a tax file number (TFN), the financial institution will not withhold tax and they don't need to lodge a tax return
  - doesn't provide either their date of birth or TFN, the financial institution will withhold PAYG tax at 47% and they need to lodge a tax return if they want a refund
- less than 16 years old and earns \$420 or more from savings accounts per year and
  - provides their TFN, the financial institution will not withhold tax
  - doesn't provide their TFN, the financial institution will withhold PAYG tax at 47% and they need to lodge a tax return if they want a refund
- 16 or 17 years old, earns \$120 or more from their savings account per year and
  - provides their TFN, the financial institution will not withhold tax
  - doesn't provide their TFN, the financial institution

will withhold PAYG tax at 47% and they need to lodge a tax return if they want a refund.

If you have a joint account between an adult and a child aged under 16 years, the same rules apply as those for a 16 or 17 year old.

## AMOUNT OF INTEREST EARNED

The amount of interest applies to the total interest earned – not just the amount above the threshold (\$420 or \$120, depending on their circumstances). Where a deposit has a term of less than one year, or where interest is paid more than once per year, the ATO applies a daily pro-rata calculation of the threshold (\$420 or \$120 depending on their circumstances).

## LODGING A TAX RETURN

If your child has had PAYG tax deducted, you will need to lodge a tax return on their behalf if they wish to claim any refund owed. If your child does not have a TFN, you will need to get one before you can lodge a tax return on their behalf. ■

# Rental property owners: Top 10 tips to avoid common mistakes



Photo by Brandon Griggs on Unsplash

The ATO is reminding rental property owners that each year it sees some fairly common mistakes being made with tax claims, and the outcomes that result, in regard to investment properties. It has therefore released a list of the top 10 stumbles, and how best to avoid them.

## **1 APPORTIONING EXPENSES AND INCOME FOR CO-OWNED PROPERTIES**

If you own a rental property with someone else, you must declare rental income and claim expenses according to your legal ownership of the property. As joint tenants your legal interest will be an equal split, but as tenants in common you may have different ownership interests.

## **2 MAKE SURE YOUR PROPERTY IS GENUINELY AVAILABLE FOR RENT**

Your property must be genuinely available for rent to claim a tax deduction. This means:

- you must be able to show a clear intention to rent the property

- advertising the property so that someone is likely to rent it and set the rent in line with similar properties in the area
- avoiding unreasonable rental conditions.

## **3 GETTING INITIAL REPAIRS AND CAPITAL IMPROVEMENTS RIGHT**

Ongoing repairs that relate directly to wear and tear or other damage that happened as a result of you renting out the property can be claimed in full in the same year you incurred the expense. For example, repairing the hot water system or part of a damaged roof can be deducted immediately.

Initial repairs for damage that existed when the property was purchased, such as replacing broken light fittings and repairing damaged floor boards, are not immediately deductible. Instead these costs are used to work out your capital gain or capital loss when you sell the property.

Replacing an entire structure like a roof when only part of it is damaged or renovating a bathroom is classified as an improvement and not immediately deductible. These are building costs that you can claim at 2.5% each year for 40 years from the date of completion.

If you completely replace a damaged item that is detachable from the house and it costs more than \$300 (for example, replacing the entire hot water system) the cost must be depreciated over a number of years.



## **4 CLAIMING BORROWING EXPENSES**

If your borrowing expenses are over \$100, the deduction is spread over five years. If they are \$100 or less, you can claim the full amount in the same income year you incurred the expense. Borrowing expenses include loan establishment fees, title search fees and costs of preparing and filing mortgage documents.

## **5 CLAIMING PURCHASE COSTS**

You can't claim any deductions for the costs of buying your property. These include conveyancing fees and stamp duty (for properties outside the ACT). If you sell your property, these costs are then used when working out whether you need to pay capital gains tax.

## **6 CLAIMING INTEREST ON YOUR LOAN**

You can claim interest as a deduction if you take out a loan for your rental property. If you use some of the loan money for personal use such as buying a boat or going on a holiday, you can't claim the interest on that part of the loan. You can only claim the part of the interest that relates to the rental property.

## **7 GETTING CONSTRUCTION COSTS RIGHT**

You can claim certain building costs, including extensions, alterations and structural improvements as capital works deductions. As a general rule, you can claim a capital works deduction at 2.5% of the construction cost for 40 years from the date the construction was completed.

Where your property was owned by someone else previously, and they claimed capital works deductions, ask them to provide you with the details so you can correctly calculate the deduction you're entitled to claim. If you can't obtain those details from the previous owner, you can use the services of a qualified professional who can estimate previous construction costs.

## **8 CLAIMING THE RIGHT PORTION OF YOUR EXPENSES**

If your rental property is rented out to family or friends below market rate, you can only claim a deduction for that period up to the amount of rent you received. You can't claim deductions when your family or friends stay free of charge, or for periods of personal use.

## **9 KEEPING THE RIGHT RECORDS**

You must have evidence of your income and expenses so you can claim everything you are entitled to. Capital gains tax may apply when you sell your rental property. So keep records over the period you own the property and for five years from the date you sell the property.

## **10 GETTING YOUR CAPITAL GAINS RIGHT WHEN SELLING**

When you sell your rental property, you may make either a capital gain or a capital loss. Generally, this is the difference between what it cost you to buy and improve the property, and what you receive when you sell it.

Your costs must not include amounts already claimed as a deduction against rental income earned from the property, including depreciation and capital works. If you make a capital gain, you will need to include the gain in your tax return for that income year. If you make a capital loss, you can carry the loss forward and deduct it from capital gains in later years. ■

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This information has been prepared without taking into account your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation or needs.