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Ban on SMSF in-specie contributions dropped

After the fuss generated by the government's decision last year to ban related party off-market asset transfers, self-managed superannuation funds (SMSFs) can rejoice following the quiet removal of the proposed amendments from legislation that passed the House of Representatives in early June.

Under the initial proposal, the government announced that off-market transactions that result in a contribution being made to an SMSF in the form of an asset – otherwise known as in-specie contributions – were to be no longer permitted.

The move followed the Cooper Review findings that pointed to a lack of transparency and the potential for greater abuse of related party off-market asset transfers when compared to non-related party transactions.

Now that these amendments are not coming into effect on July 1, 2013 as previously intended:

- off-market asset transfers from a related party to an SMSF are still permitted
- an independent qualified valuation will not be required when acquiring business real property from a related party or for disposal of real property to a related party, (however arms' length transactions are necessary for all SMSF dealings), and
- measures will not be introduced to prevent the disposal of assets to related parties, unless otherwise covered within superannuation law (e.g. collectables).

The SMSF Professionals' Association of Australia (SPAA) welcomed the government's decision, saying it would have imposed "inequitable and costly compliance conditions" on SMSFs looking to buy or sell assets to or from related parties.

"SPAA was especially concerned about increased costs for SMSFs transferring listed securities from a related party into the SMSF and is pleased to see that SMSF trustees will not be faced with increased costs," SPAA chief executive Andrea Slattery said.

"The proposed legislation also removed the existing requirement that an SMSF must intentionally acquire an asset from a related party in order to fall foul of the law. This could have seen more SMSF trustees penalised by the legislation where they have made an unintentional mistake," she added.

According to Slattery, another problem with the proposed amendments, as they stood, was the requirement for qualified independent valuations every time a transfer of business real property took place into or out of an SMSF.

In the area of collectable investments and SMSFs, the SPAA also had concerns. "The simple fact is that for some collectables it is difficult to find valuers and professional advisers who have the specific knowledge, experience and judgement to make a decision," said Slattery. ■

About this newsletter

Welcome to Geoffrey Cliff & Associates' client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us via the details below.

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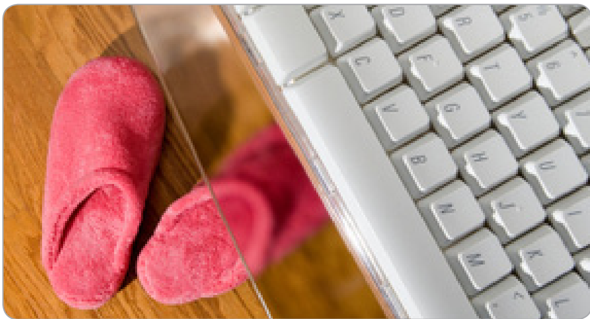
Tax and working from home

The ATO usually views expenses associated with a person's home as those of a private nature. But if you produce your income at home, or some of it, and incur expenses from using your home as your "office" or "workshop", you will generally be able to claim certain expenses as deductions.



Tax deductions are available from the use of your home to earn income in two circumstances. First, if your home is used in connection with your income earning activities but isn't a place of business (that is, your home is not your principal place of business, but you might do a few hours of work there). The second situation in which you can claim a tax deduction is when the home is being used as a place of business. The tax implications are different depending on which of these circumstances applies.

In broad terms, expenses fall into the following categories — running expenses, occupancy expenses, and depreciation on equipment.

Running expenses

You can generally view running expenses as those costs that result from you using facilities in your home to help run the business or home office. These would include electricity, gas, phone bills and perhaps cleaning costs. But again you can only claim a deduction for the amount of usage from the business or home office, not general household expenses.

Using your floor area may be an appropriate way of working out some running expenses. If the floor area of your home office or workshop is 10% of the total area of your home, you can claim 10% of heating costs. An alternative can be to compare before and after average usage for each cost. Another possibility is to keep a representative four-week diary to work out a pattern of use for your home work area for the entire financial year.

Instead of recording actual expenses for heating, cooling or lighting, you may be able to claim a deduction of 34 cents per hour based on actual use or an established pattern of use. This rate is based on average energy costs used in home work areas.

Telephone expenses

If you use a phone exclusively for business, you can claim a deduction for the phone rental and calls, but not the cost of installing the phone. If you use a phone for both business and private calls, you can claim a deduction for business calls and part of the rental costs.

You can identify business calls from an itemised phone account. If you do not have an itemised account, you can keep a record for a representative four-week period to work out a pattern of business calls for the entire year.

Mostly what the ATO wants to see with all of the above expenses is that an effort has been made to establish a reasonable claim, and that the private or domestic part of these expenses has been excluded. Talk to this office about what will be most appropriate to your circumstances.

Deductions for occupancy

Occupancy expenses are those expenses you pay to own, rent or use your home, even if you are not carrying on a home-based business. Occupancy expenses typically include:

- rent, or mortgage interest
- council rates
- land taxes
- house insurance premiums.

You must pass what the ATO calls an "interest deductibility test" before you can claim occupancy expenses (ask us about this). This generally means however that the ATO expects you will have an area of

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your home set aside exclusively for business activities, such as an office or workshop, and that this area has "the character of a place of business" rather than simply being an office you use incidentally for income producing purposes.

You can generally claim the same percentage of occupancy expenses as the percentage area of your home that is used to make income. One common way to work this out is to use the floor area put aside for work. This is calculated as a proportion of the floor area of your home as a whole (as can be used for some running expenses, as mentioned above).

So if, for example, your home office is 10% of the total area, then you may be able to claim 10% of rent costs or mortgage interest, council rates, insurance etc. In some situations it may be necessary to adopt a basis other than floor area, for example where say a huge workshop attached to the home may take up a great amount of floor space but contribute much less to the value of the overall property.

Note that where you are running a business from home rather than having a home office you can opt to claim occupancy expenses, such as mortgage interest. However, you'll be expected to account for any capital gains attributable to the business area of the home when you sell the house. Generally the family home is exempt from capital gains tax (CGT), but if you've carried on a business based on the above, that portion of the home attributable to the business activity will be subject to CGT. There are however some CGT concessions for small businesses, which we can detail for you should this be relevant to your situation.

Depreciation deductions

There are also deductions available for a "decline in value" (depreciation) of items such as electrical tools, desks, computers and other electronic devices, as well as for carpets, curtains, chairs and so on.

If you use your depreciating asset solely for business purposes, you can claim a full deduction for the decline in value (generally over its "effective life"). Remember however, that if you qualify as a "small business entity" (less than $2 million a year turnover) you can immediately write off most depreciating assets that cost less than $6,500 (from the 2012-13 income year onward). You may also be able to pool most other depreciating assets and claim a deduction for them at a rate of 30% (15% for the first year of purchase).

However, if you also use the depreciating asset for non-business purposes, you must reduce the deduction for decline in value by an amount that reflects this non-business use. Talk to this office for more information about claiming depreciation expenses. ■

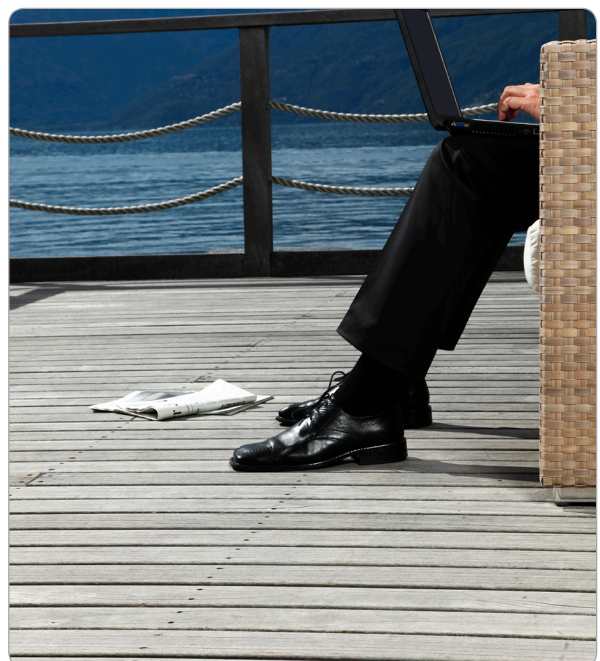
Common SMSF property investment mistakes

In the four years to June 30, 2012, the self-managed superannuation fund (SMSF) sector grew by 33%, or $109 billion, making it not only the largest slice of the total Australian superannuation pie, but also the fastest growing.

The recent growth in the value of assets held in SMSFs has seen a particular investment area dominate — and that is real estate. Being able to invest retirement savings beyond the stalwart asset classes of shares, fixed interest or cash and into real property has been eagerly taken up by many SMSF trustees.

And ever since the way was opened for trustees to borrow to invest in property, many SMSFs have been entering the real estate market with renewed gusto.

However this in itself has been found to lead to other potential problems — so much so the ATO saw fit to issue a taxpayer alert on the subject. The ATO's concerns specifically focus on the arrangements being used by SMSFs to invest in direct property. In short, it



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is worried that the mistakes it has seen being made by SMSF trustees (some of which would admittedly be easy mistakes to make) could end up fast-tracking many SMSFs to the non-compliant sin bin.

Geared property bought in the name of the individual rather than fund

A common error with SMSF property purchases is having the title recorded in the individual person's name, and not the SMSF. This can come about from the trustee turning up at a property for sale that they are interested in and signing on the dotted line without putting proper thought into the deal. To remain compliant, the property should not be held in an individual's name. Even where a sale contract has "and/or nominee" to be potentially added later, a lot of the time the paperwork is never rectified.

A property is purchased with two or more titles

The gearing arrangement that is applied for an SMSF buying property only allows for a "single acquirable asset", so real estate that is already sub-divided or comes with more than one title is off the agenda. Not only that, but real estate for which there is no legal impediment to sub-division or to having portions "assigned or transferred separately" are also in breach of the provisions.

Property is acquired before trustee or holding trust are established

At the time a property contract is signed to acquire a real property asset, the trustee and the holding trust must be in existence. Again, this error can occur simply through bad timing regarding the actual transaction of buying the property. If say a bargain property is leapt upon over a weekend, and the buyer calls us the very next Monday to set up a holding trust and corporate trustee, the rules will have already been breached. The acquiring entity must already exist before a contract to acquire a property asset is signed.

Purchase of residential property from a related party

It's a straightforward rule, but one that seems to be an ongoing problem. While a property from which a business is run is another matter, if structured in the correct manner, your SMSF just cannot buy residential property from yourself or a related entity.

And not only purchasing, but even leasing out such a property is breaking the rules (so no renting out the SMSF-owned holiday house to relatives, for example).

The real estate in question is an empty block

An easy mistake to make, but as SMSFs are not allowed to use borrowings to improve property investments, a vacant lot of land cannot then have a house built on it under the loan arrangements available to SMSFs. So there is no, for example, borrowing $500,000, buying an empty block for $300,000, and using the rest of the loan amount to construct a building.

While owning a property and making improvements to it are fine for an SMSF that owns the real estate outright, if there is borrowed money involved, the rules change. ■

Trustees: July 31 deadline for new beneficiaries to provide TFNs

Closely held and family trust beneficiaries are reminded that they must quote their tax file numbers (TFNs) to trustees before July 31. Otherwise, the trustee is obliged to withhold tax at the top marginal rate, plus Medicare, from any payments distributed to you. A trustee failing to do so can also have penalties applied.

In particular, the trustee must lodge a "TFN report" to the ATO by July 31, disclosing new beneficiaries to whom distributions are to be made to.

An "Annual trustee payment report" containing details of all payments made to beneficiaries for the year is also required. This is done by completing relevant information in the trust tax return.

The ATO uses this information to determine whether taxpayers have correctly disclosed trust income in their own tax returns.

So, if you're a trustee of a trust which is distributing to new beneficiaries in the 2012-13 income tax year, make sure you contact our office. We can assist you in lodging a TFN report (if necessary) so that you pass on the relevant TFNs to the ATO.

Increase in Medicare levy to affect other tax rates

By now, most of you will be aware of the government's decision to increase the Medicare levy by 0.5% to fund Australia's DisabilityCare program. From July 1, 2014, the Medicare levy will increase from 1.5% to 2% of taxable income. What many people may not realise however is that the Medicare levy increase will cause a number of other tax rates to increase by 0.5% as well.

These include taxation rates involving issues as diverse as fringe benefits tax, employee share schemes and even first home saver accounts.

A summary of the key tax rates that are linked and will be affected by the increase in the Medicare levy are included in the table set out below.

Status of legislation

Following the Federal Budget, the *Medicare Levy Amendment (DisabilityCare Australia) Bill 2013* to increase the Medicare levy and other accompanying bills to amend other linked tax rates were introduced into the House of Representatives on May 15, 2013. These passed the House of Representatives and the Senate on May 15 and 16 respectively and became law on May 28, 2013 after receiving Royal Assent. ■

Area of tax law	Current rate	New rate	Date of effect
Fringe Benefits Tax	46.5%	47%[1]	April 1, 2014 and later tax years
Superannuation			
- Excess concessional contributions tax	31.5%	32%	2014-15 financial year and later
- Excess non-concessional contributions tax	46.5%	47%	2014-15 financial year and later
- Excess untaxed roll-over amounts tax	46.5%	47%	Excess untaxed roll-over amounts paid on or after July 1, 2014
Withholding for Tax File Number (TFN) or Australian Business Number (ABN) not quoted[2]	46.5%	47%	Applies to payments made on or after July 1, 2014
Trusts			
- Family Trust Distributions Tax	46.5%	47%	Applies to tax payable on notices given by the Commissioner of Taxation on or after July 1, 2014
- Trustee Beneficiary Non-disclosure Tax	46.5%	47%	2014-15 income year and later income years
Employee Share Schemes (ESS) - TFN/ABN Withholding Tax	46.5%	47%	Applies to 'ESS interests' provided on or after 1 July 2014
First Home Saver Accounts (FHSA) - FHSA Misuse Tax	46.5%	47%	Applies to payments from a FHSA made on or after 1 July 2014

1: Note that gross-up rates for FBT purposes will also change due the Medicare levy increase. The Type 1 and Type 2 gross-up rates will be 2.0802 and 1.8868 respectively.

2: The tax rates for withholding where a TFN or ABN have not been quoted have been automatically revised to 47% to reflect an increase in the Medicare levy – no amending legislation was required. An example of such TFN withholding is where a taxpayer fails to provide their TFN details to a bank where interest income is being derived.

Employee or contractor? Some common myths

The ATO still finds that there are several assumptions adopted by both workers and employers when determining the tax status of a job appointment, and that employers continually rely on some inaccurate factors when working out whether a worker is an "employee" or "contractor". Getting that assessment wrong can have significant tax consequences for employers' tax and super obligations.

To separate fact from fiction, here are a few of the common myths the ATO says can often get both businesses and workers into hot water.

Having an Australian Business Number (ABN)

Myth: If a worker has an ABN they are a contractor.

Fact: Just because a worker has an ABN does not mean they will be a contractor for every job. Whether the worker has or quotes an ABN makes no difference and will not change the worker into a contractor. To determine whether a worker is one or the other, you need to look at the whole working arrangement and examine the specific terms and conditions under which the work is performed.

Using invoices

Myth: If a worker submits an invoice for their work, they are a contractor.

Fact: Submitting an invoice for work done or being "paid on invoice" does not automatically make a worker a contractor. It is necessary to examine the specific terms and conditions under which the work is performed. If based on the working arrangement that a worker is an employee, submitting an invoice or being paid on the basis of an invoice will not change the worker into a contractor.

The 80% rule

Myth: A worker cannot work more than 80% of their time for one business if they want to be considered a contractor.

Fact: The 80% rule, or 80/20 rule as it is sometimes called, relates to personal services income (PSI) and how a contractor:

- reports their income in their own tax return, and
- determines if they can claim some business-like deductions.

It is not a factor a business should consider when they determine whether a worker is an employee or contractor.

Registered business name

Myth: If a worker has a registered business name, they are a contractor.

Fact: Having a registered business name makes no difference to whether a worker should be an employee or contractor for a particular job. Just because a worker has registered their business name does not mean they will be a contractor for every job or working arrangement.

Paying superannuation

Myth: "My business should only take on contractors so we do not have to worry about super."

Fact: A business may in fact be required to pay super for their contractors. If you pay an individual contractor under a contract that is wholly or principally for the labour of the person, you have to pay super contributions for them.

Short-term work

Myth: Employees cannot be used for short jobs or to get extra work done during busy periods.

Fact: The length of a job (short or long duration) or regularity of work makes no difference to whether a worker is an employee or contractor. Both can be used for the following:

- casual, temporary, on call and infrequent work

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- busy periods, or
- short jobs, specific tasks and projects.

To determine whether a worker is an employee or contractor, you need to look at the whole working arrangement and examine the specific terms and conditions under which the work is performed.

Contracting on different jobs

Myth: If a worker is a contractor for one job, they will be a contractor for all jobs.

Fact: If a worker is a contractor for one job, it does not guarantee they will be a contractor for every job. The terms and conditions under which the work is performed will determine whether a worker is an employee or contractor for each job.

Depending on the working arrangement, a worker could be an:

- employee for one job and a contractor for the next engagement, or
- employee and a contractor — if completing two jobs at the same time for different businesses.

Specialist skills or qualifications

Myth: Workers used for their specialist skills or qualifications should be engaged as contractors.

Fact: If a business takes on a worker for their specific skills it does not automatically mean they are a contractor. A worker with specialist skills or qualifications can either be an employee or contractor depending on the terms and conditions under which the work is performed. Qualifications or the level of skill a worker has (including whether they are "blue" or "white" collar) makes no difference to whether a worker is an employee or contractor.

Past use of contractors

Myth: "My business has always used contractors, so we do not need to check whether new workers are employees or contractors."

Fact: Before engaging a new worker (and entering into any agreement or contract), a business should always check whether the worker is an employee or contractor by examining the working arrangement.

Unless a working arrangement (including the specific terms and conditions under which the work is performed) are identical, it could change the outcome of whether the worker is an employee or contractor.

Sometimes a business may also have incorrectly determined their worker is a contractor. Continuing to rely on the original decision would mean the business is incorrectly treating all future workers as contractors when they are employees.

It is common industry practice

Myth: "Everyone in my industry takes on workers as contractors, so my business should too."

Fact: Just because "everyone" in an industry uses contractors does not mean they have correctly worked out the decision. Do not consider common industry practice when determining whether work is undertaken as an employee or contractor. ■

TIP: To help employers work out whether they have engaged an employee or contractor, the ATO has made available an "employee/contractor" decision tool on its website at www.ato.gov.au.

Can paying for insurance be tax deductible?

The pain of having to fork out for insurance premiums can be somewhat justified when the event you are insuring against comes to fruition. It's probably safe to say that most people would rather not make a claim. However, there can be some pre-emptive relief from the pain of these payments through taking account of any possible tax deductions available for premiums on certain forms of insurance cover.

General rules for claiming a deduction

As a general guide, the ATO will allow a deduction for insurance premiums if it can be shown that the insurance relates to a taxpayer earning assessable income.

Income protection insurance is one example of the kind of cover that generally provides an allowable tax deduction for premiums. This may also be the case for sickness and accident insurance cover.

The ATO states that "you can claim the cost of any premiums you pay for insurance against the loss of your income", and that you "must include any payment you received under the policy for loss of your income ... on your tax return". Such payments must be declared as income for the financial year in which it is received.

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The ATO notes however that you cannot claim a deduction for policies to compensate for such things as physical injury. Life insurance, trauma insurance and critical care insurance are other policies for which premiums are commonly not deductible.

The deciding factor centres on whether the insured event influences a taxpayer's ability to earn assessable income. For the self-employed for example, this can mean that taking out disability insurance against loss of income could generate a tax deduction for the premiums paid.

For anyone running a small business, insurance premiums incurred in relation to protecting the business's income earning capacity or protecting its business assets (eg. premises) would typically be deductible. Commonly deductible premiums include car insurance, building insurance or cover for professional or public liability.

Combined insurance covers

Some combined insurance products may cover both a loss of income and capital, which can create difficulties in working out the extent of any deductions for the premium paid. Income protection cover, for example, is often offered with combined death and disability cover. This means there is a form of "capital" that is covered – this being the value allowed for the death of a person, or that person's injury or disablement. These are normally paid out in a lump sum.

In working out the premium's tax deductibility, it is only the income protection component that is allowable. Where the policy provides benefits that are capital in nature, premiums may have to be apportioned between the income and capital components. It is important to note that if the premiums cannot be apportioned, the ATO has been known to treat the whole of the premium as being non-deductible.

Insurance cover taken by business

For a business, premiums paid for workers compensation are generally tax deductible. Some businesses may pay premiums that cover for foreign exchange losses that may arise from obtaining loan funds overseas to be used in the business. A deduction is generally available for costs incurred in respect of such cover.

Another type of insurance product that is common for businesses is "key person" or "key employee" insurance. This is to cover situations where the loss of a key employee, even if temporarily out of action, can be financially damaging to the business.

While the deductibility of premiums for this type of cover may seem a given, this may not always be the case. Premiums for such cover will be deductible if the protection is for "revenue" – such as having the policy specify that cover is for loss of profit or business revenue due to the death, injury or otherwise of the key person insured.

But if the policy is seen by the ATO to be taken out to protect from losses that are more of a "capital" nature (for example, where a lump sum is paid to the key person's deceased estate) then the premiums may not be allowed as deductions.

Where both types of cover are involved in the one policy, again some apportionment of premiums may be needed to work out the amount deductible. Some policies may not clearly define these items.

Where to from here?

To work out whether insurance premiums are deductible, it would be necessary to refer to the insurance contract, including any product disclosure statements from the provider. This will allow you to fully understand the type of cover sought and whether there are any "revenue" and/or "capital" components.

The simple message therefore is: if you are considering various forms of insurance cover, consult with this office before committing to your policy or paying your premium. We can help you work out if a deduction is available. ■