SUPA MORTGAGES

Money News

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Happy Tax Returns.

So we're all going to get a tax cut next financial year – always a welcome event. But, in the dying stages of 2006-07, how do you set about reducing this year's liability?

There are, of course, all the usual techniques. These broadly fall into two categories: incur tax-deductible expenses now and defer taxable income, where possible, until next year.

But the experts suggest you try the following. If you have made some hefty capital gains over the year - a strong possibility given the roaring share market– KPMG tax partner Lachlan Wolfer says there are a few ways to cut your tax.

The first is to sell off loss-making investments as soon as possible as these can be used to offset your gains. Remember, if you have participated in a buyback during the year you may have racked up an effective loss. The second strategy applies to those who have derived less than 10 per cent of their income from employment this financial year. By making a contribution to super before July 1st, you can claim a tax deduction up to the age-based limits.

Where you own shares in a takeover target, you might also consider taking script rather than cash - this allows you a CGT rollover until you sell the new shares, at which time tax rates will be lower.

On the salary package front, you can perform a classic double-dip by buying a laptop computer, personal digital assistant, electronic diary or calculator before the end of the tax year. Andrew Gardiner, spokesman for the National Tax and Accountants Association, says that while the reimbursement from your employer will include GST, you need only salary package the GST-exclusive amount because the employer can generally claim GST input tax credits. So you might be reimbursed $3300 but salary package only $3000.

Better still, even though you have received that reimbursement, you can still claim depreciation– on the GST-inclusive cost, hence $3300 in the example above. The only proviso is that you use the equipment for income-producing purposes.

Modelling by the NTAA shows the strategy will increase net disposable income by $1245 for someone on a salary of only $35,000. Naturally, employees on higher salaries stand to save much more.

With regards to super, be aware that is you have inadvertently contributed more that $1 million after tax between May 10 and December 6, 2006, you need to get the money out - and fast. Michael Perry, a superannuation specialist with Superannuation Australia, says you will pay at 46.5 per cent on the excess unless you submit a request for a transitional release authority to the Tax Office before July 1 - and it is subsequently approved. Besides the above ways to cut your tax, there is also the tried and tested technique of borrowing to invest, which is even more attractive at this time of year because you can pre pay next year's interest.

Remember, though you should never undertake any investment purely to attain a tax advantage.

Source: Financial Review, Smart Investor: June 2007.

Deductions - General Rules.

Allowable deductions are losses or outgoings to the extent that:

- They are incurred in gaining or producing your assessable income, or
- Necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.

However, you cannot deduct an outgoing if it is of a capital, private or domestic nature, or relates to the earning of exempt income.

Capital expenditure is not deductible; however it is possible to claim depreciation in respect of plant and equipment used to gain assessable income. You can also claim capital works deductions for the cost of buildings used in producing income.

Some expenses may be for both business and private purposes. The business proportion is deductible and it is helpful if you maintain a diary or some other evidence of business usage.

Some expenses are required to be substantiated. You can read extensive explanations about deductions and depreciation in The Taxation Examiner Ready Reference. A depreciation checklist is also available. There are also a number of other provisions in the Income Tax Assessment Act which provide specific deductions for other payments (such as bad debts, borrowing costs, environmental protection expenditure etc.).

ACCOUNTING COSTS

Payments to your accountants are deductible if they are related to your business or your income tax affairs. If you are not on STS they are deductible in the year you incur the expenses, even if you have not paid them. Accordingly, an invoice dated prior to the end of the income year will be deductible even if not paid by year end.

AGENTS' FEES

When paid in the normal course of business are deductible. Agent's fees in relation to a rental property are deductible against rental income. Non-deductible fees paid on disposal of capital assets can be included in the cost of the assets when calculating the capital gain or loss.

BANK CHARGES

Bank charges and taxes are deductible for business accounts.

BODY CORPORATE FEES

These are deductible to the extent that the property is used to produce assessable income. Where the costs are not deductible they may form part of the cost base of the property as holding costs if the asset is not used for private purposes.

BORROWING EXPENSES

Are deductible if the proceeds of the loans are used for income producing purposes.

Borrowing expense include legal expenses, stamp duty, valuation and survey fees, mortgage insurance and guarantee fees. If over $100 the deduction is spread equally over the term of the borrowing up to a maximum five years.

Interest as incurred is also deductible.

Source: The Taxation Examiner, 2006-2007

Shifting Gears.

Rising rental prices are a potential godsend for Adam Schwab, a former lawyer turned property investor.

While many of Australian's residents, particularly in capital cities, fear a wave of rental hikes in the aftermath of interest rate rises that have contributed to a squeeze on the availability of accommodation, Schwab and his business partner Jeremy Same have a chance to recoup some of the capital they have poured into inner-city CBD properties in Melbourne.

In a nation that typically focuses on negatively-geared property, Schwab is an exception: through his apartment rental business Living Corporate, the aim is to positively-geared properties – a scenario whereby the annual rental income received from a property covers or exceeds the annual loan repayments and costs. Such profits incur tax, of course, but the investor is still ahead on the balance sheet.

A catch in recent years has been rents. The market for Melbourne inner-city apartments had been hot until about two years ago when rental growth "dropped dead", making it tough to get reasonable returns on property investments.

"Finally, rents are slowly starting to catch up," Schwab says. "But it's still pretty hard to positively gear in this market when you've got your body corporate fees and the like. You've got to pick and choose pretty carefully."

<u>A Positive Mindset.</u>

The Australian property market is built around negative gearing in the mortgage belt courtesy of government tax breaks that are not the norm in most Western countries.

This tax minimization toll allows property upkeep and loan costs such as interest to be deducted from a person's total income, reducing some of the pain or property costs.

MFAA CEO Phil Naylor comments that the nation's embrace of negative gearing is a "bit of an oddity". "In very few other countries can you negatively- gear. In fact, the Americans look at us and think we've got it back to front because in the US you can claim the interest paid on your home loan buy you can't claim the interest paid on an investment loan." Naylor says positive gearing tends to be the domain of serious, ongoing investors. "They're probably people who have been around for a while and have decided that owning property as an investment is part of their life strategy."

He says mortgage brokers have to be careful when dealing with clients: they should focus on offering the right financing advice rather than providing purchasing and gearing tips.

"The type of finance may influence buying – whether they're negative gearing or positive gearing. But really that's a decision the investor would most likely already have made. They're really saying… 'how do I get the right sort of loan to do that?'

<u>Bargain Hunting</u>.

As property and rental markets shift, positive gearing is becoming a more likely option in many parts of the country. Jan Somers, the founder of Somersoft Financial Services and the author of *Building Wealth through Investment Property*, has made millions buying and selling property. She expects markets to start favoring positive gearing again after a flat period caused by soaring property prices that have put property bargains on hold. "There's a huge pressure on rents again," she says. "We may well see the time come when they're creeping into positively – geared territory, but in the past two years there's been (few) positively-geared properties – virtually none, not even in regional Australia."

Before the property boom – which had its roots in Sydney and gradually spread to cities such as Brisbane, Melbourne, Hobart and Perth – Somer says there was an abundance of properties that were positively-geared. "In fact, I would say half the properties were positively-geared and half would have been negatively-geared."

In the mid –to-late-1990's and early noughties, Somer says astute investors tended to head in the bush to find positively-geared properties, Queensland was a prime target. "You could have got any numbers of positively-geared properties that were west of Ipswich and provincial towns such as Rockhampton and Mackay."

However, even opportunities in the west have dried up because of mining booms that have seen massive property rises accompanied by relatively low rent increases. There is still potential in regional areas, Somer says, "but you'd have to go well out bush, a long way out because property prices in all those places have gone through the roof. But I think the tide is turning because (rental) vacancies are down to less than 1% in some areas. When you hear that people are holding auctions just to rent a property, then that's an awful lot of pressure on rents."

Pick and Choose.

Schwab says the art of property investing clearly lies in choosing the right properties. He has bought desirable CBD and Southbank apartments in Melbourne that suit short-to medium-term rentals – "defiantly a one-month minimum, but generally we prefer three to six months". He advices steering clear of elite inner-city developments that are too expensive to purchase. "You're not going to be able to positively gear anything in (those properties), short of a miracle."

Schwab boasts returns of 8% to 10% a year, with the added bonus of capital growth on properties when they are eventually sold. He says success requires hard work. "It comes down to how well you market your product. If we have vacant properties, we're not positively gearing anything – we'll be massively negatively gearing." Others around the country are also taking a strategic approach. Two workmates in the fast-growing Mandurah region in Western Australia, for example, are tapping into the town Ravensthrope, where the impending opening of a mine ramped up demand for quality housing while also offering the prospect of significant long-term capital growth. They wanted property on which they could claim a large depreciation on their tax statements. They were also seeking a quality home that would require low maintenance and repairs. Elsewhere, a Queensland couple living in Brisbane has tapped into the searchage city of Mackay in north Queensland and the tree-change area in Lockyer Valley between Ipswich and Toowoomba, west of Brisbane. While avoiding inflated city prices, they have bought properties in growth areas.

Do Your Homework.

Warren O'Rourke, national corporate affairs manager for Mortgage Choice, says finding a positively-geared property in the city is tough because investors require a relatively cheap property that still delivers high rents – an unusual scenario.

"It would have to be a very small terrace within five minutes of the city and for some reason it's going cheap – but you can't even imagine that being the case in almost any capital in Australia," he says. O'Rourke says clever property investment "requires a fair degree of research. There will be bargains around in any market whether it's boom or bust. You've (just) got to find them…If someone has the mindset that they'll only buy if it's positively-geared then they're probably going to have to do a lot more work than someone who is going to buy on the basis of it being negatively- geared. There's no reason why you can't achieve that objective, but it's going to take a lot of work."

O'Rourke says that the rental market is defiantly tightening across many parts of the country because of a lack of new apartment developments. "That's really pushing the vacancy rates down and starting to push the rents up."

At Somersoft, Somers says markets tend to move in sequences – Sydney growth has been followed by booms in Brisbane and Perth, for example – "so it's a ripple effect and it depends where the ripple is as to what state of the game you're at."

I think the rents will continue to spiral for a good two years yet," advices Somers. "And then there comes a point where people say 'hey, it's cheaper to buy than it is to rent'. That's the point where property prices start to increase and rents fall off."

Source: Mortgage and Finance, May-June 2007.

The New Super System.

Hopefully you maximized your opportunities prior to 30 June 2007 but where do stand under the new rules? Here are the fundamentals:

- Lets deal first with tax deductible or "concessional" contributions.
- If you were aged less than 50 on 1 July 2007 the maximum in super contributions that may be made on your behalf is $50,000
- If you were 50 after 1 July 2007 the limit is $100,000 per annum up to and including 30 June 2012. These are known as the transitional provisions.
- Note that the new contributions limits are new defined in terms of the employee **not** the employer. As such "double dip" opportunities no longer exist.
- If you exceed the above limits you will be taxed 31.5% on the excess on top of the 15% contributions tax paid by your fund. This means the excess is being taxed at the top marginal rate of 46.5%.
- The Government has undertaken to index the $50,000 concessional limit in $5,000 increments. No plans exist to index the $100,000 for the over 50's because as mentioned this is a transitional measure.

What is the situation with after tax (undeducted) contributions?

From 1 July 2007 a limit of $150,000 now applies.

This limit now covers any personal contributions for which a tax deductions has not been claimed, including:

- Excess concessional contributions for which a tax deduction has not been claimed.
- Contributions on your behalf made by your spouse.
- Contributions made to claim the co-contribution (the government con-contribution does not count).
- Transfers made from foreign superannuation which are not assessable.

If you're under 65 it is possible to average the contributions over 3 years by making a contribution up to $450,000.

For example it would be possible for couples to contribute $900,000 prior to 30 June 2008. However, under averaging they couldn't make another after-tax contribution until 2010-11.

However, be careful for if you exceed the "after tax" (undeducted) limits a penalty tax of 46.5% will apply.

The $150,000 non concessional limit is indexed and will always be 3 times the concessional limit.

CONTRIBUTIONS AFTER 65.

These are possible if you meet a (work) test-discussed in past issues. However, you can't use the averaging provision meaning you are limited to after tax contributions of $150,000 per annum.

The work text requires you to work 40 hours in 30 consecutive days in the financial year of the desired contribution.

If this work test is met, you are eligible for both before and after tax contributions until you turn 75.

SELF EMPLOYED PERSONS.

The self employed have fared well under the changes

- From 1 July 2007 the self employed can now claim a full tax deduction on their contributions. Formerly they could only claim a 75% deduction on contributions over $5,000. To qualify as self employed you must earn less than 10% of your taxable income from employment.
- The self employed are able to make non consessional contributions above the $150,000 limit from the sale of assets that qualify for the small business capital gains tax exemptions. There is a lifetime limit of $1 million on such contributions.
- The self employed are now eligible for the super co-contribution.

Source: The Taxation Examiner Newsletter, August, 2007.

Too dear for young buyers.

People aged under 35 are less willing to invest in property than their elders, according to a survey.

The Galaxy Research survey of 1051 people, commissioned by Suncorp Insurance and GIO Insurance, found that while most eastern state residents believed now was a good time to buy property, pessimism was greatest among the young. They cited high interest rates and property being too expensive as the main deterrents to investing. Eighteen to 24-yr-olds were almost evenly divided among those who thought now was a good time to invest and those who disagreed, at 47 per cent each.

Fifty per cent of 25-to 34-yr-olds felt it was a good time to invest, rising to 57 per cent of 35 to 49-yr-olds and 55 per cent of people aged over 50. Of those prepared to invest, 83 per cent expected property prices would continue to rise, and 79 per cent were keen to capitalize on rising rents. Surprisingly, given the higher median house and apartment prices in NSW, a higher proportion of respondents in that state than in Victoria or Queensland believed the time was ripe to invest in property. Meanwhile, the Housing Industry Association has called for aspiring home owners to be able to salary sacrifice for their deposit. Under the so-called Home Super Saver scheme, additional voluntary contributions could be made into a superannuation account to later be used as a deposit for a home. According to HIA modeling, a household with a combined income of $100,000 saving an additional 6 per cent in super would have an extra $32,800 for their deposit after five years, the equivalent to an 11 per cent deposit on the national median first home price of $298,000.

Source: The Australian Financial Review, Sep, 2007.

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