

Landlords under ATO scrutiny

Increasing property prices and low interest rates have drawn a large number of investors into the property market. In the 2002/03 financial year, 1.3 million taxpayers claimed deductions for rental properties. Of those, 220,000 were new rental property owners. In total, deductions claimed by investors exceeded income received by over \$700 million.

It is little wonder that the ATO is taking a closer look at rental property deductions claimed. Over the last month, 5000 rental property investors

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have been asked to explain deductions claimed for depreciation.

Deductions for capital expenditure on rental properties fall into two camps:

- **Depreciating assets** - Rental property owners can claim a deduction against income for depreciating asset over the life of that asset (effective life). For example, if you replaced an electric hot water system in your rental property in July this year you can claim a deduction for the hot water system over its effective life, in this case 12 years.

and

- **Capital works** – Rental property owners can claim a deduction for expenditure on capital works completed for the purpose of producing assessable income. For example, the construction of a building for or the addition of an extra room on the rental property. Generally, capital works are written off at the rate of 2.5% per year.

The ATO recently released a new list of depreciating assets that will apply from 1 July 2004. The list covers over 150 depreciating assets common to rental properties and nominates their effective life. The list also includes assets that had not previously been allocated an effective life such as dishwashers (10 years) and ducted gas heaters (20 years). In some circumstances the effective life of some depreciating assets has been shortened enabling you to make the deductions much faster. Electric hot water systems are a case in point with the effective life reduced to 12 years from 20 years for assets purchased from 1 July 2004.

The distinction between depreciating assets and capital works has often been an area of confusion. To this end, the ATO have released a draft ruling on ‘plant’ in residential properties which aims to add clarity as to whether an asset is a depreciating asset or a capital work. Items classified as plant are generally written-off at a faster rate to those classified as capital works and are considered to be part of the building structure.

Here are a few examples of how the new ruling on plant applies in practice:

- Fire sprinklers, fire hydrants, fire hose reels and emergency lighting are considered capital works

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Choice of fund: what employers need to know

Late last month, the superannuation choice of fund legislation passed its final hurdle on its passage through Parliament with a deal brokered between the Government and the Democrats.

From 1 July 2005, employees will have the ability to choose which superannuation fund their employer directs their super guarantee to.

Currently, employees are restricted in their choice of a superannuation fund, with the superannuation guarantee directed either into a superannuation fund nominated by an Award, the majority fund of the employees, or a complying fund of the employers choosing. While employees are able to propose their preferred superannuation fund, the employer has the right to reject that proposal. As a result, employees often have several superannuation funds operating at any one time, all in line with their pattern of employment.

The new choice of fund rules places the burden of administration on the employer. From 1 July 2005, employers must give their employees a choice of funds (unless the employees are covered by state awards or have entered into certified agreements or Australian Workplace Agreements that specify the superannuation fund).

The ATO will provide employers with a standard choice form to give employees. Where an employee does not choose a fund, the employer continues to make contributions into the same fund as they do now, provided that fund offers minimum levels of insurance cover (the minimum level of insurance cover has yet to be determined).

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Low document loans: Crackdown on undeclared income

Over the last few months, 176 taxpayers became part of an Australian Taxation Office review of low document loans. Or more specifically, the difference between income declared to finance companies to substantiate their ability to repay a loan and the income declared to the ATO.

Of 176 cases examined, the ATO found that 70% appear to have either understated income or failed to lodge tax returns. In some cases, the repayments required to service the loan were greater than the annual income declared to the ATO.

Over the last few years, low or no document loans have become increasingly popular particularly with tradespeople and small business operators. Once the domain of non-bank financiers seeking market share, the speed with which the market has adopted low doc loans forced the four pillar banks to produce their own low doc offering. The Australian Prudential Regulation Authority estimates that 15% of residential mortgages are low doc loans.

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As opposed to traditional loans that require income substantiation through tax returns, low doc loans only require a declaration of income and loan serviceability.

Following the review, the ATO is likely to start a broader program of

datamatching details provided by loan providers and information provided to the ATO by taxpayers. Any discrepancies will lead to requests for additional information and in some cases audit.

To help draw out those who have failed to declare their full income, the ATO is offering a reduction in penalties where any understatement of income is voluntarily disclosed.

Call us today to discuss finding the right finance structure and mix for your business.

One off opportunity to clear tax debt

This month, the ATO is offering around 500,000 small businesses a reduction in interest and flexible payment options to clear tax debts owing.

Of the 500,000 small businesses with tax debts outstanding, half have debts of less than \$1,000.

Those that fail to take up the offer can expect to face firm recovery action.

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continued

- Ducted air conditioning is considered to be a capital work (other forms of air conditioning are considered to be plant and are depreciable over their effective life).

- Light fittings are only depreciable assets if they are external to the building.

You can find the list of depreciating assets and the new effective lives from 1 July 2004 and the draft ruling on plant in residential properties on the ATO website at www.ato.gov.au

Managing your investments and ensuring that you not only meet your compliance obligations but claim your full entitlements can be difficult. Why not give us a call today to arrange a time to discuss your tax planning and investment position.

Choice of fund: what employers need to know

Continued

Employers can refuse to change funds where the employee has changed funds within the previous 12 months or where the employee provides insufficient evidence that the fund will accept the employee's superannuation contributions.

As the new regulations for Choice of Fund are released, we'll keep you up to date of any important information. We will also be working to assist our clients to implement the changes in their workplace in the most efficient way possible.

Quote of the month

And in the end it's not the years in your life that count.

It is the life in your years.

Abraham Lincoln