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Client Information Newsletter - Tax & Super August 2014

Financial advice: What's deductible, what's not

The cherry on top of your sensible decision to obtain quality tax planning or investment advice is to find that some of the costs involved are tax deductible. But while the tax law allows specific deductions for certain expenditures regarding your tax affairs, not all costs involved with seeking investment advice are deductible. Working out whether a claim can be made for such outgoings involves a close examination of the nature of the expense.

Under the tax law's general deduction provisions, claims are allowed for outgoings to the extent that they are incurred in gaining or producing a taxpayer's assessable income. The crux of the matter in regard to financial planning comes down to the fact of there being a "connection" between deriving income and the relevant expenditure in relation to the advice sought.

Further, it is also necessary to consider whether the claim may be disallowed because it is on "capital account", or is of a private or domestic nature. You should ask this office about these distinctions.

Certain deductions however are specifically made available under tax law – a common example being that taxpayers can claim a deduction for "tax-related" expenditure such as tax return preparation and tax advice from a "recognised tax adviser".

Obtaining financial advice

With financial planning advice, the first thing to tick off is to make sure that you are taking such advice from a registered Australian Financial Services (AFS) licensee, or their representative, so that you are provided with protection if something goes wrong.



Note that if the financial planner says that they hold an AFS licence, check the company name and AFS licence number on ASIC's website.

The taxman's view on claiming a deduction

Guidance on the Tax Office's stance on these matters can be drawn from certain announcements that have been made by the Tax Commissioner — in this case, a "tax determination" specifically applying to individuals who are not running an investment business (this latter situation is an area of the tax law that is well covered).

Contact Us

Welcome to Collison Accounting's 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.

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The determination covers two types of expenses: (i) drawing up an investment plan, and (ii) ongoing fees or retainers in relation to the investment portfolio.

Generally speaking, the cost of drawing up an investment plan is not deductible, however ongoing fees in relation to an investment portfolio are.

Investment plan costs

The Tax Office does not consider the costs for creating an investment plan as deductible expenses because of three main reasons:

- these costs are incurred too early in time to be directly relatable to gaining or producing assessable income from the investment
- they are an expense associated with putting a possible income-earning investment in place, and therefore has insufficient connection to that income (if there is any at all), and
- the costs are an incidental expense and are an outlay to acquire the investment, and so warrant a conclusion that this is an outlay that is capital in nature.

Ongoing fees

The Tax Commissioner concluded that once in place, the ongoing fees or retainers made in relation to an investment portfolio are typically deductible. This is consistent with the Tax Office's position adopted in a taxation ruling which concluded that costs relating to the "servicing" of an investment portfolio should be viewed as being of a "revenue character" (although the ruling states that to remain wholly deductible, the entire fee should relate to producing income).

Further, the ruling stated that should advice be obtained over the life of an investment portfolio that suggested changes be made to the make-up of the investments therein, that this would be part and parcel of managing the portfolio, not the drawing up of a new investment plan. As such, the cost of this advice would therefore retain its "allowable deduction" status.

However where a taxpayer with existing investments approaches a planner to advise on a new investment plan, the expenditure would be deemed to be a capital outlay (that is, it would lose its deduction status), even though existing investments are incorporated.

Other deductions that would typically be deductible in relation to financial planning include the costs of attending a property investment seminar. To claim, the taxpayer must own an existing rental property, and expenses claimed must relate to the gaining of assessable income. Also, subscriptions to sharemarket information, investment journals and analysis reports of listed companies may qualify, but again must relate to earning assessable income from such investments.

New law may mean more deductions

The government has been aware for some time that financial planners sometimes incidentally provide advice that strays into the taxation area. This is a natural and at times unavoidable consequence of dealing with money matters, as tax can be a consideration with all manner of financial transactions.

From July 1, 2014, new law amendments require that AFS licensees (or their representatives) who provide what is deemed to be "tax (financial) advice services" will need to be registered with the Tax Practitioners Board (TPB, which is the official regulator of tax agents).

This is an important distinction, and certainly provides scope for taxpayers to claim legitimate deductions – particularly where it does not involve creating an investment plan or are in regard to ongoing fees such as described above.

The ability to claim a deduction for a fee or commission for advice about the operation of a tax law is restricted to advice that is provided by a "recognised tax adviser". That term includes "registered tax agents" who provide tax advice to their clients. The regulations have now been amended to include a "tax (financial) adviser" – that is, AFS licensees and their representatives who have registered with the TPB.

A deduction for tax advice from a financial planner would seem to be available as a consequence of this amendment. It is fair to say that apportionment will still be required however, where the overall advice contains non-tax related matters, with claims for the non-tax portion to be considered on a case-by-case basis (we can assist you with this).

Note that lodging tax returns on behalf of others (the services we offer, among other things) must still be provided by an appropriately registered tax agent and not by a "tax (financial) adviser" or BAS agent. ■

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Common errors of new rental property owners



Putting your money into bricks and mortar has been a traditional stalwart of investing for generations of Australians. It continues to be viewed as a solid place to park spare cash and build wealth in the long term. For many years a lot of us seem to have heeded the quote attributed to Mark Twain: "Buy land, they're not making it anymore."

Although property has the reputation of being less volatile than say the sharemarket, this isn't necessarily always the case. Valuations for property can rise or fall depending on many influences, and interest rates are ever changing, which makes maximising allowable tax deductions a priority for every rental property owner.

However, it is not uncommon for first-time rental property owners to make some mistakes when claiming rental deductions on their first tax return as a new landlord. These mistakes could end up being costly with the Tax Office increasing its focus on rental property deductions for the 2013-14 tax year.

What are these mistakes?

The Tax Office has identified some of the common errors that have been made by rental property owners in past income years. These include:

- claiming rental deductions for properties not genuinely available for rent
- incorrectly claiming deductions for properties only available for rent part of the year (such as a holiday home)
- incorrectly claiming structural improvement costs as repairs when they are capital works deductions, such as re-modelling a bathroom or building a pergola, and
- overstating deduction claims for the interest on loans taken out to purchase, renovate or maintain a rental property.

Which deductions are allowable?

There are two categories of rental property expenses you can claim:

- expenses deductible in the year you paid them — like council rates, repairs, insurance and loan interest, and
- expenses that are deductible over a number of years — like borrowing costs, claims for structural improvements, and the costs of depreciating assets (for example, a stove).

While a "non-capital" outlay to repair damage, defects or deterioration can be claimed as an immediate deduction, other costs associated with a substantial structure, such as a fence, are considered to be capital expenditure and need to be deducted over a number of years.

The amount of time the deduction for such capital expenditure is spread across depends on the type of expense incurred. For example, borrowing expenses in respect of a loan is spread over the lesser of five years or the life of the loan, assets that depreciate in value do so over their "effective life", and certain construction work deductions may even have to be spread across 40 years.

Sundry costs

Below are further sundry costs that would typically be deductible:

- cost of calls or letters to tenants, real estate agents and tradesmen
- fees and commissions paid to real estate agents to let properties and collect rent
- secretary, bookkeeping and safekeeping fees associated with the collection of rent, payment of expenses and title documents respectively
- rent paid if subletting
- cost of preparing, registering or stamping a lease of a property
- legal expenses to eject a tenant for non-payment of rent
- advertising for tenants
- mortgage discharge fees
- council rates and land tax
- insurance premiums paid for building, contents or public liability
- bank charges on the rental account

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Common errors of new rental property owners (cont)

- pest control
- cutting new keys
- cleaning expenses (eg. rubbish removal)
- gardening expenses (eg. tree trimming)
- advice about taxation matters relevant to the property
- services of tradesmen (when not associated with a "capital expense")
- servicing costs
- security system monitoring, maintenance and patrol fees, and
- losses and outgoings when letting a residence while on transfer of employment.

TIP! Remember to keep accurate records so we can ensure you only pay the right amount of tax.

What you cannot claim

Common expenses that are not deductible include:

- acquisition and disposal costs – such as purchase cost of the property, advertising expenses, stamp duty on the transfer of the property and legal costs (although they may be included in the calculation of a capital gain or loss on disposal)
- expenses that your tenants pay such as electricity or water charges, and
- expenses not related to the rental of a property such as during personal use of a holiday home that is rented out for part of the year.

The above is not an exhaustive list of all claimable and non-claimable rental property expenses. Contact this office for more, and for a full list of depreciation tables for capital expenditure deductions. ■

SMSFs: Note that trauma insurance is not allowed after July 1, 2014

From July 1, 2014, a self-managed superannuation fund (SMSF) can only provide an insured benefit for a member for an event that is consistent with one of the below conditions of release of a member's superannuation benefits:

- death
- terminal medical condition
- permanent incapacity (causing the member to permanently cease working), or
- temporary incapacity (causing the member to temporarily cease working).

An event covered by a trauma insurance benefit is not consistent with any of the above conditions of release. This means that from July 1, 2014, an SMSF that provides a trauma insurance benefit in relation to a member will generally be in breach of the new regulation.

The new regulation does not, however, apply to the continued provision of insurance benefits to SMSF members who joined a fund before July 1, 2014 and were covered in respect of that insured benefit from July 1, 2014.

As a result, SMSFs are allowed to continue to provide trauma insurance benefits to members who joined a fund before July 1, 2014 and were covered in respect of that insured benefit before that time, and such members can vary the level of that cover. For example, the cover for these fund members can be increased or decreased, and any associated insurance premiums adjusted after July 1, 2014.

An SMSF trustee that continues to provide a trauma insurance benefit to a fund member can purchase an insurance policy to support the provision of that benefit and can still satisfy the sole purpose test – provided the following conditions are met:

- any benefits payable under the policy are required to be paid to a trustee of the SMSF
- those benefits will become part of the assets of the SMSF at least until such time as the relevant member satisfies a condition of release, and
- the policy was not acquired to secure some other benefit for another person, such as a member or a member's relative.

An SMSF may not, however, provide one of its members with a type of insurance cover they did not have prior to July 1, 2014 unless the insured event is consistent with one of the conditions of release that was specified earlier. ■

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What powers does the taxman have to access your information?

When it comes to collecting tax money owing, the Tax Office has considerable legal powers at its disposal. This isn't all that surprising, given that government coffers would be empty were it not for the activities of its principal revenue collection agency. But just how far can the Tax Office go in its efforts to extract taxpayer payment obligations?



The laws that govern the regulatory activities that the Tax Office administers give it quite wide-ranging powers to obtain information, and in the situations where it deems it necessary to use those powers it is certainly not shy about doing so.

Although the Tax Office says it generally prefers to gather information by simply requesting it, from yourself or through this office, there are times when this "cooperative approach" is deemed to be inadequate in the eyes of the Tax Commissioner. In these instances, the use of its "formal powers" can come into play.

Formal powers

So what are these formal powers, and how are they utilised? The Tax Office says these fall into the two broad categories – "notice" powers (including notices to attend an interview) and "access" powers.

Notice powers

Written into the notice guidelines is that taxpayers must be given a reasonable time to comply with a notice asking for information or documents, or for you to attend an interview. This is usually 28 days, although there is room you, or us on your behalf, to negotiate a shorter or longer time period.

Access powers

The Tax Office's access powers allows its tax officers to gain access to your premises and documents. Although the Tax Office's own guidelines states that it will only exercise its rights of access for the purposes of the laws it administers, the legislation that endows it with these rights gives little wriggle room about its intention.

The law states that the Tax Commissioner, or any of the Commissioner's authorised officers, "shall at all times have ***full and free access*** to all buildings, places, books, documents and other papers for any purposes of this act" (our emphasis).

The law also gives the Tax Office free rein to take extracts from or copies of such documents, books or papers. Under the indirect tax and excise laws, this also extends to goods and includes the capacity to take samples.

It will generally give prior notice before exercising an access power, but says that in exceptional circumstances it may not give notice beforehand – "for example, if we believe that documents we need may be destroyed".

One concerning aspect of the Tax Office's access powers is that in most cases it does not necessarily have to inform taxpayers of this access.

"If we ask third parties about you, we will normally tell you about this before we make the inquiry," its guideline document says, however then goes on to concede that there are some situations where a taxpayer would not normally be told.

These include but are not limited to:

- where it collects information relating to a large number of taxpayers in similar circumstances, such as from a financial institution, investment manager or employer
- where it uses the information to help decide which individuals or businesses to audit
- where it makes inquiries under an international tax treaty
- transfer pricing audits
- where it collects information relating to inquiries, reviews or investigations under the promoter penalty laws

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What access powers does the Tax Office have? (cont)

- where it decides access without notice is appropriate, or
- where it has asked you for the information but this has not been provided.

It is also the case, even though you have taken the sensible step of having your tax affairs handled through this office, that the Tax Commissioner can request information from absolutely anyone — although some prior warning is required.

The legislation states: "The Commissioner may by notice in writing require any person, whether a taxpayer or not … (to furnish) such information as the Commissioner may require; and to attend and give evidence … (concerning) the person's or any other person's income or assessment".

Certain documents and certain communications may be protected

In some situations, you may be able to claim that your documents are "protected" from Tax Office access.

Although the Tax Office has wide powers to access most documents, there are specific common law principles that protects certain communications made as part of the confidential relationship between certain professionals and their clients.

For example, communications between lawyers and their clients may be claimed as having "legal professional privilege".

The accountant's concession

Although legal professional privilege does not generally extend to the confidential relationship between accountants and clients, the Tax Office has conceded that there should be an exemption from its information gathering powers for certain documents prepared by "external, professional accounting advisers".

For the purposes of the "accountants' concession" as it is known, documents have been classified by the Tax Office into three categories:

- source documents (records of transactions)
- restricted source documents (advice documents shedding light on transactions), and
- non-source documents.

Generally, the accountants' concession applies only to restricted source and non-source documents. However, the Tax Office's guidelines to accessing professional accounting advisers' papers provide that in "exceptional circumstances" the case officer may seek written approval for access. These include:

- where the facts remain unclear
- if there is a suspicion of avoidance or evasion, or
- there is risk of document destruction or removal.

Claiming protection under such professional privilege is never easy however, and the Tax Office is not obliged to provide this concession. Consult this office, and remember to ask us for guidance should the Tax Office come knocking. ■

Did you know… The ATO wants your personal contact details

The *Individual tax return 2014* for tax agents includes additional fields asking us to provide your email address and mobile phone number. The Tax Office states that this will enable it to directly contact you with any queries about your tax and superannuation affairs.

Note however these fields are not mandatory, and can be left blank.

As your nominated representative, this office can act as a point of contact between you and the Tax Office. Even so, the Tax Office insists that there may be times when it will be more appropriate to write directly to you, and not come through this office. Its own guidelines dictate that when written correspondence is issued directly to a client of a tax agent, the tax agent must be informed at least one week before the letter is sent.

But it also stipulates that in high-risk "seriously non-compliant" situations it may contact a taxpayer without issuing prior notice — for example, if a person is involved in fraudulent activities, offshore secrecy havens or tax evasion. This can also be the case if the Tax Office is securing assets or making unannounced visits (see the article on its access powers above).

However, apart from the obvious advantages of having an extension to lodge and being able to deduct fees for tax return preparation, engaging a tax agent such as this office will not only assist in helping you understand your tax obligations but will make sure all your tax affairs are above board. ■

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SMSF compliance regime for the upcoming year



This year, the Tax Office will be turning its attention to the following emerging risks within the self-managed superannuation fund (SMSF) sector. Ensure you do not partake in any of the practices below or risk being caught in the Tax Office's net.

Dividend washing

Dividend washing is a share trading strategy that enables a taxpayer to access double the franking credits attached to fully franked dividends even though the taxpayer effectively holds only one parcel of shares. The shares are purchased in a special market that allows the taxpayer, often an SMSF, to re-acquire shares with a dividend attached, after the ex-dividend date, allowing them to take advantage of the additional franking credits to offset their tax liability or receive a refund of the excess imputation credits.

In the 2013-14 Budget, the government announced that tax legislation would be amended to close this loophole. In March, the Tax Office sent self-amendment letters to around 2,000 SMSFs identified as potentially having implemented a dividend washing arrangement. Of the identified SMSFs, 38% were in pension phase.

Dividend stripping

The Tax Office has noticed a retirement planning arrangement that involves a private company with retained earnings distributed by way of a franked distribution to an SMSF in circumstances where the SMSF is entitled to a refund in relation to the franking credits attached to the distribution.

This means ultimately earnings of the company are tax-free in circumstances where the SMSF holds the shares for a short period of time at no risk to realise the cash and franking credits in the most tax effective manner within an income year.

Overseas conferences

The Tax Office is keeping its eye on promoters who advertise questionable SMSF conferences in overseas destinations. The promotions target SMSF trustees citing they can claim a deduction for the full cost of the travel, accommodation and meals incurred when attending these seminars or workshops. The conferences appear to contain minimal training related to SMSF activities, and trustees contemplating attending such events have been warned of the potential to contravene the sole purpose test.

Home loan unit trusts

The Tax Office has identified a potential home loan unit trust arrangement which involves the purchase of a residential property by a non-geared trust whereby units are purchased by the SMSF, related family trust and SMSF members. The purchase of the asset is effectively financed by the SMSF and the property is occupied and rented by the member. The rental income less expenses is paid out to unit holders but the proportion of distributions is not consistent year by year.

Again, trustees should be aware of the potential to contravene the sole purpose test and/or of providing financial assistance to a member. If there is a form of "gearing" or investments in other entities involved within the trust, then the SMSF may also be in breach of the in-house asset provisions.

Illegal early release

The Tax Office continues to risk assess all newly registered SMSFs and take action to prevent suspect funds from entering the system. Where SMSFs the Tax Office has reviewed fail to lodge their first return by the due date, it will review them again to determine why they have not lodged.

Traditional illegal early release schemes and sophisticated schemes – such as round robin loans to purported unrelated entities – are under scrutiny. If the Tax Office finds that super savings are being illegally accessed, it will investigate the SMSF in question and remove it from Super Fund Lookup. If it finds illegal early release has occurred, it will take further compliance action and impose penalties.

In 2012-13, the Tax Office prevented 191 SMSFs from entering the system and removed 438 suspect funds from Super Fund Lookup.

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SMSF compliance regime for the year (cont)

Late lodgement

The pressure is on trustees of SMSFs with two or more lodgement obligations overdue, who will have their regulation details removed from the Super Fund Lookup until their lodgements are brought up-to-date, or in the case of non-operating funds, wound up.

Affected funds will not be able to receive rollovers or establish new contribution arrangements until they address their lodgement obligations.

The Tax Office will be reminding APRA superannuation funds and employers to check the regulation details of SMSFs on Super Fund Lookup before progressing rollovers or contributions. SMSF trustees affected by this strategy will be notified in writing by the end of September.

This year, the Tax Office is also focusing on SMSFs that have never lodged (it will also, in serious cases, remove their details from Super Fund Lookup) and will consider using its new administrative penalties to fine trustees directly for not preparing accounts.

Exempt current pension income

The Tax Office will continue to monitor the compliance of SMSFs paying pensions to ensure they are claiming the correct amount of exempt current pension income. The key issues that can affect a fund's claim to exempt current pension income include missing the minimum pension payment, segregation of pension assets and apportionment of expenses.

As part of its ongoing SMSF compliance program, the Tax Office risk assesses funds and then decides on appropriate follow up. It will analyse multiple indicators of non-compliance – including regulatory and income tax matters, drawing information from the SMSF annual return, auditor contravention reports and other sources including trustee and member records.

It will then determine a fund's overall level of risk – low, medium or high – from both a regulatory and income tax perspective and take appropriate action to treat non-compliance. Consult this office for tips on how you can best adhere to your SMSF trustee obligations. ■

Help the Tax Office grow its small business expertise

The Tax Office has invited Australia's small business owners to apply to join its new small business consultation panel.

This has been built with an aim to help cut the red tape small businesses are saddled with and boost its efficacy when dealing with small business owners.

The Tax Office is looking for small business operators with at least two years experience running a business and which has up to $2 million in annual turnover. It has stressed that taxation, consulting or accounting experience is not necessary.

Small business representatives will provide the small business person's view on Tax Office and other government agency business processes.

Appointed small business owners, referred to by the Tax Office as the consultation panel's "multi-use list" of representatives, will be used as a central database to manage small business experts and to better facilitate engagement in workshops and programs.

Representatives will be contracted on a short-term, "as needed" basis to participate in various consultation activities, including;

- providing feedback on processes and documentation
- participating in workshops
- providing opinions from the perspective of a small business operator
- conducting end-user testing on products and prototypes, and/or
- writing articles (eg. for industry newsletters).

Representatives will be remunerated for all activities undertaken.

The Tax Office's Second Commissioner, Neil Olesen, said the panel will help it to better understand the way small businesses interact with the organisation and other government agencies.

"Our objective for the panel is to explore opportunities to reduce the time it takes for business operators to comply with their employer, super and tax obligations so they can get back to the important job of running their small business," he said.

Applications are open for the remainder of 2014. Interested small business operators (with two years experience and with an annual turnover of less than $2 million) can email smallbusinessconsultation@ato.gov.au to request an information and application pack, or see this office for more details. ■

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