

# Tax Time for Unit Owners

(Body Corporate Systems Owners' Seminar)

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# Overview

- Tax deductions v's Cash expenditure
- Hidden Traps
- What's on the ATO radar?
- When can a Rental Property be a Main Residence?
- Body Corporates and their tax obligations
- What can we expect the future to hold?
- Questions

# Tax Deductions v's Cash Expenditure

Major Deductions that will match cash flow:

- *Interest, Repairs, Agent Commission, Pest Control, Rates, Body Corporate Fees, Insurance*

Minor Deductions that will match cash flow:

- *Phone, Travel for inspections, mowing, letting fees, replacements (glassware, linen, cutlery, etc...)*

Deductions that won't match cash flow:

- > *Depreciation, Capital Allowance, Borrowing Costs*

# Hidden Traps

## Repair v's Capital

- A **Repair** occurs when an asset or part of an asset is changed to bring it back to its original state when you first purchased it
- **Capital** expenditure is an improvement on what you originally purchased
- Is the property available to be rented – relevant for all deductions?
- Be careful of “renovations” after acquisition and trying to pass them off as repairs. Little things such as painting in the first 12 months can end up becoming capital.

# Hidden Traps

## The Need for a Quantity Surveyors Report

- Gives access to claiming a % of your capital improvements.
- The deduction is called a *Capital Allowance*
- Accountant's CAN NOT calculate this on new properties and can only claim 2.5% on any improvements you incur
- A Quantity Surveyor can calculate a substantially higher deduction by being able to split between depreciable items and capital improvements.

# Hidden Traps

Consequences of a Capital Allowance Deduction when you sell

- Any Capital Allowance Deduction you claim against your rental property will reduce your cost base on sale

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# Hidden Traps

## Example

May purchases a property for \$200,000 and sells 10 years later for \$400,000. Over the 10 years May claims Capital Allowance deductions of \$30,000 providing a tax benefit of \$10,000 (assuming she has an average tax rate of 30%). Will May be better off?

# Hidden Traps

## Example

	With CA	Without CA
Sale Price =	400,000	400,000
Cost Base =	(200,000)	(200,000)
CA add Back =	<u>30,000</u>	<u>0</u>
Capital Gain =	230,000	200,000
Discounting =	<u>(115,000)</u>	<u>(100,000)</u>
Net Capital Gain =	115,000	100,000
Tax Payable on sale =	34,500	30,000
Tax Benefit from CA =	<u>(10,000)</u>	<u>0</u>
Net Tax Position =	24,500	30,000

# Hidden Traps

Interest Deductibility – don't take advice from your banker!

- The ATO only look at one thing....
- What you do with the funds you borrow.
- Security has no impact on whether interest is deductible or not.
- Don't mix your debt, the ATO will only allow a deduction if correct apportioning is kept. You can not pay down the private portion without paying down the deductible portion i.e. repayments **MUST** be apportioned.

# What's on the ATO's Radar?

- Large repairs (especially on new properties)
- Large bank changes in year one
- Increases in interest deduction beyond the normal interest rate changes
- Variances to the ATO ratios
- Legal expenses
- Location... The beach unit with low income and no private use apportionment in the tax return
- Matching data.... Titles Office data v's what is shown in the tax return
- Who prepares the return.

# When Can a Rental Property be a Main Residence?

- “The 6 Year Exemption”
- Allows a property owner to rent out their property for up to 6 years before they lose their Main Residence exemption for Capital Gain Tax purposes
- A Few Rules Though
- Must live in the house first (we say 12 months)
- Can only have one main residence at any given time (i.e. all other properties are investment properties)
- Only one main residence per couple
- Rental activity must be declared in income tax return
- Must have purchased the house with the intention to be a main residence and not a development site or investment property

# Body Corporate's & Their Tax Obligations

## Income Tax

- > Organisations that are operated on a not for profit basis are exempted by the Mutuality Rules
- > This means income and expenses from member activities are exempt
- > Other earnings and related expenses are taxed at company tax rates (i.e. interest on sinking funds)

# Body Corporate's & Their Tax Obligations

## GST

An entity must register for GST if:

- An entity exists and it is carrying on an enterprise
- The turnover is greater than \$75,000 or \$150,000 for non-profit enterprises
- May register for GST if less than \$75,000 if it is in the organisations best interests (i.e. likely to receive GST refunds more often than not)
- For GST purposes the ATO and courts consider a Body Corporate to be a normal enterprise and NOT a non-profit. Therefore the turnover threshold is \$75,000 for Body Corporates.

# What Can We Expect The Future To Hold?

- When will the good days return (if at all)?
- How many interest rate rises are left?
- The South East Queensland factor.
- Will the Baby Boomers change the market long term?

# Wrap Up

- There are no magic deductions. Talk to your advisor to ensure maximum tax effectiveness.
- Quantity Surveyor Reports are tax effective but there is a hidden catch on sale.
- Repairs are not always repairs for tax.
- Don't muddy the waters when borrowing.
- When making an investment decision do your numbers and know your worst case scenario.
- Questions/Discussions

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