



Building a new home? Is it exempt from CGT?

There is a concession in the CGT rules that can allow a taxpayer to treat a property as their “main residence” even though it does not yet have a habitable dwelling.

About this newsletter

Welcome to BT Accounting Pty Ltd’s client information newsletter. We are sure you will find the content informative and up to date. Should you have any queries regarding the content please contact us on:

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It is a widely recognised fact that a capital gains tax (CGT) exemption applies to a taxpayer’s principal or main residential property. And one of the requirements for this main residence CGT exemption is that there needs to be a building on that property.

What is less well known is that the period when this main residence CGT exemption applies can be extended to cover the time it takes to finish construction (or complete repairs made to) the residence on the property. This is commonly referred to as the “building concession” or sometimes the “four year rule” for reasons that are outlined below.

For questions on how to apply the main residence exemption, under any circumstances, please contact us.

What is the building concession?

The “building concession” allows a taxpayer to choose to treat a property they have acquired as their main residence during the period that they “construct, repair, renovate or finish building” a dwelling on that property. The land at the time of acquisition may or may not contain an existing dwelling on it, or if there is a dwelling, the taxpayer has vacated it in order to affect repairs.

Note that vacant land may also be treated as a taxpayer’s “main residence” if the land is vacant because the taxpayer’s home has been destroyed (see more on this below).

What are the conditions?

The relevant dwelling must become the taxpayer’s main residence “as soon as practicable” after building or renovations are complete, and remain so for at least three months. Further, the concession applies for a maximum period of four years from the time the taxpayer acquires the land, or ceases to occupy a dwelling already on the land, until the constructed or repaired dwelling is occupied as the taxpayer’s main residence. This is the reason the concession is sometimes also referred to as the “four year rule”.

In limited circumstances, the Tax Office can exercise some discretion to extend these four years — examples include where the builder becomes bankrupt and is unable to complete the construction or where a family member has a severe illness. Ask us if you need an extension.

And if the four year period elapses?

If more than four years pass before the constructed or repaired dwelling is occupied as a main residence, a partial main residence CGT exemption can apply in respect of that excess period.

What if a dwelling is destroyed or is compulsorily acquired?

A taxpayer can choose to apply the main residence exemption to a property even if

they no longer reside in the property. This rule is commonly referred as the “absence concession” or sometimes the “six year rule”. The requirements for this rule to apply can be tricky, so see this office for information.

If a dwelling that is subject to the absence concession is accidentally destroyed (or compulsorily acquired) and land is bought on which to build the replacement (“substitute”) dwelling, the building concession can also be used in these circumstances to preserve the effect of the absence concession in relation to the substitute dwelling.

The land however must be acquired within one year after the income year in which the original dwelling was accidentally destroyed or was compulsorily acquired (although there is some discretion allowed by the Tax Office).

Can the concession apply to vacant land for the period after the dwelling is destroyed?

Yes. The concession is also available if a main residence is accidentally destroyed (such as with a bushfire or flood) and the vacant land is subsequently sold or disposed.

Importantly, the destruction must be by way of “accident”.

The concession will apply to treat the vacant land as the taxpayer’s main residence for an unlimited period of time from when the dwelling was destroyed until the disposal of the land, provided the dwelling was the individual’s main residence at the time of its destruction, or taken to be by way of choosing to apply the absence concession, and no other dwelling was subsequently built on the land.

Further, if a choice is made to apply the concession, no other dwelling can be treated as the individual’s main residence during the period it covers.

For further questions on how to apply the CGT main residence exemption, under any of the various circumstances, please contact this office. ■

Information provided is of a general nature only, is not personal financial or investment advice, and we accept no responsibility for persons acting on information contained herein. Clients should not act solely on the basis of material contained in this document. We recommend that our formal advice be obtained before acting on the basis of the topics presented here.

Have you thought about the small business pool write-off?



The temporary \$20,000 immediate write-off for “small business entities” attracts regular queries, even though it has been many months since the initiative was first announced with the Federal Budget early this year.

While most inquiries relate to claiming the immediate deduction, there has also been confusion about the rules in claiming general small business pool balances that are below \$20,000 at year end.

The measure is particularly relevant for those small businesses that:

- have made a choice to apply the simplified depreciation rules during the 2014-15 income year, or
- have previously made that choice and had an opening pool balance as at July 1, 2014.

How does the general small business pool work?

Before the introduction of these measures with the last Federal Budget in May, “small business entities” (aggregated turnover of less than \$2 million) could allocate depreciating assets that cost \$1,000 or more to their general small business pool and claim a deduction at a rate of 15% in the year they are allocated, and 30% in subsequent income years.

A depreciating asset is an asset that is expected to decline in value – for example, a coffee machine used in a café.

From the 2015 budget night, depreciating assets that cost \$20,000 or more need to be allocated to a small business entity’s general small business pool and deducted at those specified rates. Assets costing less than \$20,000 can be written off immediately in the year that the asset is used or installed ready to use.

The previous rules, the new rules

Before budget night, small business entities were able to claim a deduction for the entire balance of their general small business pool if the pool balance was less than \$1,000 at the end of the income year.

With the new threshold, if the balance of a general small business pool is less than \$20,000 at the end of an income year, the small business entity can claim a deduction for the entire balance of the pool.



These amendments to the simplified depreciation rules are part of a suite of small business measures. These include the 1.5% tax cut for incorporated businesses; 5% small business tax offset for individuals of unincorporated entities; immediate deduction for certain business start-up costs; and FBT exemption for the provision of multiple portable electronic devices to employees.

See this office if you require further information on any of these measures.



This measure is however temporary, as is the \$20,000 immediate write-off for asset purchases. A deduction for the pool balance may be claimed if it is less than \$20,000 at the end of the income years ending June 30, 2015, 2016 or 2017. After June 30, 2017 the threshold reverts from \$20,000 to \$1,000.

Determining pool balance for the \$20,000 write-off

The entire pool balance can be written-off if the balance at year end is less than \$20,000. However the pool balance is not the “closing pool balance”; instead a special calculation applies in working this sum out.

In very simple terms, the balance is:

- the opening pool balance
- **plus** the cost of any additions to the pool (adjusted for any private use)
- **plus** the cost of any modifications, and update to or moving of, existing assets in the pool (adjusted for any private use)
- **less** the consideration received from the disposal of any pool assets.

If this calculation results in a balance less than \$20,000 at the end of the relevant income year, that balance can be written off, thereby reducing the closing balance of the pool for that income year to zero.

This calculation can be complex, so please contact this office if you require some assistance.

Tips for claiming the pool balance

When claiming a deduction for the entire low value pool balance, the following should be noted:

- It is not necessary to calculate the pool deduction in the usual way if the small business entity is eligible to write-off the balance. This takes precedence.
- The balance of the pool is determined prior to calculating any deductions in respect of the pool. That is, the calculation of the low value pool balance does not take into account any “depreciation” deductions being claimed at 15% for additions or 30% for existing assets in the pool.
- If there are no acquisitions or disposals of pool assets by the small business entity during the income year, it follows that the opening pool balance must be less than the low value pool threshold (that is, \$20,000) in order for the entity to claim a deduction.

Consider the example below that was provided by the government when the initiative was announced.

Example: Levi's Pet Washing

Levi's Pet Washing is a small business entity and satisfied the conditions to make the choice to apply the small business capital allowance provisions in the 2013-14 and 2014-15 income years.

In the 2013-14 income year, Levi's Pet Washing bought a fitted-out van for \$20,000 (100% for a taxable purpose). The business did not have any other assets in its general small business pool.

In its 2013-14 income tax return, as the cost of the van was over the \$1,000 threshold that applied for the income year, the business claimed

a deduction for 15% of the cost (\$3,000), with the remaining cost (\$17,000) being deductible in later income years under the pooling rules.

There were no further purchases during the subsequent income year, and the balance of the pool at the end of the 2014-15 income year remained at \$17,000.

In its 2014-15 income tax return, Levi's Pet Washing claimed a deduction of \$17,000 for the balance of the general small business pool, as the balance of the pool at the end of the year is below the \$20,000 threshold that applied for that year. ■

New company tax franking implications

The recent cut to the tax rate for small incorporated businesses, while generally welcomed, can bring with it some important considerations when it comes to distributing franked dividends.

The rate change to 28.5%, which applies from July 1, 2015, means that small businesses could easily frank dividends in excess of the underlying taxes paid on their

profits and “overdraw” on their franking account.

While the rate has decreased, small companies are still entitled to frank dividends at a maximum 30% rate. The arbitrage between the new tax rate and maximum franking rate may trip up the unwary and means that you’re using up franking credits faster than you normally would expect. Consider the example below.

Example: New company tax rate

ABC Co Pty Ltd derives \$100 of taxable income for the income year ended June 30, 2016. Assume that the tax is paid before year end. The company’s after-tax income is paid as a fully franked dividend to Dexter, a sole shareholder of the company. Also assume that the dividend was paid before year end. Dexter is taxed at the current top marginal rate (47% plus 2% Medicare levy).

	Previous tax rate (30%)	New tax rate (28.5%)
COMPANY LEVEL – ABC CO PTY LTD		
Taxable income	\$100	\$100
Tax on taxable income	\$30	\$28.50
Profit after tax available for distribution	\$70	\$71.50
SHAREHOLDER LEVEL - DEXTER		
Dividend	\$70	\$71.50
Add: Franking credit gross-up	\$30	\$30.64*
Taxable income	\$100	\$102.14
Tax on taxable income (at 47% plus 2% Medicare levy)	\$49	\$50.05
Less: Franking offset	\$30	\$30.64
Net tax payable	\$19	\$19.41

* $\$71.50 \times 30/70$

Theoretically, assuming that there is a nil balance in the franking account at the start of the year, ABC Co’s franking account at year end could look as follows on the basis that tax is paid at 28.5%:

	DR	CR	Balance
Tax paid		\$28.50	\$28.50 CR
Franked distribution	\$30.64		\$2.14 DR

What does a franking debit at year end mean?

In the above scenario, there is a franking debit at year end of \$2.14. In simple terms, this means that the company has franked more dividends to its shareholders than the tax that it has paid (referred to as “over-franking”). Consequently, it will be liable to pay franking deficit tax (FDT) of \$2.14.

The FDT represents a prepayment of income tax rather than a penalty payment. A tax offset for any FDT that has been incurred is generally available to the company.

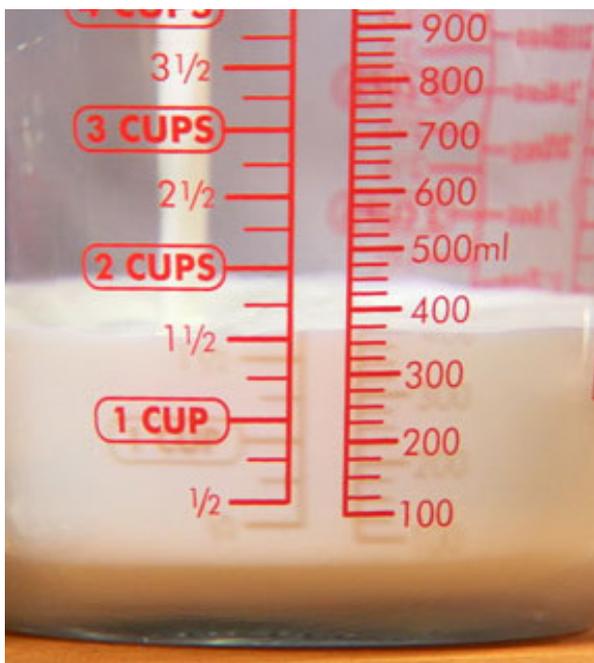
Be aware however that this FDT offset is applied against the company’s tax liability after all other tax offsets have been applied, such as foreign income tax offsets. Any excess unused FDT offsets may also be carried forward and applied against a future tax liability of the company.

Is there penalty taxes if a company over-franks?

Yes. A FDT penalty may apply where there is excessive “over-franking” – referred to as over-franking tax. Broadly speaking, this occurs in cases where the FDT exceeds 10% of the total franking credits arising in the income year. This is sometimes referred to as the “10% rule”.

Where this happens, the FDT offset is reduced by 30% as a penalty. Put another way, the tax offset is 70% of the FDT amount and the remaining 30% is never set against the income tax liability as a tax offset. In the above example, the available offset would be limited to \$1.50 (that is, $\$2.14 \times 70\%$).

The calculations and implications can be complicated, so please contact this office if you need assistance. ■



What is adjusted taxable income and why you might need to know

If you recently have or ever plan to apply for certain tax offsets, concessions or government benefits, the basis for eligibility can be determined based on your “adjusted taxable income” (ATI).

Adjusted taxable income (ATI) is used to assess entitlement eligibility for Centrelink and Child Support Agency benefits, the Family Tax Benefit (both A and B), and the Child Care Benefit. Parental Leave pay and Dad and Partner pay thresholds are based on ATI.

The Low Income Supplement and Low Income Family Supplement – as well as entitlement to the Commonwealth Seniors Health Card – are subject to ATI thresholds. The Medicare Levy Surcharge thresholds, Private Health Insurance rebate, Higher Education Loan Program (HELP) repayments and Dependent (invalid and carer) tax offset are also affected by the ATI.

How the ATI is calculated

ATI is based on your taxable income — your assessable income less allowable deductions — with an array of other adjustments applied.

These applicable adjustments may involve including any of the following:

- reportable employer superannuation contributions
- deductible personal superannuation contributions
- adjusted reportable fringe benefits
- certain tax-free government pensions or benefits received
- target foreign income (income and certain other amounts from sources outside Australia not included in your taxable income or received as a fringe benefit)
- net financial investment loss (the amount by which the person’s deductions attributable to financial investments exceeded their total financial investment

income – for example, negatively geared losses on shares)

- net rental property loss (the amount by which deductions attributable to rental property exceeded rental property income — that is, negatively geared rental property losses).

Note that while any of the above are added to taxable income, for the purposes of some government payments or services any child support you pay to another person may be deducted from the final ATI. Ask this office if this is a factor in your circumstances.

Nitty gritty details

Because ATI is affected by many adjustments, there are strategies you can use to ensure continuing eligibility through managing levels of ATI.

The Dependent (invalid and carer) tax offset for example is available for a spouse who is an invalid or who cares for an invalid, but the offset can’t be claimed if your ATI is above \$100,000 (for the 2015-16 year) or if your spouse’s ATI is more than \$10,634.

You may have some space to reduce yours or your spouse’s ATI through superannuation salary sacrificing arrangements (because reportable employer super contributions are included) but FBT-free benefits including work-related items (phone, laptop, tools of trade) could reduce your ATI as well.

Depending on the entitlement or offset, calculating of the ATI can be tricky and time consuming – speak to this office for assistance. ■



Tax and cyber security: Are you prepared?

Since July this year, scams targeting both individual and business taxpayers have been running rife.

From fake Tax Office “delayed return” or “proof of identity” emails to telephone calls conveying similar requests, taxpayers have had to keep their guard up. So how can individuals and businesses protect themselves from online fraud and crime?

Why are cyber scams on the rise?

Scams have always been around in some form or another, but have been given fertile ground since governments have started adopting cyber solutions to transform the way they interact with both individual and business taxpayers.

Lowering costs has been a big motivator behind this trend, including the cost of collecting tax. According to the government, a service transacted over the phone costs about 16 times the digital equivalent, through the post about 32 times more, and on face-to-face transactions it is about 42 times more costly. So given both the convenience and possible cost savings, digital is the way of the future. This is further evidenced by the introduction of the government’s myGov online portal and its myTax tool.

Cyber security therefore looks like becoming an even bigger issue for taxpayers now and into the future. This has been underlined by the fact that individual taxpayers

have already started to receive direct Tax Office contact through myGov rather than through their tax agent.

With more direct contact channels being opened up online for taxation and superannuation transactions, the greater the temptation will be for hackers and fraudsters to target individuals and businesses. And the greater the volume of sensitive information out there in cyber space, the greater the need to be careful.

How can individuals protect themselves?

The Tax Office says it takes the security and privacy of individuals’ personal information very seriously, and has a range of systems and controls to guard people’s data and records of its interactions with taxpayers.

It has undertaken to never request personal information such as tax file numbers (TFNs) and bank details via an electronic communication (such as emails and SMS).

If you do receive an SMS or email asking for personal information, the Tax Office advises that the entire communication should be forwarded to ReportEmailFraud@ato.gov.au.

If you are unsure about any other communication that looks like it could have come from the Tax Office, make sure you ask this office for assistance.

Tips for individuals

Other tips to protect your online information include:

- Be cautious when clicking on hyperlinks embedded in SMS messages and emails
- Make sure you keep your TFN and passwords secure. Don't share your password with others and never reply to emails with your password or other sensitive information, such as your TFN, including to prospective employers. We recommend you change your passwords regularly
- If you are unsure about the legitimacy of any notification you receive, check with this office.

Your myGov account

If you do have a myGov account, you may well receive notifications via myGov that this office may not necessarily receive. If any communications received are regarding tax, it will be best to confirm with this office.

If your myGov account was initially set-up to provide a portal to deal with government bodies other than the Tax Office (for example to deal with Medicare or Veterans' Affairs, or regarding child support, superannuation matters and so on), it is also possible for notifications regarding taxation matters to be sent to your account, even though you may not have linked myGov to myTax. It is important that you let us know if this is the case.

Protect your password

Passwords are of course central in protecting your sensitive information, but you must ensure they are "strong" (that is, think about having a mixture of characters, numbers, upper and lower cases and perhaps symbols).

Password safety tips include:

- Have different passwords for different activities and change them regularly, particularly those for sensitive transactions such as banking, social networking and your computer log-on
- Don't store a list of your passwords on your phone or on your computer in a Word document – this makes it easy for anyone who gets into your computer to access your social networking, banking and other accounts
- Select "no" when your computer offers to automatically remember a password when logging into a website, especially banking, social networking and web mail accounts. This is because scammers can use malware to find these stored within the computer.

If it helps to write your passwords down, especially if they are "strong" (that is, complicated), do so – but hide them somewhere safe, away from prying eyes and not together with your computer log-on.

What can businesses do to protect themselves?

All of the above applies equally to anyone running a business, but cyber security issues such as identity theft no longer purely apply to consumers and individuals. Fraudsters have learnt that businesses also have identities that can be stolen, and the details of unsuspecting businesses can be used for easy money and/or goods.

Business identity theft can be much like its consumer counterpart and involves the actual impersonation of the business – that is, not the people behind the business, but the business entity itself. This is somewhat different to the common notion of crime perpetrated against businesses (such as hacking into its database for financial records or confidential customer information).

A business identity can be stolen and used to commit tax fraud, create other fake business entities, lodge fraudulent GST claims, and take out loans. Unlike the identity theft of a consumer, who may notice a compromised bank balance fairly quickly, victimised businesses could unwittingly be giving thieves up to 30 days (a common payment term on invoices) after fraudulently ordering goods and services.

Of course, identity thieves who access your business's information may also find they have access to employee personal information, such as TFNs, bank details from payroll data, super fund details and personal addresses.

Tips for business

To protect your business and your employees from identity theft, it is recommended that you:

- Secure your business files and employee information when they are not in use
- Regularly change all passwords
- Ensure that you and all your staff log out of systems and lock computers when they are not in use
- Make sure that your computers and other devices have up-to-date security and anti-virus software.

It should also be emphasised that a business's AUSKey needs to be kept safe, and that if it is used on multiple devices to consider storing your AUSKey on a secure memory stick with a password. Other information that will need to be secured are your activity statements, forms and other records that hold supplier details, invoices and client information.

And remember, considerable time and effort is required to restore a business's identity, amend credit profiles and sort out financial arrangements. Talk to this office for our help if you have concerns. ■