

Newsletter
February 2017



Introduction

Welcome to our first newsletter for 2017! This newsletter contains all the blog articles that we have posted since the start of December, plus the all-important market update for the two main investment asset classes: residential property and the Australian share market. As ever, please feel free to send this newsletter to anyone you think would find it useful – and get in touch with us yourself if there is something you would like to discuss.

Did You Know... the month of February

February has been an important month in Australian history.

In 1606 a ship of the Dutch East India Company explored the top of what is now Queensland, becoming the first non-Aboriginal people to land in Australia. In 1966 Australia moved to decimal currency, happily ignoring Robert Menzies suggestion that our unit of currency be called the 'Royal,' rather than the dollar. In 1992, Queenslanders voted not to follow the rest of the eastern seaboard in implementing daylight saving – a move the sleep specialists now say was in the best interests of a better night's sleep. And in 2001, Australian cricketing icon Sir Donald Bradman died nine short of what would have been his most impressive century.

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Market Update 1 February 2017



The share market and the residential property market as 2017 kicks off

The Residential Property Market

The current state of the property market may be good news or it may be bad news. It all depends, really.

If you already own a home, then 2016 would have seemed like a good year for you. In Australia, most markets did well during 2016. Even those that did not do 'well,' like Perth, did less badly than they had done in previous years. The 'national average' rate of growth for capital cities was 10.9% for residential property (Source: Corelogic). Once again, this prompted Barnaby Joyce to [invite everyone to move to Tamworth](#) – perhaps in the hope that this would drive up the value of his own home.

That said, if you only own one home and that is the one you live in, then whether an increase of such huge proportions is good for you is debatable. Why do we say that? Well, you are living in this property now, and if you sell the property so as to move somewhere else, then the chances are that that other property has increased to about the same extent. That is, of course, unless your next home is intended to be an upgrade, in which case that next home is now *more* expensive and therefore *less* affordable for you.

In fact, rising house prices are really only good news for owner-occupiers who either: (i) intend to downsize to a less expensive home; or (ii) won't need to buy another property when they sell the current one. And there is only one point in life when you do not need to find a new home when you 'move out' of the current one.

So, if you the only home you own is the one you live in, then the state of the market in 2016 was really good news for your inheritors.

Yes, we know: if you owe money on your home and the value rises then your level of proportional debt has fallen. But you still have to repay the bank as much as they lent you. Rising prices are OK news – but they are not great.

Things are different if you own more than one property. If that is you, and all (or most) of your properties rose in value during 2016, then you did indeed get wealthier. You can sell one of the properties, have more money than you started with – and you still have somewhere to live. No change in lifestyle and more money in the bank – that is good news.

Of course, if your properties have gone up in value, then selling should be less of a plan than before: after all, what will you do with your money after you sell one? Buy another one? At the higher prices? If so, then why sell?

And if you do not own any properties? Well, assuming you want to own one in the future, then 2016 was a bit of a shocker for you. Buying a home got harder just about everywhere, except Perth where median prices fell a few percent (source www.reiwa.com.au).

So, that was 2016: a good year for property investors who own more than one property, an OK year for property owners who own the home they live in, and a crappy one for people who have not bought a property yet, but who want to.

Except for people living in Perth, who can reverse the previous paragraph.

Now, what about 2017?

Well, to be honest, trying to forecast short term property price movements is a mug's game. Every year, someone predicts a fall, presumably on the basis that if you predict it enough times then eventually you will get it right and look like a guru.

Which is the truth of it: property prices will fall from time to time. Double digit growth is not perpetually sustainable. Things need to rebalance. This is why we always encourage people to (i) invest in property if they can; (ii) build in a buffer (that is, don't borrow to your absolute limit, both in terms of LVR and your ability to service the debt); and (iii) invest with a very long-term timeframe in mind, so that you can ride out the down years and benefit from the more frequent good years.

For what it is worth, the better money seems to be thinking that this will be a year for moderate price growth. One of the best analyses we have seen is from NAB, who as lenders have a particular interest in getting these things right. They are expecting average national growth of around 3.5% for houses and a little less than 1% for units. These increases are skewed up by the large markets in Melbourne and Sydney. Areas other than this are expected to do less well or even see slightly negative house prices (yes, including Perth, although the NAB expect falls of less than 1% there).

Please note, though, that these expectations are for houses: apartments, especially high rise ones, are expected to fall everywhere.

Much will depend on interest rate movements – undoubtedly the two cuts in 2016, designed to stimulate business activity and boost the economy, had a huge impact on prices in 2016. Few people are predicting further falls in 2017 – and given how low rates already are, it would be hard to reduce them further anyway. But there are also few people predicting that they will increase.

The Share Market

Following on a terrific December, during which the ASX rose by 3%, January was more or less flat. This is not unusual – most of the institutions whose trading moves the market take their holidays in January, as does much of the rest of the economy.

There is one thing that we can be sure of when it comes to the share market in 2017: things will likely be volatile. This is not really a prediction – things are always volatile. But with Trump having just been sworn in as President, we expect that the markets will be a little more jittery than usual.

Dealing with volatile markets is like dealing with a nervous horse: it is always best not to make any sudden moves. Think your plan out and move slowly but surely to execute it. No need to buy or sell in a hurry. And no need to concentrate all your buying or selling on a single day.

The economic outlook (and the economy is where companies make their money, after all) remains quite good for Australia. The Reserve Bank of Australia (RBA) is expecting growth of 2.5 – 3.5% for the year ending 30 June, and 3 – 4% for the year ending 31 December 2018. This is consistent with Australia's long-term growth rates. This suggests no need for us to move away from our general opinion that the share market is a good place to invest – as long as you can take a long enough timeframe (ten years plus, forever looks nice) so that you can ride out any short-term fluctuations.

Same thing really: don't spook the share market horses. Act slowly and deliberately.

The List Everyone Wants to Be On



(First published December 12 2016)

So, did your job make it onto the list of the 50 highest-paying jobs in Australia? The Australian Tax Office released the list last week. You can check on their website if you made it onto the list – although if you have to check, you probably didn't.

We love these lists. They always give you some interesting things to chat about over dinner. For example:

1. The top 12 best-paid occupations for men are all in medicine.
2. But the best-paid occupation for women is a judge. This comes 13th for men – even though male and female judges get the same pay.
3. A male neurosurgeon earns \$577,000 a year. This is the highest paid profession for men.
4. A female neurosurgeon earns \$323,000 a year. This is only the second-highest paid profession for women.
5. A male member of Parliament does not make the top 50 in terms of pay. Female MPs come in 23rd.
6. Australian cricketers (male) earn more than paediatricians.

This list should help you make a few better decisions. For one thing, if you need neurosurgery, look for a female surgeon. She is either (i) cheaper; or (ii) less busy than a male one. Either of those things is probably a good thing.

What's more, you are probably better off voting for a woman than a man. Women are far less likely than men to earn more working elsewhere. That means that Parliament is a good option for a smart woman. But for a smart man, not so much. Australia's current Parliament is 71% male. Just saying.

You can see how lists like this can be good fun – but they can also be useful in more serious ways. Especially if we are running our own business, or looking to make a successful investment. The list has much to teach us about economics.

For example, almost every one of the highest paid jobs would be described as 'necessary.' In the top 20 for men, there are 18 types of doctor, a judge and a securities dealer. For women, there are 17 types of doctor, two types of judge and one futures trader. So, doing a job that people really need is good for your income.

That said, simply being needed is not enough. If it was, then teachers and nurses would also be paid a fortune. To really earn the big bucks, a job must also have a high 'barrier to entry.' A barrier to entry is anything that makes it harder to enter a particular profession. Think of that neurosurgeon: he or she had to get the very highest marks at high school simply to make it into medical school. He or she then spent more than a decade slogging it out in really difficult training before they were even allowed to start practice. Very few people can get through all that and qualify to perform neurosurgery.

High barriers to entry reduce the supply of people who can do a given job. Combine low supply with high demand (being needed), and prices rise. This is true for neurosurgeons (where the surgeon's income is the 'price'), small to medium businesses or investments. It's called 'relative scarcity' and it underpins decent economic performance in any sphere. High demand, low supply.

In business, if there are lots of people who can do what you do, and/or there is not much need for what you do, success will not follow. Conversely, if your business has some special capacity that few share, and people need it, then you can expect to succeed.

The same goes with investment. For example, take property. You know the saying: 'the thing about land is that they are not making any more.' That is, low supply. (Remember, we are talking land here. The supply of apartments is much less fixed, especially high rise ones). Combine limited supply with high demand and you get high prices. That's why land where lots of people want to live – for Australians, this usually means near (i) the city and (ii) the water – has long proven a good investment. And land where no one wants to live is never a good buy, no matter how cheap.

So when you are thinking about your business, or your investments, or even what your kids should study at Uni, keep relative scarcity in mind. Not many of us can be a neurosurgeon. But we can all learn from them.

The Power of Deductibility for Effectively Donating



(First published 19 December 2016)

At this time of year, many people decide to make some sort of donation to charity. In the UK they have found a 5% increase in the number of people donating to charity at Christmas time. It would be similar here in Australia.

As financial advisers, we want you to manage all of your financial affairs as effectively as possible. So, we want to explain a simple but powerful concept that makes sure that any donation you give does as much good as possible.

The idea is to give donations to charities for which you can claim a tax deduction. It sounds simple – it is simple – but it is also enormously effective.

Let's say you are happy to give \$100 as a donation to charity. For most people, what that actually means is that you are happy to give up spending \$100 on yourself or your family. Put another way, you would be happy to take \$100 out of your wallet or purse and give it to someone else.

The problem is, when you spend money on yourself or your family, you have to pay tax on that money first. The money in your wallet or purse gets taxed before you put it there. If you are a taxpayer, this means you have to earn more than \$100 in order to have \$100 left to spend. Here is how much you need to earn at each marginal tax rate (this rate includes the Medicare levy):

If your marginal tax rate is...	You have to earn...	And pay this much as tax...	In order to have this much left to spend on yourself...
19%	\$123	\$23	\$100
32.5%	\$148	\$48	\$100
37%	\$158	\$58	\$100
47%	\$189	\$89	\$100

So, to give \$100 to a charity for which you do not receive a tax deduction, you actually have to earn more than that. If you are in the top tax bracket (and we hope you are!), you have to earn \$189 in order to have \$100 left to donate in such a way.

But if the recipient of your donation is registered for tax purposes, things are very different. The tax office is happy not to impose tax on the donation. This gives you two ways to respond. Firstly, you might still make a donation of \$100, and then claim a tax deduction. The ATO will then give you back an amount equal to your tax rate times \$100. If your tax rate is 32.5%, you will get a payment of \$32.50 when you lodge your tax return. This means that you only actually gave up \$67.50 of personal spending to make the \$100 donation. You only have to take \$67.50 out of your wallet to give the \$100.

This is good – but maybe not in keeping with the spirit of the gift, which is to help someone else. A better response would be to ‘gross up’ the value of your gift. The ‘grossed up’ value is the amount that you have to actually earn before tax. So, if your tax rate is 32.5%, the grossed up value of \$100 is \$148. When you give the grossed up value, then the amount that ends up in your pocket is the same as the gift you intended to give. For example, if you give the charity \$148 and they give you a tax deductible receipt, then when it comes time to lodge your tax return you get \$48 back.

This means that you are personally only out of pocket \$100, which was the amount you initially decided to give (actually, it is the amount you initially decided to ‘give up’). But the charity got \$148! Your gift is almost 50% more helpful.

Not every charity can give you a tax deduction. For a start, charities need to be reasonably big to warrant the effort of registering with the ATO. So you might find that you want to make a gift that is not tax deductible. In those cases, given that the cause is obviously one you really think is important, you might just accept the fact that your donation has to be made after-tax. Alternatively, you might find other ways of making a contribution that is ‘tax effective.’ If you run a business, one way might be to make a donation ‘in kind’ (ie not as cash). For example, if you run a bakery and you give some unsold bread to a local recipient, then you can still claim all the costs of baking the bread when working out your tax bill. The ATO won’t ask you to identify the bag of flour that you used to bake the bread that you did not sell! If you are plumber and you get your apprentice to fix the taps in a local women’s refuge for no charge, then the wages you pay the apprentice are still deductible. If you run a shop and you donate some goods to a local charity for them to raffle off, you can still claim the cost of those goods as an expense of your business.

You get the picture. And you can see that it always pays to think about the tax effect of your giving. Once you have decided to give something, it makes sense to make that gift as effective as possible.

Tax Deductible On-Site Meals for Business Owners



(First published January 19 2017)

Most business owners eat at least one meal a day in the office or factory. So here is some good news: if you run your business through a company or trust, then the food you eat at work is probably tax deductible.

Some background

Usually, meals are a private expense. And usually, there is no tax deduction for private expenses. The tax laws relating to deductions specifically exclude private expenditure. This is why an employee or sole trader can't claim a deduction for meals they eat at work. Those meals are private expenses and the law prohibits individuals from claiming private expenses.

But things are different for a company (including a trustee company). A company cannot have a 'private expense.' So, the "private nature" exclusion in the tax law does not apply.

One of the effects of using a company or trust to run your business is that this generally means an employer/employee relationship exists – with the person running the business actually being classed as an employee of the company. So, if the company buys lunch, it is buying a meal for one or more of its employees.

As we say, companies cannot have private expenses and so the rules prohibiting deductions for private expenses do not apply to companies. This is usually addressed (from the point of view of the tax office) by the rules for fringe benefits. Where a company provides a non-cash benefit, this is typically referred to as a fringe benefit and taxed accordingly. This usually stops companies from paying the private expenses of its employees.

However, as with most rules, there are exceptions. When it comes to fringe benefits tax, one of the exceptions is meals. Food and/or drink provided by an employer (the company or trust) to employees is often FBT exempt. This means that the company can claim a deduction for it in certain circumstances. These circumstances are: that the food is consumed on the employer's premises; that the food is not related to a "social function;" and that no alcohol is served with the meal (booze makes things social, not functional).

So, if a company provides things like sandwiches, wraps, cups of soup and other "light lunch" type food to be consumed on site, GST is claimable, a tax deduction is allowed and there is no FBT liability.

And the meal does not need to be lunch. Brekky and dinner can be deducted as well. Just make sure that

1. the relevant staff eat the relevant meal at work; and
2. they don't have a beer for breakfast.

What this means for you

Let's say you usually eat your breakfast/lunch/dinner while at work and what you eat passes the "light meal/no alcohol" test. You simply pay for the meal using your dedicated business credit card (that is, the credit card that you only use to pay business expenses).

Let's say you buy yourself a sandwich and a soft drink each day. The light meal costs \$13.20, with \$1.20 being GST. The company can claim back the GST immediately. Depending on the ultimate tax rate of the person who receives the company's profits, the company can also claim an effective deduction for up to 49% of the remaining \$12 (if the profit recipient is in the top tax bracket). That's \$5.88.

This means that the after-tax cost of the lunch falls from \$13.20 to \$6.12, a saving of \$7.08 or 54%.

\$6.12 for a sandwich and a drink. You probably could not make it yourself for that price.

If this happened five days a week for 48 weeks, the annual saving would be \$1,700.

And, of course, if you start early and/or work late you will probably need more than one meal while at work. The savings would be greater. Do you know any business owners who don't start early or work late? This blog was written at 7pm at night.

If you would like to know more, you can find further reading on the ATO website at FBT exempt meal allowance and Tax Ruling TR 97/17.

An employer/employee relationship

For a company to claim deductions for meals, the people eating the meals need to be employees. And the company needs to be able to substantiate (ie prove) that this is the case.

Substantiation can often be overlooked when employing related parties in a business. Normal indicators of an employment relationship include:

1. An employment agreement outlining the role to be performed;
2. Use of a software payroll system that issues periodic pay slips i.e. fortnightly or monthly;
3. Physical and regular payment of salary from the business account to a personal bank account;
4. Payment of super guarantee; and
5. Insurance through Workcover for employees of the trust/company.

As with everything to do with tax, the key is to document the employment relationship. Remember, the ATO is not there to be difficult. If the employment relationship is genuine (and most people use companies or trusts specifically so that their personal liability is limited, meaning that the employment relationship is the whole point of using the company), then the tax concession is available.

The two key things to remember

Please keep two key things in mind: the meal cannot include alcohol and the meal must be eaten on your business premises. The standard practice of business owners eating dinner at your desk while catching up on (digital) paper work meets the rules.

We really hope this tip helps you in your business. If you think it will, why not give us a call and we will show you exactly how to apply it in your workplace.

Business Owners and Deductible Overseas and Interstate Travel



(First published January 26 2017)

This story was recently told to us by a fellow adviser. He does a lot of work with doctors.

Dr Ethan and his wife Esther migrated to Australia in 1988. They were Russian Refuseniks, brought to Australia from the USSR under a special deal done by the then prime minister, Bob Hawke.

Ethan's medical qualifications were not recognized so he took a job as a trainee nurse. He completed the training and then applied to medical school, working weekends as a nurse to pay his way and feed his family. Esther worked at whatever she could.

It's a common story. Economic and/or religious refugees come to Australia and do well.

It's the modern history of Australia.

Ethan became a doctor. His singlemindedness continued post-graduation. He set up a solo general practice north of Dandenong, Victoria, in an under-doctored and under-resourced suburb, and went about his work. Twelve hours a day, seven days a week. He was relentlessly dedicated, and his patients loved him.

Esther became his practice manager.

They never took a break. Not one holiday in ten years. To be frank Ethan was irrationally convinced if he took a break his patients would not be there when he got back.

But in the absence of a holiday, something else was going to break.

So Esther and I hatched a plan: she would book herself and Ethan into a fictitious medical 'conference' in Eastern Europe – in the European summer, on the coast. Business Class all the way. CPD points in abundance. "Everything tax deductible, Ethan."

Having assured Ethan of the financial intelligence of the plan, they flew out. Slept most of the way on their fully reclining seats. When they woke on the first morning, Ethan turned to Esther and asked 'well, where is the conference?' Esther smiled and said "Sit down darling. I have something to tell you.

There is no conference. We are on a holiday."

Ethan paused, frowned, then smiled in realisation as to how well he had chosen his wife, and said "Ok, let's have a holiday!"

Of course, none of the costs were tax deductible. The trip was 100% private and domestic. And they had a ball.

Unsurprisingly, Ethan's patients were still there, waiting agreeably if a little uncomfortably, upon his return. Some of them had even saved up a couple of illnesses for when he got back.

The point is this: take holidays. Holidays are great. They are what life is about and you cannot buy memories. You have to go and make them. Ethan got it, and is now a dedicated holiday taker. He never misses a chance to fly back to Europe. Business class.

There are no deceptions for Ethan and Esther these days. Ethan won't fall for that again anyway. Now, Esther looks for genuine medical conferences that actually cover Ethan's areas of interest. There are lots of them each year in different places around the world. Those trips are often tax deductible.

Business Travel and Tax Deductions

Ethan and Esther are running a business. You probably are too. The Australian Taxation Office's position is that the cost of a business owner attending an overseas conference is tax deductible – as long as the conference is related to deriving assessable income from an existing business activity.

Purpose determines deductibility. If the purpose of a trip is to do business better, then the trip is work-related. How do you prove purpose? Paper, or an equivalent digital record, proves purpose. Contemporaneous documents (ie documents that were created at the appropriate time) are best. It starts with the e-mail to the travel agent, includes diary notes, brochures, conference papers, and ends with a better knowledge and understanding of your industry or profession.

There are no stand out tax cases dealing with deductible overseas travel, in the sense of a coherent, complete and compendious explanation of the major issues. It's more an ad hoc collection of tribunal rules, public and private statements by the ATO and comments by learned authors. The major points include:

1. overseas travel of any duration requires written evidence;
2. overseas travel with 6 or more nights in a row requires a travel diary or an equivalent record;

3. if your travel has a private purpose, 'apportionment' between deductible business costs and non-deductible private costs may be required, based on your specific facts. For example:
 - if you spend a week at a conference in Paris and a week on the French coast sun-baking only half your costs, ie 7 days out of 14, will be deductible. However,
 - if you spend a weekend walking around Paris, a work week at a conference, the next weekend on the French coast sun-baking, and then travel to London to visit three businesses like yours over five days all your costs, ie 14 days out of 14, will be deductible. The weekend sun-baking and the down time between London medical facility visits does not impact the overall deductibility of your travel.

You are allowed to enjoy yourself while you work and after you knock off for the day. The ATO cannot unilaterally reduce your deduction to its preferred level of frugality. Business class air fares and five star hotels are fine. The ATO is charged with determining how much you incurred, not how little you could have incurred to achieve the same results.

Accompanying partners or others who are not involved in the business can be a problem. For these people, some costs, such as accommodation and car hire, remain effectively deductible. This is because the business traveller pays them for himself or herself anyway - the second person simply uses the same service that the business traveller needs to have bought anyway. But extra costs, such as the extra air fare/s and similar direct costs are probably not deductible - unless the partner is also involved in the business and has a legitimate business reason to make the same trip.

The Legal Stuff

General Advice and Tax Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances. All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

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