

## SUMMER / AUTUMN 2019

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## OPINION

Summer has now come to an end with changes coming as Autumn approaches. The change is not just to the weather but also to GDA and potentially to Australia.

### GDA

GDA has appointed a Business Development Manager who will be based in Melbourne with other staff to come, he will have a focus on aspects of our business outside of the financial planning area. After more than a year of preparatory work we have also completed the establishment of the GDA Representative office, which is located overseas and have appointed the first three staff again with more to come. It will allow us to continue to increase our service offering to our clients.

GDA has grown steadily over the years and we anticipate that growth will continue. A very significant portion of our growth comes from new clients being referred by our existing clients and we are very much appreciative of that fact, it would be fair to say we could not have achieved it without all of your support. Thank you.

### AUSTRALIA

We are not far away from a federal election which perhaps more than most elections, has the potential to have a serious impact on Australia and Australian people in terms of tax, immigration and living standards, particularly of senior Australians.

We will be inundated with election material, some of which has already started. A lot the material will simply be factually incorrect, wishful thinking or derived from the world of fantasy. As Trump would say "Fake News".

It is interesting that as reported by the ABC on the 21st February this year, on the day before the Australian Bureau of Statistics reported the Western Australia unemployment rate had climbed to its highest level in nearly two decades that the Premier Mark McGowan pledged to create 150,000 jobs over 5 years, this despite being 18,000 jobs short of his pre-election pledge to create 50,000 jobs. It is relatively easy to make politically inspired pledges, when most people will not remember who made the pledge and they are unlikely to be held accountable as it is bound to be superseded by more of the same, as instanced in this case.

As reported in the Australian on the 4th February 2019, you have Sally McManus head of the ACTU saying it is acceptable to break unjust laws (i.e. laws the union doesn't agree with) and comparing Australia's anti strike laws to Apartheid South Africa, the British Raj's bloody rule over India and racial segregation in the United States and then drawing a comparison on herself with Mandela, Martin Luther King and Ghandi.

Personally, I would have thought those comments were something of a stretch, bearing in mind that these statements are made in the context of a country with the highest minimum wage in the world, a history of rising wages and arguably declining productivity. This combination of wage increases, and declining productivity has seen a rapid decline and subsequent loss of jobs in the manufacturing industry and many other sectors in Australia. We are also seeing significant levels of under employment which in my view will increase.

### THE WORLD

It is interesting when you look around the world, in the United States we have recently seen the Democrats effectively shutting down the government by refusing to provide funding to continue to build the wall (or fence) between the United States and Mexico. I say continue, because construction first commenced in 1994, the wall is now well over a thousand kilometres long. It has been built by both Republican and Democrat presidents, including George W Bush, Bill Clinton and Barack Obama with the aim being to stop or slow the flow of drugs and illegal migrants in to the United States. You would have to consider the current funding crisis was politically motivated.

In France over the past 12 weeks you have riots (cars being burnt, shops vandalised) in opposition to government policies that a portion of the population do not agree with, you are also seeing similar issues in some South American countries.

You have the Brexit issues in the UK, China build up in the South Seas and trade tension between China and the United States none of which provide a great source of comfort.

It brings to mind a conversation I had last week with a 22-year-old due to graduate university in 18 months. When I asked what their aspirations were on completion of their studies, I was told the intention was to get into policy making. I asked what life experiences they would draw on to formulate the policies. I was greeted with silence, when I then asked would the policies be based on the left leaning teachings of a their Victorian University, the answer was, "most likely". It was in all probability an honest answer given the lack of any other real life experience. Perhaps you can relate this to the newly elected United States Congresswoman, Alexandria Ocasio- Cortez who was elected for the Democrats, she ran an entirely grassroots campaign, with an ultra-liberal platform that included the abolition of the Immigration and Customs Enforcement agency, tuition-free college, a federal jobs guarantee, universal Medicare, gun reform, an end to private prisons and access to affordable housing. You could view it as something for everybody that somebody else can pay for.

Perhaps that says a lot about some of the issues around the world. On a bright note the AFL season is just about to start, that should make around 50% of the population very happy, as for the rest they can select another channel or go and hold a protest.

In conclusion, I would recommend you pay attention to the upcoming election and particularly the possible financial impact on you and your family.

*John Fairlie, Chairman*

# TAX UPDATE

## INVESTORS OF RENTAL PROPERTIES ON THE ATO'S RADAR

**The Australian Taxation Office (ATO) has set out its list of targets with property investors due to the fact that about two million Australians now claim deductions on income coming from their rental properties.**

About \$45 billion in expenses for rental properties were lodged to the ATO last financial year. This, therefore, pushed property investors' compliance with tax laws to the top of the ATO's agenda.

The ATO has a large range of data to identify people who are failing to meet their tax commitments. Along with public data which is readily available to anyone, the ATO has access to information from a variety of third parties such as banks and financial institutions as well as access to rental bond data.

There are some key risk zones that the ATO has got its eye on this financial year which property investors should be aware of.

### RENTAL PROPERTIES THAT OFFER SHORT-TERM RENTALS

Due to the popularity of Airbnb, more and more Australian property investors are capitalising on the rise of the short-term rental market. Those who offer short-term rentals on their rental properties can demand a premium each week as well as become flexible when their property is vacant.

Nevertheless, the ATO has spied taxpayers who are not properly declaring their short-term rental income and has become a focus area for them this financial year.

According to the assistant commissioner at the ATO, Karen Foat, "There is no such thing as a rental hobby. All income from renting out all or part of a property needs to be declared as rental income."

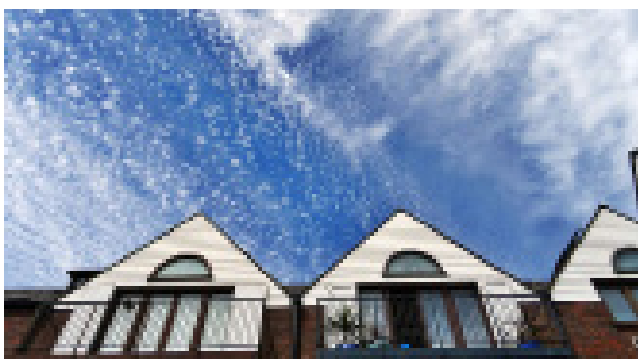
### YOUR HOLIDAY HOME AS RENTAL PROPERTY

In order for a property investor to claim expenses on a holiday home, it needs to genuinely be available for rent – a crucial factor that a few investors skip over. Ms Foat adds, "If you've refused tenants on an unreasonable basis [for example] then it starts to look a bit more like a private asset. If you're waiting for the conditions to be just right for you rather than it being an investment property, it's the same thing."

In addition, real estate investors need to be careful to separate individual or personal use expenses from those they claim to the ATO.

Furthermore, owners of rental properties should apportion their claims in relation to the holiday home. It is unlikely that you would be able to claim expenses for more than what you've charged, if you've rented your home out on mate's rates.

"The thing that we're concerned about there is creating an artificial situation – negative gearing that isn't genuine," Ms Foat stated.



**Your main residence (your home) is generally exempt from capital gains tax (CGT).**

However, you don't get the full main residence exemption if you use any part of the dwelling to produce income (such as renting out a room or running a business), and:

- you acquired your dwelling on or after 20 September 1985
- you would be allowed a deduction for interest (had you incurred it) on money borrowed to acquire the dwelling – this is the 'interest deductibility test'.

To work out your capital gain you generally need to know your home's market value at the time you first used it to produce income.

When people rent out all, or even part of their residential home, they become liable for Capital Gains Tax (CGT) when they eventually come to sell their house or apartment. That will be on the proportion of the floor area that's set aside to produce income, and the period it's used for that purpose, the Tax Office advises.

***Need tax assistance and financial strategies for your property? Contact today and we will be glad to assist - GDA Team.***

### LOAN MISCALCULATIONS

The ATO is also concerned by taxpayers claiming interest where a part of the loan was used for personal purposes. For example, a property investor might first take out a loan to buy property, but later, they'll refinance then go on a holiday or buy a boat.

"You need to only be claiming the portion of the interest [that's] related to the rental property itself," Ms Foat advised.

### IMMEDIATE DEDUCTION CLAIMS

Taxpayers are entitled to claim the cost of repair work and maintenance on their rental properties instantly. Nonetheless, there are other modifications to a home which are categorized as 'capital works' and can only be claimed over a number of years.

A good example coming from Ms Foat is if the guttering on your property is damaged in a storm, and you replace the part that's damaged, you can deduct that immediately. However, replacing the whole guttering would be considered as 'capital works' since it's a structural improvement. In this scenario, you will be able to claim that at a rate of 2.5% for 40 years.

### CAPITAL GAIN TAX ON USING YOUR HOME TO PRODUCE INCOME

Airbnb and Stayz hosts could be slammed with bills in the tens of thousands of dollars in capital gains tax when they come to sell their homes after the Australian Tax Office confirmed they'll lose part of their main residence exemption.

The Tax Office's advances in data-matching technology, it also revealed to Fairfax Media, now mean it's fully capable of "keeping up with the sharing economy", obtaining more than 650 million pieces of data a year from a range of third-party sources, including bank records of individuals' income.



# MONEY MATTERS

## IMPUTATION CREDITS - CASH REFUNDS IN JEOPARDY!

### PREAMBLE

Dividend imputation was introduced in Australia in 1987 by the Hawke-Keating Labor Government to prevent double taxation of dividends, paid by Australian companies. It entitled shareholders to tax credits on dividends equivalent to the tax already paid by the company.



This system was enhanced by the Howard-Costello government in 2001 by allowing franking credits to be fully refundable.

With 47.1% of SMSFs in full or partial pension phase in 2016, cash refunds to this sector have been substantial.



In 2017, the introduction of the Transfer Balance Cap (TBC) and removal of exempt income for Transition To Retirement (TTR) pensions, resulted in some funds that were tax free in the past, now being taxable.

Recently, the Australian Labor Party (ALP) announced that if it wins at the 2019 Federal election, it will remove cash refunds for excess dividend imputation credits. The change will start from 1 July 2019, with exceptions for:

- Cash refunds to charities and not-for-profit institutions
- Centrelink pension/allowance recipients
- SMSFs that had at least one Centrelink pension or allowance recipient before 28 March 2018.

### WHO IS AFFECTED?

Individuals, SMSF and APRA regulated funds that utilise cash refunds to improve returns are most at risk. Estimates from the ATO's Taxation Statistics indicate that 7% of cash refunds go to APRA regulated funds, 60% to SMSFs and 33% to individuals.

### APRA funds

Industry funds and super platforms receiving taxable contributions are not likely to be impacted, because these funds have tax commitments that arise from contributions and investment earnings, which exceed the imputation credits they receive. **As a result, industry and platform fund members in pension phase should continue to receive the full benefit of imputation credits.**

### SMSFs

**Most SMSFs in pension phase or that have low, or no contributions will be significantly affected if this policy becomes law**, unless they have Centrelink pension or allowance recipients as members.

### Individuals

Similar to SMSFs, individuals who receive cash refunds will be affected, unless they are Centrelink pension or allowance recipients. Information released indicates that; of 610,000 individuals who receive credits, 54% have taxable income of under \$18,200pa and therefore pay nil tax.

### WHAT IS THE POTENTIAL IMPACT

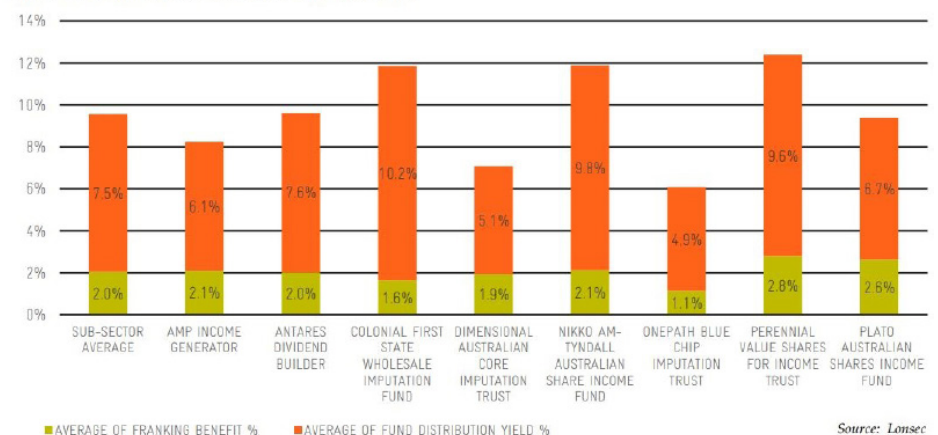
#### ON RETURNS ?

Investors with exposure to Australian equities will be affected by this proposed change, and particularly those portfolios with an emphasis on high yielding franked dividend stocks.

Lonsec research have outlined the maximum franking credits at risk for a zero percent tax payer.

The chart below shows the Average Yield and Franking Benefit for each individual fund/company over the three years from FY14 to FY17. The Franking Benefit represents the additional return (or yield) from franking credit cash refunds for an Australian 0% tax payer. Lonsec considers this measure to provide a simple and effective guide to the annual increase in distribution or return at risk a zero percent tax payer can currently receive from a year-long investment in the fund/company.

Chart : Income Dividend Focused (FY14 to FY17)



Source: Lonsec

The chart shows that the sub-sector has, on average, delivered higher than market yields and franking benefits. For comparison, the broader Australian equity market roughly delivers a yield and franking benefit of 4.3% and 1.6% respectively on an annual basis.

In recent weeks, calls have been made by institutional investors to company boards to release excess franking credits to shareholders in anticipation of a change in franking rules.

So far this year some of the more well-known dividend focused LICs, including Australian Foundation Investment Company (AFIC), BKI Investment Company (BKI), and Mirrabooka (MIR), have announced special dividends in response to this issue.

In the future, super funds may find franking credits will be limited to reducing assessed tax, affecting fund returns and thus superannuation and pension balances.

### OVERALL OUTCOME

The savings to the Federal Budget, and therefore cost to superannuation funds, are estimated to be \$10.7 billion over 2019/20 and 2020/21, and \$55.7 billion over ten years. **The ALP has said it will use these savings to fund personal tax cuts and social policy expenditure, effectively transferring wealth from SMSF pension members and share investors, to employees and social policy beneficiaries.**

### ACTION REQUIRED

SMSFs trustees and individuals who have previously relied on cash refunds will need to review their investment strategy, if the ALP wins the next election.

GDA Investment Committee is continuing to monitor developments and is actively considering potential portfolio changes, in the event of a change to current legislation.

Contact your GDA Financial Planner to discuss these issues and individual portfolios, or any other financial matter.

# MARKET REVIEW

## BREXIT: THE ROAD AHEAD

On 23 June 2016, a referendum was held in the United Kingdom to decide whether the UK should leave or remain in the European Union. More than 30 million people participated in the vote, with the Leave vote winning by 51.9% to 48.1%.

After months of negotiation, the UK and EU agreed on a Brexit deal, which comes in two parts.

■ A 585-page withdrawal agreement. This is a legally-binding text that sets the terms of the UK's divorce from the EU. It covers how much money the UK owes the EU- an estimated £39bn- and what happens to UK citizens living elsewhere in the EU and EU citizens living in the UK. It also proposes a method of avoiding the return of a physical Northern Ireland border.

■ A 26-page statement on future relations. This is not legally-binding and sketches out the kind of long-term relationship the UK and EU want to have in a range of areas, including trade, defence and security.

***As things stand, the UK is scheduled to leave the European Union (EU) at 11pm UK time on Friday, 29 March 2019.***

### Current circumstances

The Brexit deal cannot come into effect until it has been passed by UK Parliament. Theresa May (UK Prime Minister) had planned to put it to the vote on 11 December but pulled it at the last minute because she was facing a big defeat. She did put it to the vote on 15 January 2019, after seeking "further reassurances" on MPs' concerns from the EU and suffered a big defeat. She lost by 230 votes- the biggest for a sitting government in UK Parliamentary history.

Mrs May survived an attempt the following day by Labour to oust her as prime minister, with all the 118 Conservative MPs who had voted against her deal voting to keep her in power. They say they want her to have another go at getting a better deal from the EU, something she had previously insisted was not possible.

The UK parliament held a series of votes on 29 January on potential changes to Mrs May's deal, with most (including a bid to delay Brexit to prevent a no-deal departure) defeated. MPs did back a call for the government to rule out a no-deal Brexit, but it was non-binding and Mrs May has repeatedly insisted that the only way to ensure no deal is to back a deal.

The key vote for the prime minister was when MPs backed a call to replace the controversial Northern Ireland backstop clause with "alternative" arrangements. Mrs May believes the backstop is the main reason so many of her MPs and Northern Ireland's Democratic Unionist Party, who she relies on to support her in key Commons votes, are against her deal.

Currently, Mrs May is trying to get a better deal from the EU. She wants to change the legal text she agreed with the 27 other EU member states, however the EU has insisted it will not alter the legal text it has agreed with the UK and that the controversial Northern Ireland backstop is part and parcel of that. It appears that the UK hopes they will cave in at the last minute and agree to changes, when faced with the prospect of a no-deal Brexit.

### Options available

There are number of possible scenarios if Mrs May cannot get the Brexit deal through the Commons, including:

- Leaving the EU without a deal
- Another EU referendum (this can only happen if the government brings forward legislation to hold one and a majority in the Commons supports it)
- A general election- Labour's preferred option but it would need a no-confidence vote in the PM to be passed
- MPs could take control of the Brexit process from the government

Some of these options would involve delaying the official Brexit date of 29 March by a few months to allow time to renegotiate a deal, if the EU agrees to that.

### The Brexit Road Ahead

CBA Global Markets Research suggest the three most likely Brexit options are:

**I. Withdrawal Agreement (Plan B) accepted.** With Cabinet unable to agree on a way forward regarding the Irish backstop, EU leaders are unlikely to have given ground to a weakened PM May. Thus, with Plan B largely unchanged from the Withdrawal Agreement voted down by a historic margin, a similar fate may be inevitable when another vote is taken.

However, if the U.K. Parliament don't prefer the alternative options, or hard-Brexiteers perceive the no deal option won't occur, this option could eventuate. In our view GBP/USD would lift 3% to 5% as the political uncertainty subsides.

**II. No deal.** A no-deal hard Brexit means the U.K. will leave the EU on 29 March 2019 without a Withdrawal Agreement and without a 21-month transition period to adapt to being outside the EU.

In this scenario, GBP/USD will likely depreciate by over 5% against most major currencies because the UK would face negative economic consequences if it leaves the EU without a deal. According to the BoE's analysis, under a "no deal with no transition" scenario (hard Brexit), the level of U.K. GDP could fall between 3% and 8%. However, CBA Global Markets Research believe the BoE's economic forecasts is too pessimistic, and the U.K. economy will hold up better than expected.

However, at present there is not a majority of MPs in the House of Commons that favour a no-deal Brexit outcome. As such, any amendment empowering Parliament to block a no-deal outcome- as is likely to be proposed during the next week- should succeed. Less than 60 MPs, most of them members of the European Research Group (ERG), are considered hard-core Brexiters.

Moreover, the European Court of Justice (ECJ) ruling that the U.K. can decide to withdraw its notification to leave the EU (Article 50) without seeking the permission of other remaining member states significantly reduces the risk of a hard Brexit. In case the options of a general election or referendum fail to materialise, a majority of MPs would most likely look to revoke Article 50 rather than face the consequences of a hard Brexit. But that would go against the mandate of the 2016 referendum.

**III. Remain in the EU.** This can be achieved by either one of two outcomes. First, the U.K. Parliament vote to unilaterally cease from the withdrawal process and remain in the EU. The European Court of Justice has approved this outcome if the U.K. Parliament agrees to do this. Second, the U.K. Parliament could vote to hold a second referendum. In our view GBP/USD would lift some 8% to 10% if the "remain in the EU" option eventuates.

Alex Hunt & Brian Wheeler, BBC News *Source: Extract from CBA Global Markets*

*\*For a copy of the complete article please contact our office. General Advice Warning: This advice may not be suitable for you because it contains general advice that has not been tailored to your personal circumstances.*

**Please seek personal financial advice prior to acting on this information. Investment Performance: Past performance is not a reliable guide to future returns as future returns may differ from and be more or less volatile than past returns.**

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