

PINNACULAR DEAVIN

BUSINESS & INVESTMENT ADVISORS

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INTEREST RATES UP 0.25%

Interest rates have been increased by 25 basis points (0.25%) following the Reserve Bank's meeting this morning. The majority consensus amongst the "experts" had been that they would remain on hold for at least another month however there were those, around 40%, that had predicted the increase. It seems that there was sufficient data available to convince the bank that the chances of a second round of deterioration in the economy have abated.

All the economic news in the past week or so has been positive, with strong retail sales and jobs data, and the RBA has, it seems, overcome its lingering concern that a premature increase in rates would undermine the recovery. It appears that the bank's priorities 1, 2 and 3 are to keep a lid on inflation even if it negatively impacts on consumer confidence as a result. It would appear that rates are now on their way back towards 5% which is considered, by the RBA, to be a level which is sustainable for the longer term. Governor Stephens has stated recently that he expects an orderly increase in rates as we come out of the downturn so it is doubtful that they will increase again before Christmas. When they do it should be by a further 0.25% only. All eyes will now be fixed on the February meeting.

Grass Roots Economic Observations

We are also very aware that a substantial number of businesses have been stretching themselves to retain staff. This has included modified hours, using up annual leave entitlements, and in many cases allowing staff to access long service leave entitlements ahead of any obligation to do so.

Many businesses are reporting that things are improved for them but to place that in context, they were in water up to their necks 6 months ago and now it is only up to their knees.

Many of the individual business operators are treating the reported economic improvement figures with some scepticism. Anyone dependent on the retailer consumer is hoping that the traditional Christmas spend will offset the lack of further government stimulus at the individual level and is very concerned about post Xmas trading. There are even some hard nosed financial commentators suggesting that those very concerns are behind the timing of the Myer float.

Businesses in Australia are making profits and seem better placed than many overseas. However most are working hard to make the profits and the margins are slim. Credit risk is a continuing concern and for those who think they are making reasonable margins and winning sales by providing favourable credit terms they need to be careful. At the risk of being too negative, if someone is outselling the market they may just be a really good operator with a really good product or service. Alternatively they may just have a really good time for a short period until the bills add up quicker than the money rolls in.

Investment Opportunities

Tough markets create opportunities. The once in a generation economic event we have just experienced, and continue to experience, has provided opportunities for wealth accumulation. Many have acquired assets cheaply in the depressed market. If they can hold onto those assets the buyers will likely experience substantial gain in the longer term.

Gearing up to Invest

Gearing up to buy. i.e. borrowing money is a sound strategy. However any strategy needs to be underpinned by "what if" calculations.

What if interest rates spike upwards?

What if I lose my tenant?

What if share prices spike down in the short term?

What if I lose my income or it reduces substantially?

You need to have "rainy day" as well as "sunny day" projections for any investment but particularly so if you are intending to use borrowed money. If you feel really good about an investment strategy, talk to someone who is not in love with the idea and sees it as simply a potential transaction. If conversely you are looking for an excuse not to invest make sure you are using current information and don't leave yourself in later years counting the lost opportunity of a once in lifetime event.

We have a general view, like many others that we won't see interest rates on home loans above 10% p.a. for a very long time and that an average of 8% p.a. is probably a sound working rule but with the crystal ball there is no guarantee. If you want to punt on interest rates then you need to recognise that it is a punt. If you look at longer term fixed rates provided by the major banks currently in comparison to their standard variable rates you can see that they are building in an increase of up to 2% p.a. more in the next few years. It may not happen but the Banks are covering themselves and that is what prudent borrowers should also be doing. Not necessarily locking into a fixed rate but doing calculations assuming a higher interest cost.

TAX BREAK

Remember that you only have until 31 December 2009 to acquire eligible assets to entitle you to claim the tax break.

For businesses with a turnover of less than \$2M, the rate remains at 50% and the minimum spend \$1,000. Remember that the asset needs to be used, installed ready for use or improved (investment commitment time) by **31 December 2010**.

For businesses with a turnover of more than \$2M, the rate has now been reduced to 10% however the minimum spend remains at \$10,000 and the use/install/improve date remains at 31 December 2010.

Note that if a depreciating asset is subject to a hire purchase agreement, then the "investment commitment time" is the time at which the H/P agreement is entered into, not the time that the purchase order is placed with the supplier. The ATO has released an interpretative decision which gives the example of a taxpayer who places an order with a supplier in August 2009 and pays a deposit at that time. The asset is delivered in October 2009 and at that time the taxpayer enters into an H/P agreement with a financier. The taxpayer did not become the legal owner of the asset prior to entering into the H/P agreement.

Note also that the hirer of a depreciating asset which is the subject of a H/P agreement will be taken to be the holder of the asset for purposes of the tax break where:

- they possess the asset , or have a right to do so immediately;
- they have a right to become the legal owner; and
- it is reasonable to expect that they will become the legal owner, or that the asset will be disposed of for their benefit.

In this case the right of possession and the right to become the legal owner are rights acquired by the taxpayer under the H/P agreement and therefore the taxpayer becomes the holder of the depreciating asset when they entered into the H/P agreement.

SUPERANNUATION GUARANTEE CHARGE

Employers should note that they have until 28 October 2009 to meet their September quarter super guarantee charge obligations.

EMPLOYEE SHARE SCHEME ARRANGEMENTS

Following the uproar that arose after the proposed changes to employee share scheme arrangements announced in the budget, the Board of Taxation has announced draft changes to the legislation and has now invited submissions from interested parties who wish to comment on those proposals.

The draft application and transitional provisions provide, amongst other things, that:

- the new employee share scheme rules will apply to ESS interest acquired on and after 1 July 2009
- if a share or right was acquired under the current law before 1 July 2009, generally the old law continues to apply to that arrangement
- shares or rights acquired before 1 July 2009, on which tax has been deferred beyond 1 July 2009, will be brought within the new ESS rules.

We will update you further when the provisions are finalised.

CLAIMING TAX DEDUCTIONS FOR SHARE LOSSES

It is a statement of the bleeding obvious that the global economic downturn has decreased the value of many people's investments over the past year, and that some clients may be confused about the difference between capital losses (share holding) and revenue losses (share trading). The ATO is very much aware of this and is on the lookout for changes in treatment of realised and unrealised losses on shares during 2008/09.

The taxation of investments in prior years is relevant when working out the treatment in the current year. If there has been minimal change in the nature of your investment activity then the same tax treatment as last year will need to be applied this year. For example, if you have previously sold shares at a gain and claimed the 50% CGT discount, and have realised a loss in the current year, then you will be expected to show this as a capital loss in 2009. That is, you will only be able to offset the loss against other capital gains, not against normal income.

Where you seek to reclassify your activities you may be asked by the ATO to provide evidence that demonstrates a change in the nature of your activities or that you have declared your income correctly in the past.

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