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The **Australian**

Australian Expat Investment & Taxation News

A new month and issue of **The Australian** from **Imperium Capital**.

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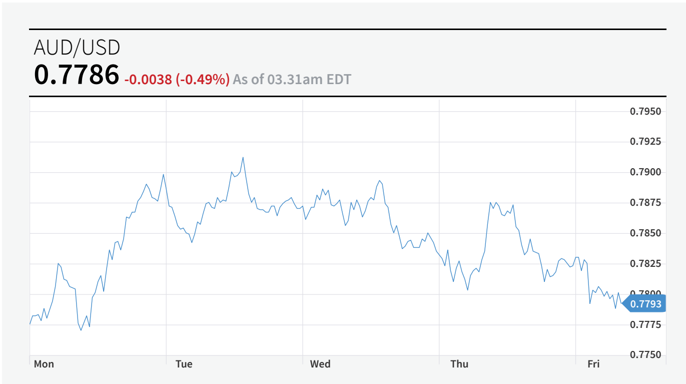


Last week recap (AUD/USD)

Gained sharply last week as New Zealand reported mixed economic numbers and the Greenback was pressured by a dovish FOMC Statement. The week began with the pair gaining ground on Monday after lower than expected U.S. economic numbers. The rate then declined on Tuesday after the New Zealand GDT Price Index declined -8.8% compared to a previous reading of +1.1%, while the New Zealand Current Account showed a decline of -3.19B, in line with expectations. On Wednesday, the pair made its weekly low of 0.7273 before trading sharply higher after the FOMC Statement suggested the Fed would hold off on any rate hikes at least through April. Also out on Wednesday, New Zealand GDP increased +0.8% q/q as widely anticipated. The rate then lost ground on Thursday despite lower than expected U.S. Current Account and Manufacturing data. The pair gained sharply on Friday, making its weekly high of 0.7590 in the absence of any significant data out of either country. NZD/USD went on to close at 0.7562, with an overall weekly gain of +3.0%.

The week ahead (AUD)

The Australian economic calendar is quiet this coming week, only featuring a speech by RBA Assistant Governor Edey on Tuesday and the RBA's Financial Stability Review on Wednesday. Resistance for AUD/USD is seen at 0.7846/75, 0.7912 and 0.8024/34, with support noted at 0.7719/56, 0.7625/43 and 0.7684/0.7705.

Stock Market Update

Hartleys

BHP Billiton a buy for yield hungry SMSFs Wash your mouth out I hear you cry. This is sacrilegious. You are excommunicated from the Church of Income Investing. I guess now you can tell where I went to school. Well, I think BHP Billiton could be a lost sheep and should be welcomed into the income investing flock. I know there will be those who disagree, but at least let me put my case.

Image courtesy **BHP Billiton** www.bhpbilliton.com

BHP's result for the six months to 31 December clearly reflected the pain felt from the substantially lower commodity prices across its diversified portfolio. It equally reflected the steely determination of management to drive costs out of the organisation, lift productivity and reset current and future capital expenditure budgets. So far the progress has been significant on both fronts resulting in a strong balance sheet without guillotining growth options. Low hanging fruit has been harvested but there is more fruit available further up the tree. Management will continue to reduce the cost base without impacting production.

In line with the progressive dividend policy, the 1H15 dividend increased 5% to US$0.62 cents fully franked. On a steady 2H15 dividend the FY15 fully franked yield is an attractive 4.7%. On an adjusted basis BHP has not cut its dividend in 26 years. Few companies are in this company. Management reiterated maintenance of the progressive dividend policy and importantly will not re-base the dividend should South32 demerge, so the payout ratio rises. Our preliminary estimate of South32 value is between $1.50 and $2.00 per share - around 5% of our BHP fair value estimate. Should this assessment be accurate, BHP's share price should slip by $1.50-$2.00 ex-demerger. The yield, based on our FY15 estimate of US$1.24 would drift higher to just over 5.00% fully franked as the share price re-adjusts downward. Is the lost sheep getting closer to being invited to join the flock? Let's look a little closer. BHP has a narrow economic moat. Competitive advantage stems from the ownership of a very substantial portion of the earth's long-life, low-cost, export-orientated, expandable mining assets. Many are irreplaceable, with low sovereign risk and with close proximity to key Asian markets. Low production costs ensure profitability throughout the commodity cycle. World class deposits also have superior exploration and expansion potential. BHP's commodity and geographical diversification reduces the risk profile, smooths the earnings stream, and importantly allows hopefully sensible reinvestment through the cycle.

I want to use the Pilbara iron ore assets to reinforce BHP's unique position. We are all acutely aware of the iron ore price fall of the past year or two - collapsing from an unsustainable US$160/tonne in 2012 to around US$60/tonne currently. In the six months to 31 December BHP's iron ore EBIT/tonne was US$37.00, including offshore Samarco operations which are slightly less profitable. Back in the 2011 and 2012 boom days the margin was US$98.00 and US$90.00 respectively. But US$37.00 is still very attractive courtesy of a very low invested capital base thanks to scale and distant past investment at much lower unit capital costs.

On the other hand Fortescue finds itself in an entirely different situation. It is a late comer to the iron ore industry and has made significant progress. But its investment has been high cost, a casualty of the elevated capital and wage costs in boom times. So to maximise the return Fortescue must lift production levels as servicing the large invested capital base, in large part financed by debt still on the balance sheet, is an enemy when prices fall. That is stark reality and in the six months to 31 December Fortescue's EBIT/tonne margin was US$9.23, of which US$3.90 is interest. The pre-tax margin is a skinny US$5.33/tonne. If the iron ore price fell a further US$7.00/tonne to say US$54.00, then Fortescue's pre-tax earnings vanish on a 1H15 'frozen' cost base. Meanwhile BHP would still make a not too shabby US$30/tonne. Fortescue is reducing its cost base, but as a high cost player is running hard to stand still and the margin for error is much less.

I believe we are nearing the bottom of the commodity price cycle but I am certainly not predicting a v-reversal in prices. The 1H15 BHP result is a reflection of where we are in the cycle and the company remains profitable, has one of the strongest Australian company balance sheets and continues to generate excellent free cash flow to pay down debt and dividends. Cycles are cycles. Troughs become peaks and peaks become troughs. BHP has shown it has the ability to ride the cycle and look after shareholders. Hopefully management will be more careful when the next peak occurs, as it inevitably will. I am increasingly comfortable recommending BHP Billiton as an income stock for SMSF portfolios.

Where do I put my cash?

The equity market is not the focus of dinner party conversation. Who has dinner parties anyway - so 1990s. The cab driver is not tipping Commonwealth Bank or Telstra. More to the point, where should I put my CASH? Where can I get a better return without going too far out the risk curve? I guess it is a nice problem to have, many don't.

But as term deposit rates fall, attention focuses on what's the alternative. Clearly the equity market is a high priority alternative. The attributes around liquidity, ease and cost of dealing and three day settlement are difficult to match. Only racetracks or casinos provide better liquidity and faster settlement, but activity of this nature is not on a prudent person's investment risk curve. Property is at the other end of the liquidity, cost of dealing and settlement scale. But it does offer much more choice.

Self-managed super funds (SMSFs), sitting on an estimated $150bn in cash, are in a real bind, made even more difficult by the concentration of the Australian equity market. Superimposed on this concentration is a dearth of stocks ticking the financial sustainability box with reliable cash flow, earnings and dividends through the economic cycle. The numbers shrink even more in the current below trend environment. Consequently, the share prices of "yield favourites" or perhaps in the current climate those stocks generally viewed as "bond-like" - the four major banks, APA Group and Transurban for example - have been pushed to levels, which on almost every investment criteria, suggest they are expensive. But while global bond yields stay down and it appears bonds will be 'bid' rather than 'offered' for some time, these stocks will remain expensive and may in fact become more expensive, relative to fundamentals. The market reacts to the forces of demand and supply and at present demand is stronger. I believe this lack of choice has seen more investment money spill into the property market than would usually be the case. Obviously the ability of SMSFs to borrow has added to the surge. The conundrum facing Australian investors is rising equity markets and falling bond yields. Rising equity markets normally indicate better economic times and improving corporate profitability. Falling bond yields generally indicate the opposite, low inflation and low economic growth. These are indeed strange times.

Yellen buoys yield plays

Chairman of the Federal Reserve, Janet Yellen has given yield stocks a reprieve. Her dovish comments to the U.S. Senate banking committee highlighted the meaningful divergence between the beneficiaries of the improvement or growth in the economic pie - the growth in the country's GDP. Yellen sees the significant increase in corporate America's share as opposed to that of the average worker - Wall Street versus Main Street. It will be interesting to see how Yellen and her colleagues traverse the terrain. Increasing the Fed Funds rate from 0.25% should not affect bond yields from which mortgage rates take their cue. With inflation well below the long-term objective, some moderate wage increases could be tolerated.

It appears there will be no change until after June, perhaps September. That would take some near term heat out of the US$ as well to the collective approval of the multinationals. Remember Paul Volcker's comment, "the easy part is easing; the hard part is tightening." The dual role to stabilise inflation and maximise employment can be counter-productive. It can confuse Main Street when sometimes the Fed is against inflation and sometimes, like now, for it and lower inflation doesn't necessarily create more employment. Good luck Janet.

Peter Warnes

Tax & The Aussie Expat

A COUPLE OF WINS TO THE TAXPAYER ON TAX RESIDENCY FOR AUSTRALIAN TAX PURPOSES

PINNACLE GROUP

During May 2014, the AAT in Dempsey v Commissioner of Taxation, rejected the Commissioner's submissions that the ordinary meaning of 'resides' should be given a wide interpretation so as to generate as much income tax as possible.

The AAT concluded that Mr Dempsey was not a resident of Australia for tax purposes, and was not required to make a 'donation' to the Australian consolidated revenue.

Mr Dempsey's particular circumstances

Mr Dempsey is a building and construction industry project manager, who worked on a construction project in Saudi Arabia from September 2007 until May 2010.

While living and working in Saudi Arabia, he:
- maintained a house in Australia (formerly his home), which, while he lived abroad, he used to store his furniture and cars; and
- returned to Australia about twice a year for holidays and visiting family (who he had never lived with), usually staying two or three days at the house to check everything was in order.

In Saudi Arabia, he lived in a residential apartment supplied by his employer, and had a visa that was renewed every 12 months. He holidayed primarily in Thailand, but also in Bahrain and Australia.

'Resides' has its ordinary meaning

In its decision, the AAT confirmed that the meaning of the word 'resides' in Australia has its ordinary English meaning, which is: 'to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place'. The AAT rejected the Commissioner's submissions, stating that case law provides 'no warrant for adopting some broad meaning'.

ATO checklists are not the law

Our experience is that the ATO often works through a checklist of factors, which can sometimes distract from the real question of where a person 'resides' – meaning where the person 'dwells permanently', has a 'settled or usual abode' and 'lives in or at a particular place'. In its decision, the AAT explicitly warned against relying on these checklists.

Interpreting the legislation with a view to collecting more revenue

The AAT also made it clear that the tax-free status of the overseas country cannot affect a taxpayer's liability to tax in Australia. The AAT stated that Mr Dempsey: 'was not obliged to make a donation to Australian consolidated revenue in respect of income derived from non-Australian sources just because that income was not subject to taxation abroad. Nor was he obliged to make such a donation because he retained Australian citizenship.'

The notion of 'resides' under ordinary concepts is further highlighted in another recent case 'The Engineering Manager - 2014/0089' that was published in December 2014 by the AAT, involving an engineer manager working abroad.

The AAT concluded that Mr M was not a resident of Australia for tax purposes for the entire 2011 income year and subsequently did not have to include his foreign employment income in his annual return.

Mr M's particular circumstances

Mr M was an engineering manager who during the 2011 income year, worked in Oman from the 1 July 2010 to the 28 April 2011. Mr M returned to Australia permanently on the 29 April 2011. Prior to working in Oman, Mr M was working abroad in Qatar and Japan since 2004 and during this time his family remained in Australia.

Whilst working overseas only some of Mr M's personal belongings remained in his family home.
While living and working in Oman, he:

- rented a house in his personal name, exclusively for his own use and furnished mainly with his personal belongings;
- joined the local squash club, played golf and made an effort to take in the local culture and interact with the local community; and
- visited his children in Perth 4 times in the 2011 income year totalling 62 days. He continued to attend to all work matters when in Australia as there was no replacement engineering manager while he was on leave.

'Resides' to be determined on the totality of a taxpayers factual circumstances

The Commissioner contended that due to the connection between Mr M and his family who remained in Australia and the pattern of consistently coming to Australia when on leave that Mr M retained a continuity of association with Australia and therefore was a resident of Australia for the whole of the 2011 income year.

The AAT rejected this on the basis that in Mr M's case, his dedication and commitment to his work outweighed his family ties, even though he financially supported his family. The fact that Mr M's marital relationship was far from harmonious further supports this.
Although there was physical, emotional and financial ties to Australia, under the ordinary meaning of 'resides', the AAT determined that for most of the part Mr M was not physically present in Australia nor did he intend to live in Australia during the 2011 income year. Mr M's intention was to continue to work and live in Oman subject to the renewal of his employment contract. Mr M's priority was his work, and his career. Mr M's life revolved around his work and he ordered his lifestyle around his work commitments. This was evident as Mr M continued to work in Perth even when on leave.

In a dispute with the ATO? Or concerned a dispute could be around the corner?

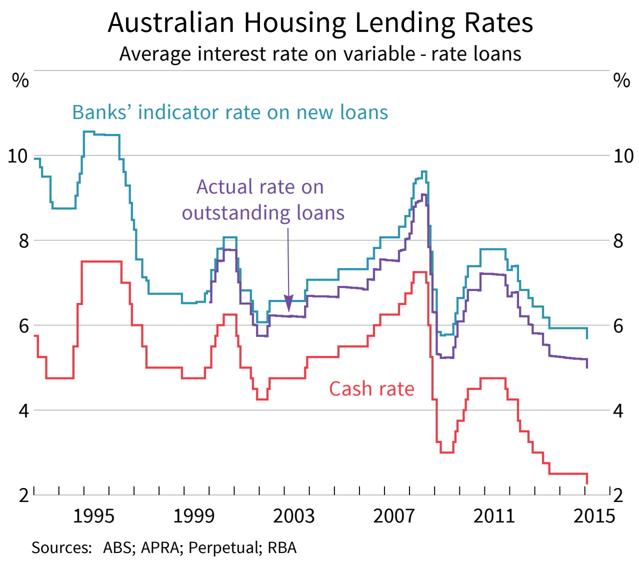
Each matter must be considered based on its particular facts. However, the decisions in the above cases may provide some relief to taxpayers who have become unsure of the meaning of the word 'resides' given the Commissioner's expansive interpretation in recent years. In existing disputes with the ATO, the key is to collate all of the relevant evidence, as the total circumstances must be considered (not just those in the checklist). Prudent taxpayers will also collect evidence and take steps to reduce their risk of the ATO commencing audit activity.

This is for general information only and should not be relied upon for individual circumstances. Should you wish to discuss your tax residency or have any queries relating to the above article please contact: **Craig van Wegen** (craigvanwegen@pinnaclegroup.com.au) or **Nora Fairbanks** (norafairbanks@pinnaclegroup.com.au) at the **Pinnacle Advisory Group**.

Mortgage Rates

As Economists debate RBA thinking and the future of the Cash Rate in Australia, variable interest rates have dropped to their lowest in a generation. Rates around 4.40% and in some cases lower are on offer, subject to meeting the banks' lending criteria. Fixed rates as low as 4.28% are on offer for 3 year terms and some lenders are offering 5 year fixed rates @ 4.59%.

If the RBA drops the Cash Rate further we would expect to see lenders pass on reductions in variable rates, however fixed rates may have plateaued due to the changing interest rate landscape outside Australia.



Property

The Perfect Investment Property - Eleanor Street Apartments

If you can afford to send home $84.00* (Aus) per week, then you can't go past this excellent one bedroom + study investment property priced at only $367,000, and located opposite The Western General Hospital which is only 7 kilometers from the Melbourne CBD.

The Western General Hospital employs over 3000 staff, making this property attractive to Hospital employees working long and irregular shifts.

Eleanor Street development is already 75% sold, this is the last one bedroom apartment available. Construction is due to commence shortly with completion due in early 2016. And as construction has not commenced, this property offers massive stamp duty savings.

And, if you are paid US dollars, investing in Australian property has never been more attractive!

Eleanor Street, the perfect investment property!

- Location - Only 7 kilometers from the CBD
- Opposite the Western General Hospital (Over 3000 staff)
- High rental demand area
- High capital growth corridor
- Small low-rise property, only 17 apartments in the development
- Massive stamp duty savings
- And you will accumulate approx. $75,000 in tax credits in the first 5 years!

If you would like to know more about this Eleanor Street apartment, or any of our other properties, contact Greg Shand at greg@expatpropertyplanners.com.au

** Based on a 20% deposit (($74,000 Aus) and at 4.99% interest rate.*

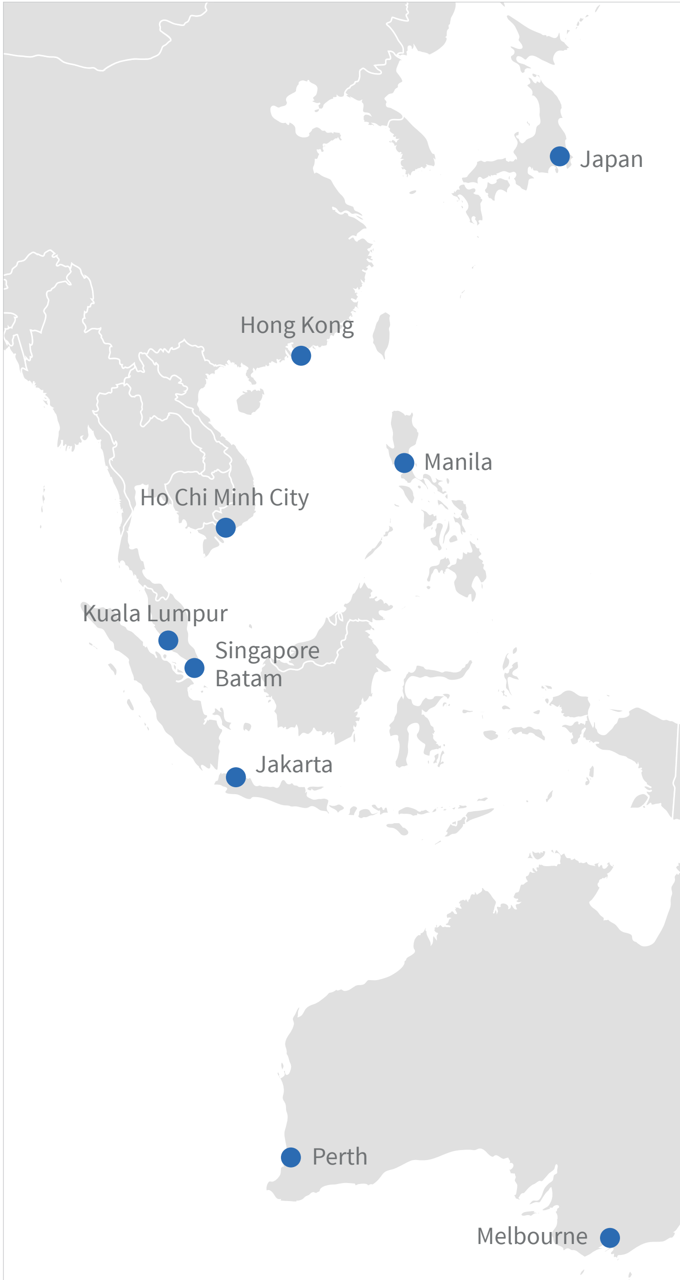
Client Wins

HOW WE HAVE BEEN HELPING AUSSIE'S AROUND THE WORLD

This year we've taken on new clients in Perth, Jakarta, Manila, Japan, Melbourne, Hong Kong, Singapore, Ho Chi Minh City, Batam & Kuala Lumpur.

We've helped them with:

- Saving over $2,000 in interest charges by providing mortgage structure advice for a client in Kuala Lumpur
- We've helped several clients with the very tricky and technical area of multi-jurisdiction redundancy pay outs and helped them with over $40,000 in tax savings
- Strategy advice for investment properties for clients in Melbourne, Jakarta, Perth, Batam & Kuala Lumpur to ensure the clients situation has been maximised. In some cases including clients putting 0% (cash) deposit down and substantial tax credits being built up
- Clients in all the above mentioned locations have had life, income protection, trauma and total and permanent disability insurances put in place to ensure that should the unfortunate happen, both themselves and their family will be protected. We have also helped these clients 'upgrade' their policies while at the same time providing cost savings
- We've helped many clients get 'back on track' with their superannuation by helping them amalgamate their various funds, ensure that their investment allocation is managed and saved each client substantial amounts in fees and charges



Important Notes

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