WEALTH WISE

YOUR PERSONAL GUIDE TO WEALTH CREATION

wealth journey

SMSF assets new ruling

The ATO has changed the rules in regards to SMSF funds valuation of their assets and introduced tough new penalties for non-compliant funds.

The ruling came into place on 1 July, and requires funds to value their assets at net market value when completing annual returns. A fine of up to $11,000 can be enforced on trustees for false information.

Previously the law stated an SMSF could use a variety of ways to form a valuation of assets, which included historical value, book value and general market value.

The changes mean the assets can only be defined by 'net market value' which is the amount a fund expects to receive after the sale of the asset in an orderly market, minus the costs of the sale.

The costs involved in a sale may include commissions to salespeople, advertising or auction expenses, and brokerage fees.

The new laws also apply to a fund that sells an asset to a related entity, such as a family member or another fund.

The consequence of this change is that the trustee must put a lot of time into having the value of many assets verified by a third party. Failure to do so may alter the funds compliance status and result in a much higher tax rate, as well as potentially incur a fine.

Collectable or personal-use assets sold to a related party must also have the assets market value determined by a qualified independent valuer and keep records of this valuation in the event of a sale.

This also applies in the case of listed shares, which will no longer be transferable from the member to the fund through off-market transfers.

This change in law requires trustees to reassess their funds assets and if necessary make arrangements for to ensure the funds compliance status is not changed.

The only assets which may not require an annual valuation are properties.

Unless a significant change to the value of the property has occurred, such as a natural disaster or new development in the area, a formal valuation will only be required every three years.

Records of all annual valuations must be kept on file. The ATO may request these documents during an audit on the fund.

IN THIS ISSUE - NUMBER 20

WEALTH JOURNEY

SUITE 3, LEVEL 10
280 GEORGE ST, SYDNEY
NSW

TEL (02) 9235 0066
FAX (02) 9235 3882

E-MAIL
mark@wealthjourney.com.au

WEBSITE
www.wealthjourney.com.au

PRINCIPAL
Mark Marcos

Financial Planning,
Property Investment,
Self-Managed Super Funds

Personal insolvency and bankruptcy

Individuals with high debts can see bankruptcy as a solution to their problems. However, being declared bankrupt has some serious long term consequences and should be seen as a last resort.

There are many reasons a person may become bankrupt, generally poor planning and management of personal finances is to blame, as well as incurring large amounts of enforceable debt, such as being sued or gambling losses.

If an individual is unable to pay their debts, under Australian law they become legally insolvent. The individual may have enough assets to cover their debts but if they are unable to liquidate them, they may declare themselves bankrupt, or another individual or company may do so.

What is bankruptcy?

Bankruptcy is a legal process where a trustee is appointed to administer the individual's affairs and to distribute their assets to creditors. A creditor may bankrupt an individual through the courts, this is called a 'creditors petition'.

It is a legitimate way for a debtor to solve their debt problems. It is also the common method for creditors to take action against someone with unpaid debts.

Negatives of bankruptcy

If an individual is declared bankrupt, the bankruptcy period ends three years after the date the court action was filed.

A bankrupt period can be extended if the trustee of the estate files an action in court.

There is also a 'bad credit rating' that will appear of the individuals file for seven years, which means every time the individual applies for credit a lender will be see they have been declared bankrupt and may refuse to service them.

The individual may also be summoned to attend a public examination in order to explain their affairs to the court and creditors, which will be made public and put on record.

All assets, including inheritance from a decreased estate may be sold off to begin repayments to creditors.

There are a few assets that are protected, such as super, necessary housing, primary means of transport and insurance policies. Assets such as a second car, collectables or valuables may be sold.

Homeowners made bankrupt risk losing their homes, seeing as the vast majority of homes are subject to a mortgage.

The mortgage can be enforced during the bankruptcy, although homeowners can sell their home during bankruptcy to help pay off debts.

Benefits of declaring bankruptcy

Personal debts that the individual had prior to declaring bankruptcy become claims against the estate and creditors must deal with the trustee instead of the individual and cannot take legal action after or during the bankruptcy.

The Bankruptcy Act was developed to guide and protect both debtors and creditors. A bankrupt debtor is protected from being pursued by his or her creditors and, within limits, is released from their debts at the end of the bankruptcy.

A bankrupt person can still apply for credit, and while many lenders will not deal with someone after bankruptcy, there are a companies that specialise in loans for those struggling financially.

A Debt Agreement Proposal can save an individual from declaring bankruptcy. The proposal requires the debtor to come to an agreement with their creditors about a repayment plan, which is administered by a third party, generally a court appointed accountant or lawyer.

Although the economy is doing well, there are high numbers of insolvency's as a result of the global financial crisis.

For those currently struggling, preparation for bankruptcy can protect some assets and save the individual from losing everything they have.

Most funds and payments held in regulated superannuation funds received after bankruptcy are protected.

Also assets held by the individual in a trust for another person, for example a child, are also protected.

Devising a well thought out plan of action for asset protection will be very beneficial to all trustees in the event of future bankruptcy or hardships.

Debtors prison

Once a common way to deal with people who owed debts in Europe and America, 'debtors prison' was brought to Australia by the English in 1834.

The prison sentence was specifically for those who were not honest, and not those who were given a loan by someone who should have known that they could not repay it.

Debtors prison was abolished in 1842, after the colony was hit so hard by drought that the Government suspended imprisonment to avoid overcrowding the jails.

SMSF suffer fallout from family feuds

Settling a dispute can end up costing much more than it may be worth.

The most common disputes over SMSFs involve inheritance, real estate, family businesses and divorces.

When disputes over SMSFs are resolved in the courts, the legal fees can quickly eat up a huge amount of the money being disputed over.

A common problem for many funds is the addition of a new family member through a new marriage.

Often the new spouse does not get added as a trustee until an issue with the fund arises, at which time other trustees object to the new member being added.

Under superannuation law, it is specified that all SMSF members must be either individual trustees or directors of a fund's corporate trustee.

The Australian Taxation Office (ATO), as regulator of self-managed funds, recently published the Superannuation and Relationship Breakdown Guide to give trustees guidelines to consider in the instance of a dispute.

This guide emphasises the fact that despite the differences between individuals, all trustees must act in the best interests of all fund members.

For example, a trustee cannot exclude another trustee from decisions concerning the SMSF.

Also a trustee must not ignore requests from others to redeem assets from the fund or to transfer super savings into another super fund. All requests must be addressed and discussed equally.

If a fund does not comply with superannuation law following a dispute between trustees, there will be costly consequences for all members of the SMSF.

If the ATO deems the fund as non-compliant, it can revoke the fund's 'complying status'.

Non-complying SMSFs are not entitled to receive concessional tax treatments and the assessable income of the fund will be taxed at the highest marginal tax rate.

In the after-math of a relationship breakdown, updating legal documents can easily be overlooked, many may intend to split their superannuation and other assets as soon as possible but this is often a long and difficult process.

Throughout this process, trustees must ensure their fund remains compliant with superannuation law.

Retirees rely on reverse mortgages

The global financial crisis has had an impact on many retirement plans.

Lost capital gains and dwindling returns coupled with poor asset protection and lack of money management skills has lead many retirees to make some difficult decisions in regards to their futures.

As a result, many retirees are now considering new ways of increasing their cashflow, and investigating options they might not have previously considered.

A reverse mortgage applies to a home where the mortgage has already been paid off. The equity from that property can be drawn on as a loan.

The loan repayments begin when the residence is sold, until then, the retiree can live in the home on reverse mortgage funds without repayments.

Advantages of a reverse mortgage

Australians are living longer than ever before and, coupled with improved health and advances in medical technology, are able to enjoy a retirement lifestyle not even contemplated in decades past.

The idea of an inheritance, leaving the family home to children or grandchildren, is waning as retirees realise the financial potential in their homes.

The main reason seniors are requiring these loans are to maintain an income stream, undertake home improvements, and repay debts.

Last year the reverse mortgage market grew by 10 per cent on the previous year, to now be the fastest growing sector in the mortgage market.

The average size of the loan was roughly \$78,250. The majority of people applying for these loans are aged between 70-75 years old, who are relying on the pension and super to fund their living expenses.

Given the aging population in Australia, it is likely reverse mortgages will continue to be a growth area.

Disadvantages of a reverse mortgage

These loans do have interest, fees and penalties, which can mean the loan is continuously growing and may end of being larger than the value of the property. Over time the debt can grow considerably.

This lingering debt can have a detrimental effect for seniors applying to live in aged care facilities, as well as leaving family or relatives with the burden of repayments. Often paying off these debts leaves little or no inheritance for children or spouses.

A reverse mortgage is not for everyone and some retirees may want to avoid a reverse mortgage being their only option.

Regular reviews of individual's current financial health and future retirement strategies are an efficient way to do this.

Currently the Government has changed the super contribution limits, checking the fund is meeting these new limits will save money in the future.

Also investments need reviewing and in some cases diversification of the investment portfolio.

Knowing the status of each investment will help individuals manage their fund and prevent loss of income stream.

SMSF court decision

SMSF trustees have gained a new way to pursue losses inflicted on their fund by fraud or theft.

A recent court decision has given hope that compensation can exist for self-managed superannuation fund trustees who have experienced recent losses.

Until now it has been widely believed that there are no laws to protect SMSF trustees should they run into any legal problems.

This recent court settlement, saw a trustee regain almost $1 million in losses after succumbing to a fraud.

The ruling was greeted positively by SMSF trustees across Australia, who have long held the view that they are on their own legally if their fund runs into trouble. Even if a fraudster was convicted, there were no avenues for compensation until this recent case was settled.

The Corporations Act was the piece of legislation that won the case for this recent court case, rather than the Superannuation Industry (Supervision) Act which several trustees have used before in court and been unsuccessful with.

Despite this recent change, SMSF trustees must remain mindful of becoming victim to potential frauds.

Gaining advice from a reputable source is the best way to protect an SMSF from scams. Also diversifying a portfolio so that investments are spread out ensures one bad investment does not ruin a trustee's overall wealth.

Despite these new developments , the trustee must not forget the onus is still on them to be vigilant in protecting their fund.

Action plan for low rates

Borrowing at time of low interest rates to invest can yield high returns in the long run, and help pay off debts.

Although borrowing to grow a portfolio of shares or a managed fund is risky, if investors have a secure income stream and extra funds, the results can be very favourable. Diversifying the investment may be a way of lowering potential risk.

Negative gearing

Taking a loan out can help reduce an individual's payable tax bill. To receive these tax benefits the investment must be negatively geared - where the borrowing costs (interest and fees) are greater than the profit received (rent or dividends).

Although this is considered a high risk strategy; an individual can deduct the overall losses from their total taxable income, therefore reducing tax.

Positive gearing

When the income received from an investment is greater than the expenses, the individual must pay tax on the total net income.

Extra funds can be used to reduce debt or be put back into the investment.

The amount of positive funds flowing back can be increased by taking advantage of the capital allowances. This is taking advantage of the building's depreciation.

Review loans

Take a three point approach to reviewing and renegotiating long and short term debt and finances:

- Consolidate all debt
- Look into refinancing
- Challenge the lender to get a better rate

The Bookshelf

The Warren Buffet Way

Author: Robert G. Hagstrom, Wiley
Publisher: John Wiley & Sons

"The Warren Buffet Way" is mandatory reading for all investors as well as all individuals who are keen on learning about value investing. This book is the culmination of 20 years spent searching for a deeper understanding of the insight that Buffet possesses.

Every theory he espouses is immediately followed by a series of case studies spanning Larson-Juhl, Geico, The Washington Post Company, General Foods, Fruit of the Loom and many more. These concrete examples serve to illustrate and emphasise the pragmatism of Warren Buffet's way.

The path is simple. It involves two major activities: firstly, it is an absolute necessity that one constantly reads everything about business, investment, the businesses in which you wish to invest and their respective industries. In his book, Hagstrom insists that research is king and reading is even more important than inhaling.

Secondly, one must have keen control of their minds and emotions. In order to avoid the trap of speculative investment, one must be willing to become an iconoclast and not be swayed by prevailing market conditions no matter how extreme.

This book represents a sharp departure from the current self help craze. It offers a realistic and well researched presentation of a solid investment philosophy. "The Warren Buffet Way" is a description of how investment works.

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.