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Self managed superannuation and family trusts

Self managed superannuation funds (SMSF's) and family trusts are both common vehicles for the investment of assets.

They are valuable tools for building, protecting and passing on family wealth. However, recent changes to superannuation rules are making it more attractive to professionals and small businesses to run family trusts, as well as a SMSF.

The increase in the super preservation age to 60 in a few years' time and lower super contribution limits has led to an increase in people using family trusts as another vehicle in their own investment portfolios.

SMSF A SMSF is a superannuation fund of one to four members, all of whom act as trustees. The trustees are responsible for running the fund, investing assets, paying benefits, and meeting compliance requirements. Keep in mind that SMSF's have strict compliance requirements. All trustees need to be aware of the laws to avoid severe penalties. Costs of running an SMSF can be significant, though people with large super balances may find it cheaper than the fees they pay on their retail or industry super fund account.

Benefits of a SMSF:

- provide its trustees with a greater choice of investment options
- includes tax benefits, such as deductions for contributions as well as low fund tax rates
- trustees have direct control over when investment assets are bought and sold, and when capital gains are realised
- trustees also exercise control over the fund's service providers and are able to seek out the best provider at the best price

Family trust A family trust is set up with after-tax money to hold a family's assets. It is generally established by a family member for the benefit of members of the 'family group.'

A family trust can add complexity and cost to financial, tax and accounting affairs. Family trusts also do not enjoy the same tax concessions as SMSF's.

Benefits of a family trust:

- no restrictions on how much money can be saved or when the money can be accessed
- income flexibility for families
- allows trustees to accumulate assets and to distribute capital and income in a manner that allows taxation to be minimised
- trustees can pass assets or trust income at their discretion to particular beneficiaries
- directors of trustee companies are able to make tax deductible contributions to super

However, the contributions made to super may not be deductible if certain rules have not been applied that allow for such deductions.

For a deduction for super contributions to be claimed at the trust level, the directors must be able to show that they are also employees of the trustee company. This involves putting on record that they are entitled to be paid for the work they do looking after the trust affairs.

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Passing the family business on

The majority of all Australian businesses are family owned and managed.

Owners of family businesses often have a strong desire to keep business ownership within the family however, this is not always possible. Contrary to popular belief, the typical family business is not always the family-run corner shop or the small business that operates at home.

In fact, many of Australia's largest and oldest businesses are family controlled. As the baby boomer generation are preparing themselves for retirement, they also need to start planning for the selling of their family business. Many owners are willing to accept a lesser financial return on the business in order to keep ownership within the family.

The key to successfully passing the family business on to the next generation is planning. Many businesses fail due to not adequately preparing for this succession.

The potential successor should be introduced to the business as early as possible. If a family member shows any interest within the business, they should be given every opportunity to be involved. This includes receiving the right training and education.

This process should take years and should not be considered a few weeks before the business owners retire.

However, sometimes there just are not any potential successors in the family with the required skills, motivation or experience.

Although passing a family business onto a nonfamily member can be challenging, it is a better solution than having an unmotivated business owner. An ideal nonfamily member could be a long serving employee

of the business as they would already possess the knowledge, skill and experience to become an owner.

Attention on superannuation pensions

There has been a significant growth in the value of superannuation assets held in retirement products.

As a result of this, regulators, super funds and super funds members are increasing their focus on superannuation pensions. This extra attention on superannuation pensions is reflected by the release of a series of rulings and other announcements regarding the interpretation of laws concerning super pensions.

The ATO is also raising concerns about the non-compliance of some pension paying SMSF's.

The ATO's Compliance in Focus 2013-2014 outlines the ATO's focus on the misuse of the concessional tax environment, either deliberately or unintentionally.

Compliance in Focus also outlines the additional efforts of regulators to identify SMSF's that are incorrectly reporting the tax-exempt pension income.

As Australia's population is rapidly ageing, this increased attention is expected to continue on pension-paying super funds.

Prevent a will from being contested

A Will is a legal document that permits a person to make decisions on how their assets will be managed and distributed upon their death.

Wills are an important part of keeping estates and finances organised. If a deceased does not leave a Will behind, their loved ones can lose control over what happens to the estate. In some cases when the only living relatives are more than distant cousins, the estate can be passed to the Government.

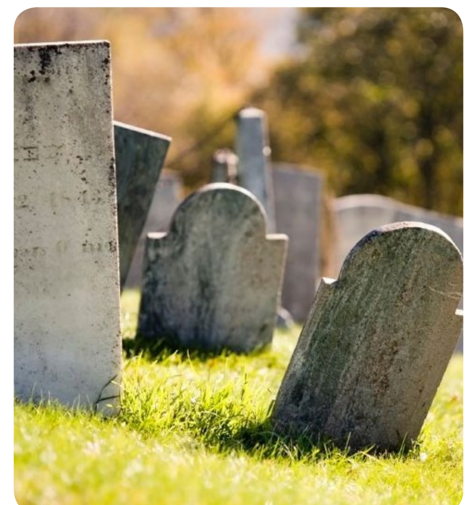
As an increasing amount of people have complex family arrangements, such as second marriages, it is increasingly common for Wills to be contested.

A person is entitled to leave their assets to anyone they wish. However, friends and relatives of the deceased can contest the Will if they believe they have been left out, or not sufficiently provided for. Under the Succession Act 2006, those who can contest a Will are not restricted to a spouse or children. Claimants can include a de-facto partner, former spouse or any other dependants.

To contest a Will the claimant must begin their claim within twelve months of the death; however, this can be extended if adequate reason can be shown. The claimant must convince the Court that the deceased failed to make sufficient provisions for their maintenance, education or advancement in life.

To prevent a Will from being contested:

- carefully word the Will, making sure it is clear and unambiguous
- review the Will regularly to represent any changes within the family
- include a clause on why dependants have been excluded



ATO compliance targets: focus on individuals

Compliance in Focus sets out the compliance issues and risks attracting the attention of the ATO.

Compliance in Focus is not an exhaustive list of all compliance activities that the ATO will undertake, but describes its key focus areas.

During 2013-2014 the ATO will focus on:

Information gathering capabilities

The ATO has increased funding to expand and improve their information gathering systems and capabilities.

From 1 July 2014, the ATO will have higher quality data to share with individuals about sales of shares, property and units in managed investment trusts, as well as a greater range of international bank transactions.

As the ATO continue to improve their information gathering capabilities, they will also expand on their information-matching program. The ATO will continually make more information available for individuals to pre-fill their tax returns.

This information will then be used in risk analysis to identify individuals who are not lodging their tax returns, failing to declare income, or lodging incorrect claims for deductions and offsets.

Targets of tax planning schemes

The ATO will focus on individuals, including self-funded retirees, who are targeted by promoters of tax planning schemes. These schemes promise high investment returns and significant deductions for complex arrangements that do not comply with tax laws.

The ATO will investigate the domestic promoters and participants involved in tax planning schemes and will consider prosecution in appropriate cases.

Fraudulent errors, identity thefts and errors

The ATO is enhancing their methods in detecting fraudulent refund attempts. They have also specifically designed their online services to protect the tax system.

The ATO will use data mining and other analytical tools to identify individuals or organised groups who deliberately make false claims, seek to exploit the tax system or engage in identify theft. Penalties and prosecution will be considered in situations where it is apparent that fraud has occurred.

The ATO will also identify errors made by individuals as a result of poor record keeping or misunderstanding of the law. The ATO will work with these individuals to ensure they are aware of their tax obligations.

High work-related expenses

The ATO will continue to maintain a strong focus on high work-related expense claims. They will pay attention to high claims made by:

- building and construction labourers
- construction supervisors
- project managers
- sales and marketing managers

The ATO will also focus on high work-related travel expense claims across individual income tax returns.

Risk of excess contributions tax

Super fund members saving for retirement should remain vigilant about the risk of excess contributions tax.

The amount of contributions an individual makes into their super each financial year is subject to contributions caps. If the contributions exceed the caps, the level of contributions above the cap is known as 'excess contributions.' These contributions are subject to an excess contributions tax.

The amount of the contributions cap and how much extra tax an individual needs to pay depends on their age and whether the contributions are concessional or non-concessional.

Concessional contributions are also referred to as 'before tax contributions.' These can take the form of employer contributions, such as salary sacrifice payments.

Non-concessional contributions are also known as 'after tax contributions.' For example, spousal contributions or transfers made from foreign super funds. The law has recently changed to allow super fund members to withdraw the excess concessional contributions made from July 2013, rather than pay the excess contributions tax, which is at the highest marginal tax rate. Withdrawn concessional contributions are taxed at a member's marginal tax rate.

However, super fund members should keep in mind that the law regarding excess non-concessional contributions has not changed. These contributions are taxed at the highest marginal rate and cannot be withdrawn to avoid the excess contributions tax.

Tax certainty after death for super funds

The government has made amendments that have provided tax certainty for superannuation funds upon the death of members in receipt of a superannuation income stream.

This amendment effectively allows a superannuation fund trustee to dispose of pension assets on a tax-free basis to fund the payment of death benefits.

Also, the meaning of 'superannuation income stream benefit' now allows the superannuation fund to continue to be entitled to the earnings tax exemption in the period of the member's death until their benefits have been paid out by:

- paying them out as a lump sum
- and/or commencing a new income stream

This is subject to the benefits being cashed as soon as possible following the member's death.

This amendment also allows the tax-free proportion of that superannuation income stream to be used in calculating the tax components of those benefits.

Investing in property

Property investments have always been a popular way for individuals to invest their wealth and secure their financial future.

Property is a long term investment that has the potential to generate wealth through rental income and benefits from capital growth.

As interest rates are currently at a historic low, it is an ideal time to consider the idea of property investment.

The following are some of the factors to be aware of when looking to invest in property:

Property market

The property market is often considered less volatile than other forms of investment, however, that does not mean the market is easily predictable.

The value of property can rise and decline, which can influence the worth of an investment. Also, changes to interest rates can affect the investment's return.

Property location

Property location is an important aspect of acquiring a good investment property. A desirable location increases the chance of gaining higher returns on the property, as well as appealing to a variety of tenants.

Ideal locations are situated in high-growth areas and have proximity to public amenities. This will increase the demand for the property by potential tenants. It is important to purchase a property based on research, not on personal feeling or emotion. Instead, research the demographics of the area and purchase a property for the potential tenant.

Tax benefits

There are three categories of tax deductions that a property investor can take advantage of:

1. Depreciation allowances

Investors are eligible to claim depreciation on certain newly purchased items which can reduce their taxable income.

2. Negative gearing

Negative gearing occurs when the ongoing costs of the property are greater than the return. A high income earner can benefit from negative gearing as the losses made can be offset against their taxable income.

3. Acquisition and maintenance costs

Investors are able to offset expenses related to the property against rental income. For example, advertising fees or travel expenses.

Expenses

Investing in property incurs many high initial and ongoing costs. These costs can potentially affect the return of the investment.

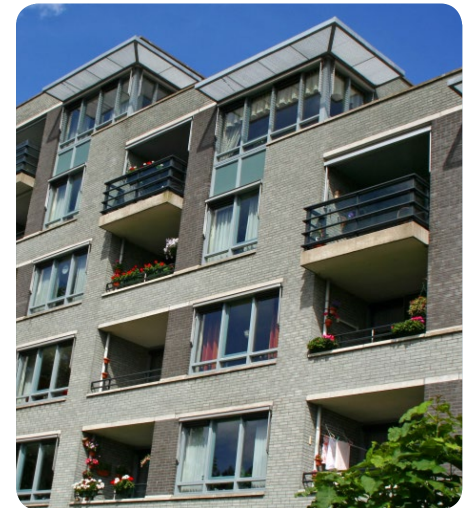
The initial costs of a property investment can include:

- deposit on the property
- loan establishment fees
- mortgage insurance
- installing utilities and services
- legal fees in the transfer of ownership

The ongoing costs can be difficult to manage as they can be monthly or annually. Ongoing costs include:

- building and landlord Insurance
- yearly mortgage fees
- body corporate fees
- council rates/government taxes
- utilities and services
- repairs needed to maintain the property

It is necessary to be aware of both initial and ongoing costs, as well as any extras that may arise. This will allow the investor to ensure that the income generated by the property covers the costs.



Crackdown on hybrid securities

Hybrid securities have recently come under fire from the Australian Securities and Investment Commission (ASIC).

Hybrid securities are higher yielding investments that feature characteristics of both debt and equity capital.

They are generally complex and highly structured instruments. Hybrid securities are one way for companies to borrow money from investors, whilst paying interest in return.

With the considerable instability in equity markets many investors are looking for alternative instruments to invest their money and hybrid securities are attractive to many investors because they offer higher returns than term deposits or government bonds.

These investments are often popular with retirees seeking higher yields than they would normally receive from a cash account. Riskier hybrids also pay a higher interest payment to compensate investors for the added risk.

Although hybrid securities offer higher returns, they also involve increased risks. Hybrid securities contain complex terms and features that even experienced investors can struggle to comprehend.

Hybrids often only have marginally higher returns than cash or fixed income, however involve significantly more risk.

The ASIC are warning investors about the hidden risks of hybrid securities.

Following a recent review into the sector, the corporate watchdog will be focusing on misleading conduct in the sale of hybrids.

This includes the inappropriate labelling of hybrids and also the unwarranted comparison of hybrids to different, less risky products such as covered bonds.

The ASIC urges consumers to ensure they understand the conditions and risks of hybrid securities before committing themselves.

The ASIC will also be exploring new ways to better educate investors in understanding hybrid securities before investing in them.

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