

PERSONAL FINANCIAL STRATEGIES

YOUR PERSONAL GUIDE TO WEALTH CREATION



SMSFs and your family business

Investing in property through a self-managed super fund (SMSF) could be risky. Business owners are advised to seek professional advice and to consider all potential challenges before entering into any landlord-and-tenant arrangements.

Consider, for example, that a tenant of a highly valuable, fund-owned property fails to pay their rent on time and this property is the sole or dominant asset of the fund. Much of its financial wellbeing could depend on these regular payments. Although necessary action would be taken to recover the overdue rent and the financially-troubled tenant may be removed from the premises, difficulties could escalate, especially if the wayward tenant is a family business.

It is a common practice for a family SMSF to own the business premises of the family business in order to gain a range of retirement, tax, business, and asset-protection advantages. The family business pays a commercial rent to the family SMSF and the fund claims tax deductions for interest on the loan to buy a typically geared property. This property

is generally out of the reach of creditors if individual fund members are declared bankrupt. If the SMSF sells the property once fund assets are backing the payment of a pension, no capital gains tax is payable on the sale.

Many family SMSFs and family businesses, however, are at risk of becoming embroiled in inter-family disputes. There may be issues of conflicting loyalties and pressures if a business strikes financial problems and fails to pay its rent.

On one hand, the family business may require those premises to keep operating in the hope that profits will return. Yet on the other, the fund's trustees – who are the same people as the business owners in these circumstances – are legally obliged to maintain the fund with the sole purpose of providing member retirement benefits.

If SMSFs have to borrow to buy a commercial property, the regular rent payments are also required to meet their loan repayment obligations.

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For businesses experiencing financial difficulties, payments to creditors are usually slowed down and it is often their owner's self-managed super fund that is the last to see any money.

If a members' business is not paying its rent to the family SMSF, the retirement savings of the members are being jeopardised.

Here are some key points to consider before entering into such arrangements:

Expect the unexpected

Plenty of problems could arise, such as the forced sale of the premises in the event of a marriage break-up, death or disability.

Understand the fund's obligations

A fund is required to diligently pursue unpaid rent, even from its member's own business. It may be appropriate for trustees to obtain personal guarantees from tenants.

Know the commercial and legal risks

If a breach to the Superannuation Industry (Supervision) Act occurs, fines may be given to its own members, the trustees could be disqualified or the fund could be



declared non-complying. The market value of non-complying funds is taxed at the top marginal rate, less any non-concessional or un-deducted contributions. This can wipe out almost half a fund's assets.

Losing ownership of geared property

If the business cannot pay rent to the SMSF, the fund could fail to make installments on its investment loan. This could lead to repossession of property by the banks.

Carefully consider affordability

Take into account the levels of debt already

being carried by the SMSF, the business and the business owners in a personal capacity. Consider the impact of future interest rate rises and the effect that the next halving of the standard cap on concessional contributions for super fund members over 50 could have on the fund's cash flow.

Ensure adequate diversification

This will mean that the fund members' savings are not overly dependent on the profitability of a single costly asset, namely the business premises.

The importance of estate planning

Estate planning is more than just having a will. It is about ensuring that a person's estate is passed on to their beneficiaries in the most tax-effective and financially efficient way possible when they are gone. Getting advice on setting up an estate plan can help you to achieve peace of mind in knowing that your wealth will be passed accordingly.

An estate plan maximises your assets and takes into account other non-financial matters such as the care of dependent children, medical treatment and accommodation if you are incapacitated. It also considers your charitable, community and cultural requirements.

If you die without a will, your assets are distributed by following a standard statutory formula and it is likely that distribution will not play out the way you would have liked.

For those who do have a will, it may only cover what to do with your personally owned assets and other considerations like superannuation, trusts and business assets may have been left out.

In developing an effective action plan for dealing with your estate, the following considerations should be made:

- How will your business wealth be dealt with?
- How should your superannuation be dealt with after your death?
- Who is to receive your gifts and legacies and when should they be given?
- Who will be appointed executors of your will?
- Who will control your non-estate wealth holding entities including family trusts?

An estate plan should balance life-time enjoyment of your assets with preservation of those assets for your family after your passing. It should be cost effective, simple to understand and operate and be revised regularly.

An estate plan is something that should be considered, no matter how young or old you are.



SMSF - think team

Self-managed superannuation funds are a popular choice amongst small business owners and professionals. Self management has strong appeal for many but these funds are particularly vulnerable to mistakes, mismanagement, dishonesty, and sometimes even serial compliance breaches, often by spouses and adult children.

It is not until the ATO moves in to act against a fund or a fund member, a marital relationship fails or member dies or retires that impropriety is detected. In the worst instances, unknowing members can see fund assets go missing. The ATO may declare a fund as non-complying for breaches of superannuation law, a move that can seriously impact fund assets in tax penalties and concessional tax.

In many cases, the negative actions of SMSF's come about from ignorance and lazy management. Funds that work like a team to the benefit of all team members are less likely to lose retirement savings. Here are some suggestions to help fund members take a 'team' approach:

Spread the load

Whilst a characteristic of SMSFs is that one member controls all of the investment and administrative decisions, this can be a risky strategy.

The majority of SMSF's comprise of husband-and-wife members with one typically dominating fund management. Under superannuation law, all SMSF members must be trustees or directors of a fund's corporate trustee; however passive members generally do little to protect their interests.



Trustees should take a team approach to the running of the fund as it is there to provide retirement security for all members.

Monitor activities and assets

Understand why a key asset may no longer be listed as a fund asset - it may have been transferred into another member's name without your knowledge.

Family lawyers and forensic accountants sometimes find that assets have been transferred into a spouse's name in an effort to prevent it being included in the pool of assets in a marital property settlement.

Know what assets your fund owns and closely follow how those assets are performing. Also, ensure that any contributions deposited in your fund's bank account are still in the account or have been invested for the fund with your agreement.

Agree on a game plan

Make sure that the strategy is being followed to the letter. You should

be alarmed, for instance, if your fund is making investments that are inconsistent with your objectives. Further, you should insist that the investment strategy is regularly updated to reflect your changing circumstances and wishes.

There is not much point in having a plan if you are not going to stick with it. Investments outside a fund's strategy may expose members to additional risks and without an investment strategy; a fund may find it hard to demonstrate to the ATO that investments are being made for the sole purpose of providing retirement benefits.

Get help

A financial adviser can tell you whether your self-managed fund is performing competitively as well as whether its investment strategy is consistent with the members' risk profiles.

Getting advice and sharing the costs among members will help keep things in perspective and allow members to determine whether the fund is on track to deliver the expected retirement income.

Stick to fundamentals

Some members use their self-managed funds to invest in high-risk investments, many of which they would not pursue with their personal money. If a member wishes to pursue investments in memorabilia, it may be done on a personal level and not with member funds.

Borrow cautiously

While SMSF can borrow within the tight legal restrictions, funds can easily get it wrong. Some funds risk losing much of their value if a costly geared investment fails.



Tread carefully with trustee changes



The life-cycle of a typical trust estate includes the establishment and its vesting or termination dates. During the course of its life, the trust deed may be varied or amended for a number of reasons. However, anyone seeking to amend a trust deed needs to be aware of the potential consequences which can result, even with a seemingly insignificant change.

The effect of any change should be considered in the overall framework of the trust relationship to ensure that the character of the trust remains true to its original form.

Any contract, if varied or amended by the parties can result in something different to what was initially intended. The same principle applies if the essential character of a trust changes. It is a contract by the settlor. If the trustee changes it, it could result in something different to what the settlor originally intended.

The ATO's view is that if changes are such that a new trust relationship arises, there must also be a new trust estate for income tax purposes. If the trustee remains the same, it would dispose of the trust property in its capacity as trustee of one trust estate and reacquire it as trustee of another. The disposal would trigger

consequences under tax legislation, specifically under capital gains.

Due to the lack of continuity of the same estate, any other attributes held would cease to exist. Previously incurred losses, for example, would be lost and unable to be claimed despite whether these losses were on a capital or revenue account.

Changes potentially leading to a new trust can arise by several means, including variations under a power in the deed and a variation by agreement among the beneficiaries. Other changes may include:

- those in beneficial interests in trust property;
- redefinitions of the beneficiary class;
- changes to the rights and obligations of the trustee;
- changes to the termination date of the trust;
- changes to the purpose of the trust; or
- if the trust splits into two or merges with another.

In light of the proposed legislation dealing with the taxation of trust income, trust deeds are now being reviewed. The areas of tax risk in a trust resettlement are not confined to just income tax but also indirect tax or stamp duty. When faced with the variation of a trust deed of a trust holding property, a prudent practitioner will first take advice before recommending any change.

The Bookshelf

Random Walk Down Wall Street:
The Time-Tested Strategy For
Successful Investing (Revised Edition)

Author: Burton Malkiel (John Wiley)

The million-copy bestseller, has been fully revised and ready for post-dot-com investors. Using the dot-com crash as a clear lesson on how not to manage your portfolio, this best seller offers gimmickfree, irreverent, vastly informative advice to navigating the market and managing investments with confidence.

The revised edition includes a new chapter that draws on behavioral finance, the field that studies the psychology of investment decisions.

Malkiel assessed the full range of investment opportunities from shares, bonds, and money markets to real estate investment trusts, home ownership, and tangible assets such as gold and collectibles.

This edition includes some new strategies for rearranging your portfolio for retirement.

A Random Walk Down Wall Street is well established as a staple of the business shelf and arguably the first book any investor should read before taking the plunge and starting a portfolio.

Adopting a life-cycle guide to investing, the book matches the needs of investors at any age bracket.

Whether you want to familiarise yourself in the ways of the market before talking to a broker or follow Malkiel's easy steps to managing your own portfolio, this revised classic remains the best investing guide money can buy.

Once you have read this practical guide it is easy to see why it has been so popular amongst investment novices and academics alike.

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