PERSONAL FINANCIAL
STRATEGIES
YOUR PERSONAL GUIDE TO WEALTH CREATION

Individual or corporate trustee?

The question of whether it is better for a SMSF to have individual trustees or a corporate trustee is one that is often raised. It is also an issue which requires careful consideration.

Why have an individual trustee?

If an individual is to act as the trustee of a SMSF they can simply be appointed as part of the normal super fund establishment process without additional costs being incurred. Incorporating a company to act as trustee incurs an additional up front registration cost.

A trustee company must also pay an annual fee to ASIC for the company annual review and prepare annual return documents.

Why have a corporate trustee?

One of the major disadvantages of a corporate trustee is the up-front cost of establishing the company. However, there may be substantial long term benefits of having a company, which outweigh the costs.

Reduced exposure to litigation

Having a corporate trustee may be beneficial when the trustee of a fund is subject to litigation. For example, if a personal liability action exists in relation to one of the fund's properties, the trustees may become liable for the costs if they are unable to be recovered from the assets of the fund. Whilst this type of action is uncommon, having a corporate trustee provides some additional protection. It limits liability to the assets of the company and not those of the underlying directors.

Minimised costs of trustee changes

The very nature of a family SMSF allows members and trustees to come and go from the fund. Parents may introduce adult children as members until such a time as the child has enough superannuation or wishes to commence their own SMSF. Members of an SMSF may pass away, requiring them to exit the SMSF as members and trustees. An executor may also need to be appointed as a trustee for a short period of time due to the death of the fund member, until the death benefits exit the fund... (continued overpage)

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SOUTHGATE ACCOUNTANTS

74 ASHMORE ROAD
BUNDALL QLD 4217

TEL: (07) 5504 6777

FAX: (07) 5504 7344

E-MAIL
adam@southgateca.com.au

WEBSITE
www.southgateca.com.au

PRINCIPAL
Adam Southgate

Business Advisors
Financial Advisors
Taxation
Superannuation
Wealth Management

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Changes in trustees and members can be a costly exercise. When membership changes it is necessary to prepare a deed of appointment and retirement to officially retire the outgoing and appoint the incoming trustees. The trustees must also notify all relevant share registries and banks of a change in trustee to reflect the new ownership in assets on behalf of the fund. This can be a time consuming process. In contrast, when a new member joins a fund with a corporate trustee, that member must simply be appointed as a Director of the Trustee Company. When a member leaves the fund it is simply necessary for them to resign as director.

Single Member Funds

Single member funds with a corporate trustee allow the sole member to be the only director of the company and have full control over the running of the fund. If the fund has individual trustees it is necessary for another individual to act as the second trustee and assist in the running of the fund.

Borrowing in Super Funds

Recent changes allow SMSFs to borrow under an instalment warrant arrangement. In many circumstances the lender requires the SMSF to have a corporate trustee.

Wills and trusts

The Christmas holiday season may be a time when many people reflect on how they can provide for the future needs of those they care for most. Despite the best intentions, many fail to act.

It may be time to consider addressing the financial issues that have been of concern in recent months.

Get a Will

A Will is a legal document that lays out the distribution of a person's property in the event of their death. In order to be valid, a Will must meet certain prescribed requirements, which are set out by the Wills Act in the person's state.

When a person dies and the situation is straightforward, meaning assets are easily distributed within a short period of time, a will may be the most appropriate option. This generally occurs when there is a simple asset holding or few beneficiaries.

Testamentary Trusts

Where asset holding is more detailed or the person wishes to plan for the ongoing use of personal assets, a testamentary trust may be used with a Will. A testamentary trust can be created, in which the Will directs that instead of distributing all of the assets of the testator, specific assets are to be held in trust. This might be for the benefit of the testator's children or spouse.

Planning for loved ones is often a task charged with emotion and often delayed. It is also an area that, if not dealt with properly, may have the undesired effect of penalising family members. Some planning strategies take time to implement, and consideration and discussion with family are often part of the process.

Taking stock of family assets

Asset rich individuals and business owners need to take stock of their particular circumstances and take time regularly to review how their assets are held. Individuals should aim to hold their investments in ways that protect assets and are tax effective.

This strategy requires a three- pronged approach to:

1. Minimise tax exposure
2. Isolate business and personal assets
3. Hold assets in a separate entity

There are several methods to achieve this, but the use of a discretionary trust is the most common.

What is a Trust?

A trust is created as a result of forming a relationship in which a person (the trustee) has an obligation to hold property for the benefit of another person (the beneficiaries).

A trust is not a separate legal entity. However, it is required to have its own set of accounting records and lodge tax returns with the Australian Taxation Office each year.

What is a Discretionary Trust?

In a discretionary trust, beneficiaries are not entitled to a fixed distribution or interest in the trust fund. The trustee has the discretion to decide which beneficiaries receive the capital and income of the trust and how much each beneficiary receives. The level of discretion is determined by the terms of the Trust Deed, which governs the operation of the trust.

A properly established trust will provide asset protection in the case of unexpected financial setback or litigation.

Assets held in a discretionary trust are generally not available to a trustee in bankruptcy. The exception is when assets have been transferred to a discretionary trust with the intention of defeating creditors.

Distribution of Income

The Trust Deed sets out various alternatives for the Trustee in relation to trust income earned in each financial year. These alternatives include:

- The trustee may distribute the net trust income amongst the beneficiaries. The entire trust income can be distributed to one beneficiary to the exclusion of others, the income can be distributed equally, or disproportionately.
- The trustee may decide not to distribute any proportion of the net income of the trust, if is possible to accumulate that income as an addition to the Trust Fund.
- The trustee may decide to distribute part of the net trust income and to accumulate the balance of that income.

Each option presents the trustee with different tax exposure for the trust or beneficiary.

From a tax perspective, discretionary trusts are an excellent way to split investment capital gains and income with beneficiaries, particularly when beneficiaries have differential marginal tax rates.

The trustee has the discretion to distribute profits to the lowest-taxed beneficiaries.

The decision to form a discretionary trust must be made by taking into consideration one's personal, financial, and legal circumstances and adopted as part of an overall asset management plan.

Discretionary trusts are an excellent way to protect assets. If you are not sure what steps to take next, or whether or not a discretionary trust would assist you with asset protection, we would be delighted to speak with you about your options.

"Wash Sales" on ATO hit list

Selling an asset for the purposes of offsetting losses in order to minimise capital gains could be a strategy that draws the attention of the ATO.

When a taxpayer makes a capital loss on the sale of an asset, that loss must be offset against capital gains or carried forward to future years, when sufficient capital gains have been realised to offset the loss. Capital gains therefore will be subject to capital gains tax, or reduced by offsetting with a current or carried forward capital loss.

Those holding shares that have a lower value compared to when they were purchased may be tempted to dispose of those shares and realise a loss for the purposes of offsetting that loss against a capital gain. This capital gain may have occurred as a result of a property sale, for instance.

Problems arise when the taxpayer wishes to retain the shares in anticipation of a share price recovery. A "wash sale" occurs when an asset is sold to an associate to realise the loss and the asset is subsequently bought back. The taxpayer effectively ends up in the same position, except they have offset their capital gains and thereby reduce their tax.

The tax office is concerned with these arrangementsand may appy the anti-avoidance provisions of the tax law.

Wash sale arrangements involve a taxpayer disposing of a capital gains tax asset, such as shares, to generate a capital loss. However, in substance, there is no significant change in the taxpayer's economic circumstances in respect of that asset.

The tax office is not concerned with the genuine disposal of an asset at market value. However, in certain circumstances the tax office may determine that wash sale arrangements are schemes simply to reduce income tax.

Investors that wish to adopt this strategy must be prepared to demonstrate that the intention of the sale is for reasons other than solely obtaining a tax benefit. It may be, for instance, that the sale of the asset was a necessary part of financial restructuring. Regardless, investors would be wise to take a very cautious approach.

ATO warning to SMSFs

The Australian Taxation Office has recently issued a warning to thousands of Self-Managed Superannuation Funds. It will be carefully watching to make sure members aren't distributing funds to themselves or relatives via investments by the super fund in trusts.

The warning states members could be breaking tax regulations by distributing funds via these methods. As a result, members must be vigilant in ensuring they do not break tax laws unintentionally.

The method used by the SMSF generally involves setting up a trust, "which purports to offer fixed rate interest yielding investments to allegedly unrelated entities", the warning states.

The SMSF then invests in the trust, after which the organiser sources "borrowers". These borrowers can often include the same members of the SMSF that invested in the trust.

Borrowers then enter into a loan agreement with the trust. These loans can often offer better deals than members would be able to source otherwise. Trust members can use the SMSF to access money, rather than applying for a bank loan. It is also possible to use the trust to access other forms of financial assistance.

Some of the benefits of these loans could include a range of interest rates, as well as a range of interest payment terms, including flexibility in the payment date. Other possible benefits include security of the loan in the form of a mortgage or personal guarantee.

The borrowed funds could also be used for multiple purposes, including business, investment or personal use. However, the ATO suggests taking out such loans contradicts the nature of SMSF legislation. These loans also go against the sole purpose of superannuation to save for retirement.

According to the ATO not only could SMSF members breach the sole purpose of superannuation, but income derived from the SMSF could be classed as 'non-arm's length income' and be subject to a higher rate of tax.

The trustee could also have breached several other laws. These include illegally accessing Super benefits if they fail to pay back the loan from the trust. The investment in the trust could also be classed as an in-house asset, and therefore subject to certain limits.

"This arrangement attempts to circumvent the prohibition on SMSF trustees lending money or providing financial assistance to a member or a relative of the member using the resources of the fund," the warning states.

The ATO also notes that penalties can apply to SMSF members if they make misleading statements or avoid tax. However, it also states that "reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the Tax Office".

If you are uncertain about your potential exposure to these issues we recommend you contact our office without delay.

The Bookshelf

The Warren Buffet Way

Author: Robert G. Hagstrom, Wiley

"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 Warren 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.

This book is ideal for the green investment novice as well as the weathered stock market veteran. It serves as the perfect introduction to a world fraught with confusion and littered with untruths. For the jaded veteran it provides a sharp reminder that investment is not a complex activity.