ISSUE 48

WEALTH MATTERS

Your personal guide to wealth creation

INSIDE:

- SMSF records you should be keeping
- The property development process
- Pros and cons of a unit trust
- And more

Marisa Gonzalez & Co
Accountant - Tax Agent

Is your SMSF adequately diversified?

Diversification can reduce the overall level of risk or volatility associated with an investment portfolio.

SMSF trustees should consider diversifying when forming a fund's investment strategy. By spreading the investments of a fund across different asset classes and markets that offer varying risks and returns, SMSF members can better position themselves for a secure retirement.

Why diversify?

The intention of diversification is to spread the investment risk of an SMSF. The idea is that if one asset underperforms, it can be offset by the success of other assets and keep the fund on track to meet its investment objectives. Diversifying investments across uncorrelated assets, such as shares and bonds, may also make it possible for investors to lower the volatility of the portfolio.

How to diversify your fund:

Accessing certain asset classes can be challenging for SMSFs due to minimum investment requirements or other ownership restrictions. Managed funds and exchange-traded funds (ETFs) are two options that can provide easy access to diversification. Managed funds pool together money from multiple investors which professional managers then invest in a variety of assets, such as global or local shares, offshore property or high-yield investments. ETFs, on the other hand, aim to replicate the performance of a particular index or group of assets, which can give an investor exposure to an entirely different market or asset class. These two methods can give SMSFs the ability to access more diverse investments.

Australian Real Estate Investment Trusts (A-REITs) are another way to diversify an investment portfolio. They are a unitised portfolio of property assets listed on the Australian Stock Exchange (ASX) that provide an alternative to direct property investment. A-REITs enable investors to access a property portfolio which may include commercial, retail or a mix of these real estate assets that may not otherwise be available to an individual investor.

Listed investment companies and other digital investment platforms have benefits that further allow low-cost access to different markets when looking into other ways to diversify an investment portfolio.

Trustees should always document their actions and decisions made, as well as their reasons for doing so. A record kept of these details will demonstrate that they have satisfied their obligations as a fund trustee.

As having an appropriately diversified portfolio can have a significant impact on members' retirement savings, trustees may consider seeking professional financial advice in the management of their SMSF's investment strategies.

Marisa Gonzalez Accountant

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RESIGSTERED TAX AGENT
ISAACS CHAMBERS
5/2 FARR PLACE
ISAACS ACT 2607

TEL (02) 6162 0908
FAX (02) 6162 0907

EMAIL
marisa@marisagonzalez.com.au
WEBSITE
www.marisagonzalez.com.au

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Considering an Australian Real Estate Investment Trust

An Australian Real Estate Investment Trust (A-REIT) owns and operates a portfolio of income-producing property, giving investors access to property assets that might otherwise be out of reach.

Similar to managed funds, A-REITs are actively managed by a fund management team that will pool together investors' money to invest in properties. They typically invest in commercial properties such as hotels, shopping centres, offices and apartment buildings. In Australia, they are traded on the ASX with the minimum initial investment generally being $500.

There are two main types of REITs:

- Equity REITs, which are more common and involve investing in and owning properties. These types of REITs typically generate their income by leasing out their properties and collecting rent. They can specialise in owning certain business types, or they can be diversified.
- Mortgage REITs, which are involved in the investment and ownership of property mortgages. They work by loaning money to the owners of real estate for mortgages and typically generate income through the interest generated on the loan.

Benefits:

One of the main benefits of A-REITs is that they provide a means of investing in the property market for individuals that may otherwise not have the money to do so. Due to the fact that each A-REIT is controlled by a fund management team, investors gain exposure to property investments without actually buying or managing one themselves. A-REITs also offer diversification benefits, as they invest in properties across multiple sectors and locations. Because the trusts trade publicly on the stock exchange, they enjoy greater liquidity than most other property investments.

Risks:

There are a number of risks involved that will need to be considered before investing in A-REITs. In the same case as a managed fund, investors will need to examine the management team behind the investment, including looking at the level of debt that a trust holds. A-REITs generate a large portion of its income from rent. Therefore, if rental incomes fall, so will profits. It may be difficult to find tenants for properties if the location is poor, there is an oversupply of similar properties, or the condition of the property is below average.

When does resettlement of a trust occur?

Changes to trust deeds are not uncommon, but caution needs to be exercised to avoid making changes that may unintentionally trigger resettlement and exposing the trust to a host of tax issues.

The law relating to what constitutes a trust resettlement has substantially evolved in recent years. Following the 2011 decision in Commission of Taxation v Clark, the ATO defined that a trust will be resettled where the variation to the trust disrupts the continuity of the essential features of a trust. These features being the terms of the trust deed, the trust property or the members of the trust.

The powers of amendment in the trust deed are critical in ascertaining what variations to the trust can be made. A trust deed cannot be amended without the express power to do so, and trustees must consider whether the amendments maintain continuity in the trust estate in order to avoid resettlement. Where a trust deed contemplates a change and the correct procedures are followed, then it is unlikely that a trust will be resettled.

The ATO's explains in its Taxation Determination (TD) 2012/21 that a trust will be resettled where it might be concluded that there is not sufficient continuity between the trust as originally constituted and the trust in its current form. TD 2012/21 notes that changes to the trust deed will not result in resettlement unless the change:

- Terminates the existing trust; or
- Leads to a particular asset being subject to a separate charter of rights and obligations, including if the asset has been settled on terms of a different trust.

When a trust is resettled, it can be associated with significant tax consequences. On a case-by-case basis, the question will arise of whether there is a liability for capital gains tax (CGT), state-based transfer duty (Stamp Duty), or income tax.

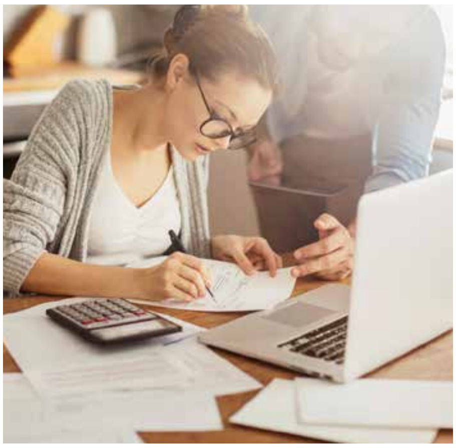
The main consequence of triggering a resettlement is that it will result in a CGT event. The disposal of the trust property into a new trust will trigger a CGT event, as assets that are held in the original trust will transfer to the new trust at market value with the trustee liable to pay. The disruption of continuity of the trust estate will also mean any losses or gains from the old trust will not be transferred into the new trust.

Due to the nature of amending a trust deed or trust resettlement being quite complex, seeking professional legal advice is recommended.

SMSF records you should be keeping

Many trustees of self-managed super funds (SMSF) struggle with the amount of effort that is required to run and maintain a fund.

Trustees of SMSFs have a responsibility to ensure proper and accurate tax and superannuation records are kept for the fund. When you have been running your fund for a long period of time and have amassed a large amount of information, it can be difficult to know exactly what records to keep, how long for and how to store them.



The ATO requires SMSF trustees to keep the following records for a minimum of five years:

- Accurate accounting records that explain the transactions and financial position of the SMSF.
- An annual operating statement and statement of the SMSF's financial position.
- Copies of all annual returns and transfer balance account reports lodged.
- Copies of any other statements the fund trustee is required to lodge with the ATO or other super funds.

The following records are required to be kept for a minimum of 10 years:

- Minutes of trustee meetings and decisions if matters affecting the fund were discussed, such as the fund's investment strategy.
- Records of all changes of trustees, and members' written consent to be appointed as trustees.
- Trustee declarations that recognise the obligations and responsibility of any trustee or director of a corporate trustee, appointed after 30 June 2007.
- Copies of all reports given to members.

Your SMSF's records must be kept in Australia, in writing and in English. The ATO allows electronic records to be kept, but they must be in a format that is easy to access and verify. If your SMSF does not keep the records for the minimum time required, you may be subject to penalties and fines. With the new tax year just beginning, now is the time to review your fund's records and ensure you are retaining all that is required in the correct format.

The property development process

Property development is one of the most effective wealth-creation strategies that can help maximise investors' cash flow.

As savvy as this strategy is, investors must determine whether or not they are in the right position before developing or expanding their property. Regardless of the reason for developing, there are several important factors investors need to consider to ensure they get the most out of the process.

When beginning the development process, investors should be looking at how much they can borrow. There are many factors that affect how much can be borrowed, such as annual income, monthly expenses, number of dependents, the proposed term of the loan and any outstanding debts. Identifying objectives and long term property goals is also a good move when planning as investors have a better chance of meeting their current and future needs when they know what they want from the start.

Generally, developers are entitled to claim back all of the GST included in the costs of developing a property (architect's fees, construction costs, etc.) provided that the property will be used solely for the purpose of making taxable supplies in the future. Developers may need to register for GST if building new residential premises for sale and the total income from the property development activities is more than $75,000 per year.

It is worth noting that residential premises are still considered 'new' even if you have developed the property and rented it out for less than five years. Therefore, if you sell the property before this five-year limit, the sale of the property will still be treated as the supply of new residential premises as well as creating a CGT event.

Larger properties come with higher costs in regards to maintenance, taxes, utilities and insurance, so investors must remember to include these factors in their development decisions. Investors also need to consider the physical aspects of developing property such as the topography of the land, boundaries, service lines (electrical, plumbing, etc.) and any council restrictions you may encounter. To make sure there are no unwanted surprises at settlement time, it is important to take into account any other costs of developing.

Pros and cons of a unit trust

Unit trusts are an effective way of holding assets and are most commonly used as a form of investment strategy.

Choosing the right trust structure is a critical step in managing your wealth. With a unit trust, individuals can pool together their resources to improve their investment leverage. Each unit trust will have a trustee that decides how and where the money is invested to generate wealth for the unitholders.

There are a number of benefits associated with unit trusts, including:

- Reduced risk due to the ability to diversify investments.
- The opportunity to invest in areas that would not be available to an individual investor due to the pooling of resources.
- The trustee has power over the assets of the trust, meaning that if one unit holder comes into debt they cannot use the trust assets to satisfy their debt.

It is necessary to also weigh up the disadvantages, such as:

- Fees associated with investing in a unit trust are comparatively higher than investing directly.
- When assets are transferred into the trust, there is no form of CGT rollover relief.
- Investors may feel they have limited control due to the trustee making investment decisions.

What to consider when giving loans to your children

Increasing costs of living are seeing more and more adult children turn to their parents for financial help.

Lending money to family is risky and should be carefully considered. When something goes awry, you could end up out of pocket thousands of dollars and have a strenuous relationship going forward. If you are financially capable of providing a loan and you choose to help your child, follow the steps below to best prepare everyone involved.

Set clear guidelines:

Instead of just handing money over, set out rules and guidelines for how the money is to be used and when it will be repaid. The loan should be for something substantial such as a car or property. Establish that the loan is for a purpose, it is not free money for them to carelessly spend. If you see them using the money for something other than it was intended, cancel the loan. Be clear on how regularly you expect repayments and to what value.

Keep records:

Documenting everything in writing will help to protect all parties should an unforeseen issue occur, such as needing the money back for urgent medical procedures. Careful consideration must be made for what will happen in the event of the death of the loan giver. Clear records can reduce family disputes and ensure settlement of the estate is not delayed. A letter of intent with the signatures of all parties involved will prevent trouble should something unforeseeable arise. Keeping a spreadsheet detailing repayments and dates can also help to keep everyone accountable.

Consequences:

Discussing the terms of the loan upfront can help to avoid any confusion later on. There should be consequences if your child does not meet the requirements of the loan, such as increasing the interest rate. If they were borrowing from a bank, this would result in a bad credit rating and more fees. In order to ensure you get your money back, they need to take responsibility for getting it to you.

Understanding tax in your estate planning

Planning for the unexpected is an important step when it comes to protecting your assets and creating peace of mind for your loved ones.

Tax is a major consideration when it comes to planning your estate and the distribution of your assets. You can minimise the taxes that your beneficiaries will pay in the event of your death by using an effective estate planning tax strategy. Having strong governance of the tax aspects of estate administration can also help to manage the risks.

Trusts and CGT:

When beneficiary takes an inheritance in their name, income that is then generated from the inheritance will be taxed at their personal tax rate. If a testamentary trust assumes the inheritance, there can be significant tax savings. Trusts can help you reduce your tax burden, especially when it comes to capital gains (CGT) and income taxes. The tax obligations faced by your beneficiaries will vary depending on the assets they receive. The rules apply to the transfer of any CGT assets from a deceased estate. CGT is only charged on the disposal of an asset, so will not apply to a beneficiary who receives an asset, however, they will be liable for CGT if they later decide to sell.

A well-governed testamentary trust can help to protect your assets and ensure that tax outcomes are achieved in cases of complex family legal disputes such as bankruptcy and divorce. A trustee of a testamentary trust will properly understand the tax profile of potential beneficiaries, maintain proper trust account records, and fully document CGT events and other concessions claimed. There may need to be a high level of cooperation between family members and the trustee to ensure that necessary tax and other financial information is shared for the trust to operate effectively.

Superannuation and death benefits:

Ensure that you understand the tax implications of estate planning and superannuation, such as the tax impact of distributions made under a binding death benefit nomination (BDBN). Assets held by a person in their superannuation fund are not automatically included in their estate. Therefore, the absence of a BDBN means that the trustee has the discretion to pay the superannuation benefits of the deceased to any of their dependents, and of deferring tax consequences.

Your beneficiary must be a dependent under the SIS Act or your estate to be entitled to superannuation death benefits. To receive the benefits tax-free, the dependent must also be a tax dependent (under 18). When the beneficiary is over the age of 18, tax would need to be levied on a death benefit at 15% on the taxed element of the taxable component of the benefit. This component will then be passed to the beneficiaries tax-free. Additionally, if you have insurance cover held in your super fund, the tax that would need to be levied on part of the death benefit could be as high as 30%.