PERSONAL FINANCIAL
STRATEGIES
YOUR PERSONAL GUIDE TO WEALTH CREATION

GEORGE SPARIS & ASSOCIATES
ACCOUNTANTS, REG. TAX AGENTS AND BUSINESS ADVISORS

Financial planning for grandparents

Grandparents may be unaware of the financial opportunity that exists in providing for their grandchildren beyond paying a lump sum death benefit via their estate.

If financial dependency exists or can be established under superannuation and taxation law, then the grandchild is able to receive a tax-free superannuation death benefit income stream regardless of their age.

Establishing dependency

For superannuation purposes the definition of 'dependent' includes the spouse of the person, any child of the person and any person whom the person has an interdependency relationship at the time of death. The dependant may also have wealth or income of their own which will not impact on the financial dependency.

The person may also be wholly or partially dependent on the deceased, whose financial contribution does not need to be relied upon for basic living requirements.

Taxation law

The ATO is more stringent in its definition of financial dependency and requires that people show reliance on regular and continuous contributions to establish dependency. The trustee of a superannuation fund will need evidence, in the form of itemised expenditure from the deceased to grandchild, to make a decision on whether the person is able to receive the death benefit income stream.

Grandchild pension vs child pension

When a fund member dies, trustees will permit the payment of a pension to a dependant, usually a child of the deceased under 18 years, a stepchild under 18 years, or in some circumstances a grandchild of the deceased. This income stream is known as the child death benefits pension.

However, where financial dependency has been established between a deceased grandparent and their grandchild, the 'grandchild pension' holds considerable tax benefits over the child pension.

One of the main advantages is that there is no age limit for the grandchild pension while the child pension ends when the child turns 25.

A child pension is taxed at the adult marginal rate, with a 15 per cent tax offset. Comparably, the grandchild pension is tax free as a non-assessable non-exempt income. There is also an effective tax free threshold for the child pension at $49,753, with no such limit for a grandchild pension.

Identifying the opportunity to pay a tax-free death benefit income stream to a grandchild due to financial dependency can be a significant outcome for grandparents.

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Tax deductions in an SMSF

SMSF members whose accounts are in the accumulation (tax paying) phase, should remain informed of which expenses of the fund are tax deductible and which are not.

The ATO has guidelines regarding tax deductible expenditure in SMSF funds.

It considers something tax deductible if it is an expense incurred while producing or gaming assessable income or is an essential part of the fund's business operations or business working expenses.

Specifically, the ATO gives a number of explicit examples of the types of expenses that are tax deductible for SMSFs. These include costs for:

- actuarial, accounting and auditing
- complying with regulations and other administrative work in managing the fund
- the calculation and payment of benefits to members (but not the cost of the benefit itself)
- investment advice and costs in providing pre-retirement services to members
- the funds annual lodgment fee, however a late lodgment penalty is not deductible
- legal expenses, although this usually depends on whether the expenses are of a capital or revenue nature

Other expenses that a SMSF may incur will need to satisfy the general principles as mentioned above to qualify as a tax deductible expense.

Examples of other expenses may include:

- life insurance premiums
- "Any occupation" total and permanent disability premiums as well as partial deduction for "own occupation"
- investment research subscriptions

Expenses that as a rule are not tax deductible include:

- upfront fees in establishing a trust and incurred in investing money
- investment or administration charges levied by a life insurance company
- the cost of the annual ASIC fee is not deductible if there is a corporate trustee in the SMSF
- costs attributable to the earnings of assets backing tax exempt income streams
- executing a new deed for an existing fund or amending a deed to enlarge or significantly alter the scope of the trusts activities

Differences between individual trustee

One of the most significant decisions that need to be made when establishing an SMSF is whether to choose an individual or corporate trustee structure for the fund.

Both are equally effective, yet 71 per cent of SMSF members decide on an individual trustee structure without necessarily considering the benefits of a corporate structure for their super fund. An individual trustee structure is one which is operated by fund members who also act as trustees.

In a corporate structure, the SMSF exists as a corporate entity, under which the members act as directors of the fund, with there being no other directors of the trustee company.

Considering both structures reveals crucial differences between the two in regards to:

- Continuity
- Clarity of Ownership
- Liability
- Cost and Convenience

Continuity

In a corporate structure, the fund has an identity of its own (much like a company), separate from its members and directors. As a result, the control of the SMSF can continue even after the death or illness of an individual SMSF member/director.

In an individual structure, if one of the trustees becomes ill or dies, then the deceased's legal representative (the executor or administrator of the estate) acts as a trustee of the SMSF until the death benefit payments begin.

After which the remaining trustee must appoint an additional trustee or become the sole director of a corporate trustee.

Clarity of ownership

Under a corporate structure, the company is the legal owner of the fund's assets, meaning that if the directors of the company change there is no change in the legal ownership of the assets.

Individual trustees risk having their personal assets intermingled with that of the fund's, as well as having to change the legal ownership of the assets each time there is a change in the trustee, which can be time consuming and expensive.

Liability

Individual trustees are personally liable while directors in a corporate structure are liable to the extent of the assets of the company, unless the directors can be made personally liable.

Cost and convenience

A corporate structure is more expensive to set up and slightly more expensive to maintain.

An individual trustee structure has negligible set up costs but poses additional costs when transferring asset ownership in the case of a new trustee.

The pros and cons of selling your business

Many business owners in the process of selling their business have considered the option of selling their business premises at the same time.

There are many advantages and disadvantages to selling the business property, with tax, business and superannuation specialists warning that the wrong decision could cost a small business owner a lot of money in income, lost tax benefits and capital gains.

This decision may face many business owners throughout their working lives, especially if they are selling one business to buy another. Much of the decision lies in the specific circumstances facing the business owner.

Advantages

Selling the business without the premises becomes more affordable for potential buyers and increases its chances of selling. Part of the sale deal may also include a very long lease agreement which can provide a reliable income for the business owner.

Owners can profit from knowledge of the property and surrounding areas, and canvas it for potential re-development opportunities.

Holding on to the property for a few more years may result in finding a developer who is willing to pay more than what it is currently worth.

If the business premises are held as part of an SMSF fund, then concessional tax rates and rental income will continue to be applied to the property investment.

Rental income is taxed at 15 per cent a year while capital gains are taxed at an effective 10 per cent during a fund's accumulation phase.

Disadvantages

For business owners who are using the business premises as part of an investment portfolio should work on diversifying their portfolio to avoid investment risk when all their money is tied into one business property.

For owners moving into retirement, it may be risky to have their lifestyle dependent on the performance of a single asset.

It may be a relief for those selling off their business to sell the premises, so that they no longer have the task of managing the property, including dealing with new tenants and property maintenance.

Capital gains tax may not always be payable upon the sale of the business premises, and a CGT liability might make some business owners reluctant to sell, especially if the value of the property has risen significantly over the years.

Small business owners, particularly those heading into retirement should consider the benefits and risks associated with selling their business property.

Super is not the only tax free option

Those who have not been able to capitalise on the retirement opportunities offered by super and have accumulated considerable wealth, may be concerned with the tax they will have to pay on their lifetime's work.

The general principle is that income from assets outside of super is taxed at the marginal rate. This excludes money from annuities bought with non-super money.

However, there are favourable tax offsets that can have considerable financial benefits for those near or in retirement.

Low income earners tax offset (LITO)

This offers a tax offset of up to $445 for those earning up to $37,000 and goes down to zero when income reaches $66,667 a year.

Pensioner tax offsets

Those who have reached the pension age (65 for men and 64.5 for women) will have access to more generous tax-free thresholds. For singles, this means that along with the LITO they may earn up to $32,279 (2012-2013 financial year) in non-super income. For couples, they have access to a threshold of $28,974 each.

Mature age worker tax offset

Australians who are aged 55 and over and earning less than $63,000 a year are eligible for a tax offset of up to $500.

Investing in property with a SMSF

One of the fastest growing investment assets for SMSFs is residential property. In the past four years, residential property acquired through self-managed super funds has jumped 45 per cent to more than $15.5 billion.

The popularity of residential properties as an investment option can be attributed to the Government making changes to borrowing rules four years ago, allowing SMSFs to take out a loan to buy investment assets, where they were previously not able.

When borrowing, SMSFs have to make sure that the debt is limited-recourse, which means that if the super fund defaults on the repayments the lender can only take the assets that the loan is secured against, even if the value of the property is less than the actual amount still owing.

This change was put in place in order to protect retirement funds from losses; however it is not entirely risk free. When borrowing money as a fund member, most banks require a personal guarantee, and the lender has up to five or six years to sue for the shortfall on any loan and another 15 years to enforce any court action.

There are many benefits to owning property through SMSFs:

- Buying and holding property all the way through to the pension phase will make it exempt from the capital gains tax.
- Any capital gain or rental income generated by the fund even before the pension phase, is taxed at a rate of 15 per cent, or 10 per cent capital gains tax if the property has been held for more than a year.
- Superannuation offers one of the best tax structures for those looking for the highest pure net return from their assets.

There are also certain disadvantages and restrictions placed on SMSFs when buying a property:

- If money is borrowed through super and is negatively geared, the tax offset only applies to other income earned within the fund–not regular income.
- Fund members cannot live in the property and neither can any friends or family members because of the in-house assets test. This test imposes a limit on the extent to which SMSFs can enter into lease arrangements and certain other transactions with related parties.
- The property cannot be renovated while it is still under an SMSF loan.
- Set up costs can run into the thousands of dollars, and there can be higher fees involved in getting a loan through an SMSF.
- Buying property through an SMSF is generally suitable for funds with $200,000 in combined funds.

Buying property through super is an effective way of creating long term financial stability, but it may be more relevant for those who are 20-25 years away from retirement as they have more super money at their disposal and are more likely to be able to hold the property until after retirement to realise the big tax savings.

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.

The Bookshelf

How will you measure your life?

Author: Clayton M. Christensen

Publisher: HarperCollins

In 2010 innovation expert Clayton M. Christensen gave a powerful speech to the Harvard Business School's graduating class. Drawing upon his business research, he offered a series of guidelines for finding meaning and happiness in life.

He used examples from his own experiences to explain how high achievers can all too often fall into traps that lead to unhappiness.

The speech was memorable not only because it was deeply revealing but also because it came at a time of intense personal reflection: Christensen had just overcome the same type of cancer that had taken his father's life.

As Christensen struggled with the disease, the question "How do you measure your life?" became more urgent and poignant, and he began to share his insights more widely with family, friends, and students.

In this groundbreaking book, Christensen puts forth a series of questions:
How can I be sure that I'll find satisfaction in my career? How can I be sure that my personal relationships become enduring sources of happiness?

Using lessons from some of the world's greatest businesses, he provides incredible insights into these challenging questions.