

# WEALTH MATTERS

YOUR PERSONAL GUIDE TO WEALTH CREATION

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## INSIDE

- The debate between property and shares
- Rolling your CGT into super
- SMSF borrowing for property
- Renovating an investment property
- Replacing an SMSF trustee
- And more



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group

## Planning out your estate's assets

A common query to arise when updating a Will or planning an estate is figuring out which assets will form part of your deceased estate.

It is critical to understand what is classified as an asset in your Will to allow for the correct nomination of beneficiaries in those financial assets that are exempt from the Will. Assets that are not part of an estate and controlled by a Will include:

### Real estate

For those tenants in common, if one party of the co-tenancy passes away the property does not get passed to the other tenant. Rather, the deceased co-tenant's share is contributed to their estate.

Joint tenants, on the other hand, have a right of

ownership. Therefore, the death of one tenant results in the automatic transfer of property to the other joint tenant.

However, note that assets in your sole name do form part of the estate and are controlled by the Will.

### Life insurance policies

Life insurance policies usually operate independent from the Will, unless a beneficiary has not been nominated. Otherwise, the nominated beneficiary or beneficiaries of the policy will receive the death benefit directly from the insurance company at the time of your death.

### Superannuation

The superannuation fund will directly distribute the death benefit funds to the spouse or children of the deceased. The superannuation trustee is

accountable for this determination. However, there are some exceptions where the funds will be paid into the deceased estate, allowing for control through the Will.

### Joint bank accounts

For those with jointly owned bank accounts, the accounts are automatically left to the survivor after one party passes away.

### Unit trusts and companies

Assets owned by unit trusts, not personally owned by individuals, cannot form part of the estate. However, the shares or units in the trust will form part of the estate and can be dealt with in the Will.

### Discretionary trusts

Assets owned by discretionary trusts yet controlled by you cannot be part of your estate, as they are owned by the trust.

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# The debate between property and shares

The age-old debate between property and shares is: which investment option generates higher returns?



There is a variety of factors to consider when choosing between the two, such as entry and ongoing costs, long-term returns, tax efficiency, and so forth. Both forms of investment present benefits and risks which should be carefully analysed.

Property investment is generally more understood and considered to provide greater stability. Property values are generally less volatile than shares, and provide the investor with a greater level of control over their investment. Property also presents the opportunity to improve its value through renovation or development, which may result in higher long-term returns.

Due to high gearing, property may be the choice for some investors, as it is a favoured form of security for financial institutions and in some circumstances may be fully financed. There are tax deductions applicable for property investors such as the deduction of a depreciation component for building write off, and plant and equipment, which both improve the after-tax return.

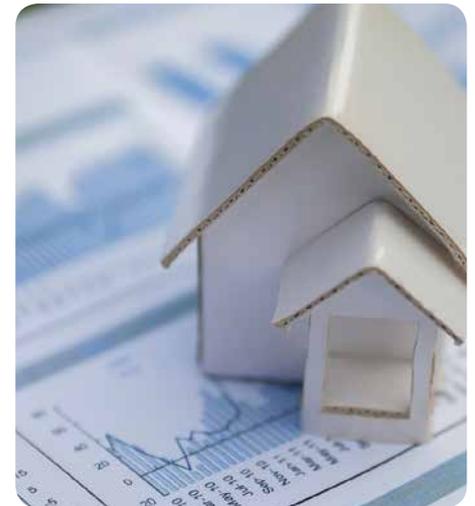
Comparatively, shares generally have low entry, transaction and ongoing costs. Investors can start a share portfolio easily with low entry costs and access to online trading. Buying or selling shares involves lower transaction costs than property which involves stamp duty, inspections and legal costs. Also, shares involve substantially lower ongoing costs than property. Direct share ownership does not involve any ongoing costs in comparison to those property costs such as body corporate fees, insurance, land tax and repair costs.

Another feature is the high visibility and

liquidity nature of shares. Shares have a price that usually fluctuates daily and is easily monitored. This allows an investor to calculate the value of their portfolio at any time. Shares can be easily converted into cash as required, rather than property that is more difficult to sell quickly.

In the context of tax efficiency, many Australian shares provide franking credits with their dividends that may be used to offset the investor's other tax liabilities. What this means is that share investors receiving dividends will get a credit for any income tax the company has paid. Taxpayers whose top marginal tax rate is less than the company's tax rate will receive a tax refund on the difference.

Overall, it is advisable to seek investment advice suitable to your personal circumstances and investment needs.



## Rolling your CGT into super

Small business owners have a number of capital gains tax (CGT) concessions available to them to reduce the capital gain that arises from a sale of active assets of a business.

For those planning their retirement, the small business retirement exemption strategy entitles the business owner to disregard up to \$500,000 of capital gains for taxation purposes. The amount of capital gain contributed to super will not be treated as a contribution if it does not exceed the person's lifetime CGT cap, which is \$1.395 million for 2015-2016.

Taxpayers who are eligible for this retirement exemption strategy must utilise this by the day that they lodge their income tax return for the income year in which the CGT event occurred. A combination of capital gains tax (CGT) small business concessions apply to help reduce your capital gain.

It is advised to seek professional advice from your accountant in this manner if you plan to fund retirement through the sale of your business.

## SMSF borrowing for property

If you are seeking to purchase an investment property with your self-managed super fund (SMSF), you should be aware of the terms associated with borrowing before devising a strategy.

The borrowing terms are much stricter within a super fund due to the superannuation rules referred to as Limited Recourse Borrowing Arrangements (LRBA). The first requirement of borrowing through an SMSF is that you cannot buy several properties under the one borrowing arrangement. Instead, it must be one single acquirable asset.

In addition, an asset purchased through an SMSF with an outstanding loan remaining cannot borrow money to "improve" the property such

as significant renovation plans. Also, the legal ownership of the asset is held in a separate holding trust until the loan is repaid. This ensures the other retirement investments in the SMSF are not placed at risk.

Those investors using SMSFs have flexibility when it comes to choosing a lender. A loan can be obtained from your business, family member, or a bank or lending institution, although if using a bank or lending institution you may be subject to high fees. It is important to consider cash flow beforehand as loan repayments must be made from your SMSF, requiring sufficient funds.

Overall, choosing your SMSF to purchase investment property can be a viable financial channel. However, investors should be aware of the constraints and complexities of this investment strategy.

## Renovating an investment property

When renovating an investment property, it is important to keep in mind the taxation deductions available such as depreciation and capital works deductions.

Investors seeking to renovate property that is used for income-producing purposes need to be aware of the tax-deductible expenses that can be claimed as a deduction, either immediately or over several years. Both negatively and positively geared properties can benefit from these deductions.

Depreciation is one such deductible expense that can be claimed over several years and is a critical factor to consider before embarking on renovation plans. Depreciating assets, also known as plant and equipment include items such as the oven, dishwasher, dryer and so forth.

Capital works is another expense that can receive deductions. Capital works refers to construction costs of buildings, extensions, alterations or structural improvements such as a carport, gazebo or retaining wall. Therefore, renovations are classified as capital works in the ATO's terms.

It is worthwhile to use a quantity surveyor who can calculate a tax depreciation schedule for your property. A pre-renovation inspection can identify what existing items have value before you throw them away. This is referred

to as a residual value write-off deduction, also known as scrapping.

Scrapping allows for deductions on depreciating assets such as carpet, furniture and appliances that may be obsolete. It is important to note that the items are only available for deduction if they were income-producing before being taken out and if the property will be income-producing after the renovations. Property investors can claim capital works in addition to the residual write off deduction on the disposed item.

It is also suggested to get a depreciation schedule on the new assets after renovations are completed. Hiring a quantity surveyor can account for a large amount of savings when claiming your tax return. Also, it can help to prevent overcapitalisation of your property as the property's value might have changed from the purchase date, hence influencing your renovation budget.

It is important to note the difference between a repair and a renovation. A common mistake that can arise is to claim initial repairs as immediate deductions. Making repairs straight after purchasing a property will be considered as capital works due to the deterioration of the property before your ownership. Also, you cannot claim the cost of repairs before renting out the property, as they relate to the period before the property was income-producing.



When embarking on renovations make sure good record-keeping measures take place, as renovation costs may need to be claimed as expenses. The costs will add to the cost base of your property, and when the cost base is high, the capital gains tax (CGT) will be reduced, resulting in higher returns.

Overall, it may be in an investor's best interest to use a quantity surveyor to create a tax depreciation schedule and to understand the deductions available before renovating your investment property to maximise returns.

## Replacing an SMSF trustee

When a trustee of a two-person self-managed super fund passes away, the decision to appoint a new trustee can be difficult.



The surviving trustee may want to consider whether an individual or corporate trustee is suitable. Surviving trustees have a six-month time frame to appoint a replacement trustee. If a legal personal representative (LPR) is appointed as a trustee or the surviving trustee has not received the deceased benefits, the fund will continue to qualify as an SMSF.

Once the death benefits are paid out, the LPR is no longer able to act as trustee and the fund's trustee structure must meet the requirements set out in the Superannuation Industry (Supervision) Act 1993 (SISA).

The option to replace the trustee with an individual trustee, such as an adult child, may result in non-favourable outcomes in the long-term. If an adult child were appointed as a trustee, it might allow for control over the SMSF when the original SMSF member deceases. Consequently, issues may arise

with the distribution of inheritance to other siblings if conflict were to occur.

Alternatively, it may be viable to change to a corporate trustee structure to avoid these issues altogether. A corporate trustee is essentially a company acting as a trustee for the fund. The surviving trustee can remain the sole director. By using a corporate trustee, the risk of merging personal assets with fund assets is minimised. Assigning a corporate trustee, however, does come at a greater cost yet may save time and effort in the future.

If the original SMSF trustee does not want the responsibility involved with managing the fund or appointing a new trustee, the SMSF can be rolled over into an industry, corporate or another public offer super fund.

If you are unsure which option is appropriate for your SMSF, seek professional advice.

# Cautions around binding death benefit nominations

Despite its significance, there are common traps that have the power to override the wishes in a binding death benefit nomination (BDBN) and render it invalid.

A BDBN is a member's written direction to their super fund's trustee that outlines who the trustee is to pay the member's death benefit to upon the member's death. BDBN's are a relatively new legal instrument, and as such, the laws regarding them continue to develop and change, which is why many pitfalls can exist to those who are unaware of changes.

A nomination will not be valid if the beneficiary does not fall within the definition



of dependant. A dependant is defined under the Superannuation Industry (Supervision) Act 1993 (SIS Act) to include the spouse, children and anyone with whom the deceased has an interdependency relationship. Therefore, individuals who do not fall into this definition are not eligible to receive superannuation benefits from the deceased member.

Careless wording is another risk area. Many BDBN's can be challenged due to poor wording such as 'the BDBN is only binding if it is to the trustee's satisfaction.' This type of wording can easily give rise to an argument if, for example, the trustee decides to reject the BDBN when the member dies.

The most critical rule for BDBN's is to read the deed. In some occasions, SMSF trust deeds state that for a BDBN to be valid it must comply with the superannuation laws. The deed defines superannuation laws as the Superannuation Industry (Supervision) Act 1993 (SIS Act) and the Superannuation Industry (Supervision) Regulations 1994 (SIS Reg). In this circumstance, for the nomination to be valid it must adhere to the following requirements as set out in the (SIS Reg) Reg 6.17A:

- a. be in writing
- b. be signed and dated by the member in the presence of two witnesses who are:
  - (i) over the age of 18; and
  - (ii) not nominated to receive a benefit in

the notice (but may be beneficiaries of the person's estate, if the legal personal representative is nominated); and

- c. contain a declaration signed and dated by the witnesses stating the notice was signed by the member in their presence

It is important to keep in mind this is only applicable to certain cases. Therefore, the trust deed must be read with careful consideration, and it is advisable to seek professional advice when reviewing your trust deed.

Poor quality documents are another pitfall to avoid. Ineffective documents may result in a member's super proceeds being paid to the wrong individuals. In quite a number of recent disputes, this has happened after an expensive and drawn out legal battle. While it can be tempting to save some money upfront by using a cheaper option, high-quality will always pay off the long run.

Lastly, prior deed history needs to be assessed. If an SMSF has existed for some time and undergone variations, a deed history review may be warranted. Such a review should encompass:

- the original deed of establishment
- any subsequent deed of variation
- any deeds of change of trustee

It may be best for an experienced professional to conduct the review. Attending to any issues promptly can be far more cost effective than being exposed to future legal challenges.

## Joint tenancy vs tenants in common

Purchasing property with a partner can be an exciting time in life, however, it is important not to overlook what kind of method of ownership you should use.

When two or more people purchase property together, they can own the property as joint tenants or tenants in common.

Joint tenancy allows for two or more co-owners to own an asset, each with an equal interest in the property. Each joint tenant has an undivided interest in the property, therefore your share cannot be left to beneficiaries in your Will, rather the surviving party or parties will receive ownership of the property.

Tenants in common operate differently, whereby each owner has a separate and distinct interest in the property. Tenants in common may hold

unequal interests in the property, for example, one may hold a 25 per cent interest and the other a 75 per cent interest.

The main difference between joint tenancy and tenants in common is what happens upon a partner's death. The autonomy of the tenants in common structure allows owners to leave their share of the property to their chosen beneficiary in their Will. This automatic transfer of property does not exist for those who jointly own a property.

Regardless of the two structures, CGT can still apply to the sale of the property. Joint tenants are treated as tenants in common that have equal shares in the asset. Each party therefore has an equal share of any capital gain or capital loss made when selling the property.

Those who own property as tenants in common make a capital gain or loss that is in line with their interest. For example, a

couple who has split their property's interest in a 20/80 per cent ratio will split the capital gain or capital loss made according to that interest when the property is sold.

