

# WEALTHMATTERS

YOUR PERSONAL GUIDE TO WEALTH CREATION

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## Succession planning for SMSFs

A mandatory component of managing a self-managed super fund (SMSF) is planning out what will happen to the fund if its trustee was to pass away.

While succession planning may not be one of the first responsibilities that comes to mind when managing an SMSF, it is a necessity that can provide certainty and peace of mind for a deceased trustee's family.

It is also especially important in cases where one trustee, for example, a husband, takes a more active role in the management of an SMSF than his wife and fellow trustee, and wants to reduce any potential burdens involved in the fund's administration and compliance if he was to pass away.

Succession planning can become quite complex if little or no attention is paid to it on an ongoing basis, but there are ways trustees can ensure the best outcome for both the fund and their family.

One option for a sole member fund is to appoint another trustee. Please note that the non-member trustee cannot be the employer of the member unless they are related. This would not be an option for a fund with two members as the available exemptions only apply to single member funds.

Those who appoint a family member or close friend must consider first whether they are suitable for the role; running an SMSF requires expertise and knowledge, and appointing someone with limited experience may not be in the best interest of the fund's future.

Some SMSF trustees may also choose to appoint

an enduring power of attorney. An enduring power of attorney is someone who makes decisions on the trustee's behalf if they become incapacitated or pass away. Common power of attorneys include accountants, financial advisors and lawyers; basically those who understand SMSF management and the associated challenges.

Another option is to have a binding death benefit nomination (BDBN) in place. Since a person's superannuation does not make up part of their estate and is therefore not automatically covered by their Will, a BDBN is often a good solution to help with the distribution of a member's super benefits.

There are alternative strategies that may be more appropriate than an SMSF, depending on your individual financial situation. As usual any investment decision is best made with the input of an appropriate financial advisor.

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# Tax risks of the granny flat

Adding a granny flat to a property is becoming an increasingly popular option among homeowners and investors alike.

While a range of granny flat scenarios and



arrangements can provide additional living space and potential rental-income, consideration must be given to the various tax implications and financial ramifications before adding such a building to your property.

Under the main residence exemption, homeowners don't pay capital gains tax (CGT) upon selling the home they live in. However, those who use any part of their property to produce income – for example, renting out a granny flat – are generally not entitled to the full exemption.

Granny flats cannot be included in a separate ownership title. Instead, the cost of the granny flat is added to the price of the property and, therefore, cannot be sold separately.

CGT applies to the granny flat portion of the property and is calculated by how many years it has been in existence. For example, if you have owned the property for 10 years, but the flat was built five years ago, you do not need to pay CGT on the first five years.

If the granny flat is rented out at normal commercial rates, all rental income received will

be taxable, and deductions can be claimed for expenses incurred such as insurance and utilities, as well as depreciation of furniture and fittings.

For those in the business of building and commercially letting out granny flats, any gains would be first assessed as ordinary income or profit and a partial CGT exemption would apply on any subsequent disposal of the property on the basis of income use.

Where the granny flat is occupied by relatives or adult children and no commercial rent is charged, the whole property will qualify for the CGT main residence exemption - resulting in no CGT payable.

Note that payments from a family member for board or lodging are considered to be domestic arrangements and are not rental income. In these situations, you cannot claim income tax deductions.

For granny flats on subdivided land, the CGT main residence exemption will not apply on the eventual disposal of the property, as it is only exempt when sold with the home that is your main residence.

## Transition to retirement changes

With the Federal Government's proposed changes to the transition to retirement (TTR) pension to take effect from 1 July 2017, those with existing arrangements should review them to avoid impact on their retirement funds.

Following changes in the 2016 Federal Budget, from 1 July 2017, transition to retirement (TTR) pensions will no longer receive a tax-free status on the investment earnings of pension accounts. The investment earnings will be taxed at 15 per cent for both new and existing TTR arrangements.

Although the tax benefits of TTR pensions will be removed, some attractions will remain. For those who have been receiving a TTR pension, if they retire or change jobs after age 60 they can access their existing super balance in an unrestricted way, as the pension converts to a full account-based pension.

The annual TTR pension will remain tax free for those over 60, however, those below this age will be discouraged to start or continue a TTR arrangement as they will be subjected to 15 per cent tax on all investment earnings.

## ATO lists tax traps

The Australian Tax Office (ATO) often focuses on specific behaviours, characteristics and tax issues that are suspicious and can lead to investigations.

Due to enhancements in technology, the ATO has expanded its data matching capabilities which have improved the ability to identify incorrect reporting in tax returns. The ATO has released a list of behaviours and characteristics that may attract their attention, including:

- tax or economic performance is not comparable to similar businesses
- low transparency of tax affairs
- large, one-off or unusual transactions, including transfer or shifting of wealth
- a history of aggressive tax planning
- tax outcomes inconsistent with the intent of tax law
- choosing not to comply or regularly taking controversial interpretations of the law
- lifestyle not supported by after-tax income
- treating private assets as business assets
- assessing business assets for tax-free private use
- poor governance and risk-management systems

One area of particular focus is incorrectly claiming franking credits or not applying appropriate governance to a franking credit balance. The ATO is concerned with the following arrangements:

- where there is a substantial increase in franking

credits as this may indicate the taxpayer has entered into an inappropriate arrangement to take advantage of franking credits.

- Using an entity that has a concessional tax rate, such as a super fund, is often incorporated into these arrangements.

The ATO continues to focus on compliance issues associated with self-managed super funds. In particular, the Tax Office is targeting:

- significant management and administration expenses.
- incorrect calculation of exempt current pension income.
- non-arm's length transactions involving companies associated with members and SMSFs that may be intended to improperly redirect dividends to the SMSF.



# Asset allocation in super funds

Asset allocation is designed to balance risk and return in a super fund portfolio by adjusting how much the fund invests in different assets based on risk tolerance, goals and investment time frame.

The way in which an individual chooses to allocate their super to different asset classes is one of the most important investment decisions they can make. Finding the right asset allocation isn't always easy, as the appropriate asset 'mix' for an individual will depend on a number of factors, such as how long they have until retirement and their attitude towards risk.

The main asset classes a super fund can invest in are shares, property, cash and fixed interest. Each asset class has varying degrees of potential return and risk.

**Cash:** Typical cash investments include term deposits, certificates of deposit, cash accounts, treasury bills, money market deposit accounts and money market funds. Cash is the safest asset class but offers the lowest return. The chances of losing money on a cash investment are extremely low.

**Fixed interest:** Fixed interest assets include government and corporate bonds, and fixed interest funds that invest in these securities. These assets offer a modest return that is

generally higher than cash yet less volatile than stocks. Certain categories of bonds offer high returns and therefore greater risk.

**Shares:** Shares hold the greatest risk among all the asset classes, however, they provide the highest returns and greatest potential for growth. Shares can be very volatile in the short term but can generate strong positive returns over long periods of time if investors are willing to ride it out.

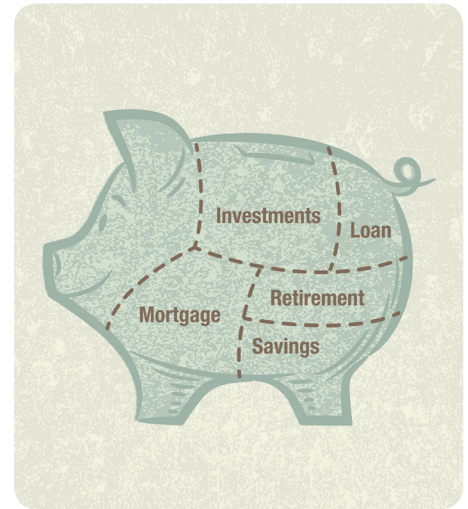
**Property:** Returns on property are usually higher since investors receive rental yields and the opportunity for capital growth through rising property values. Risks are also higher because property values can fluctuate. Property is also not a particularly liquid asset.

As different asset classes will perform better at different times depending on the underlying economic conditions at the time, it is important for a fund to invest in a diverse mix of assets.

Diversification aims to maximise an individual's return by investing in different asset classes that react differently to the same event.

Although it does not guarantee avoiding a loss, diversification is an important component of reaching long-term financial goals while minimising risk.

Before you can set out an asset allocation strategy for your super fund, you need to



establish your risk profile. For example, those with a higher tolerance for volatility can invest more of their portfolio in assets, such as shares and property, whereas conservative trustees may be better suited to a higher allocation of income assets like fixed interest and cash.

A person's risk profile will often change over time, so it is important to review it on a regular basis. Sometimes it may be in a trustee's best interest to consult a financial professional for help profiling your risk level based on your personal circumstances before deciding on an asset allocation.

## Implications for short-term rentals

Popular short-term accommodation, such as Airbnb, can be a great way to generate extra income, however, hosts need to be aware of their obligations and rising legal and regulatory issues.

Before creating an Airbnb listing, or renting out your home to short-term tenants, there are a few things hosts need to consider:

### Insurance

Hosts must notify their insurer if there is any change in circumstances, such as using their home for short-term rental accommodation. A failure to notify an insurer could result in a breach of contract and, therefore, may void the policy.

It is important to ensure accidents or damage are not excluded in your home and contents insurance. Hosts may need to upgrade their insurance to public liability

insurance to cover unforeseen incidents involving guests or their renters.

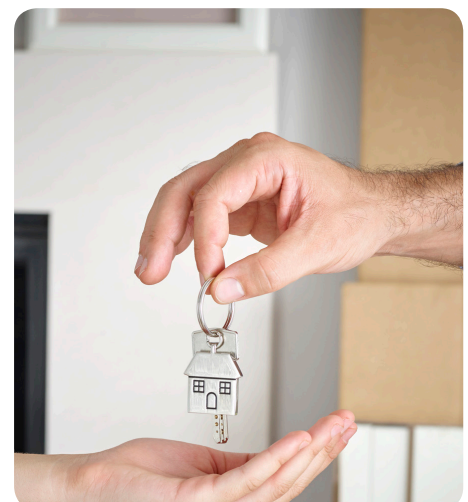
### Local council

Rules and regulations regarding short-term rentals vary between states and territories. Those who are considering hosting should seek advice as to whether they need to apply for consent from their local council. Local council planning laws also vary widely, especially, in terms of how they enforce these laws.

### Legal and tax issues

Acting as a host can give rise to many legal problems, especially when owners are not around to supervise. Residential apartments used for high rotation short-term lettings could face legal issues such as consumer protections; noise; safety, hygiene and other standards. Those looking to become hosts should check fire alarms, appliances and gas connections are all certified and discuss options with their insurer.

Hosts will also need to keep the Tax Office in the loop and be sure to disclose rental income. As there may be potential CGT implications when the property is sold, it is essential to report all income in an income tax return.





# What to consider before signing a personal guarantee

Personal guarantees are a standard business practice in commercial transactions, however, they are often misunderstood and can pose significant financial risks.

A personal guarantee is an agreement of one party to answer for the debt, default or miscarriage of another.

Director guarantees are a common type of guarantee, where the director of a company receives a request for a personal guarantee which holds them liable for the company's debt if the company does not meet their obligation, i.e. fails to pay.



These guarantees are usually required in loan, lease or other finance arrangements with small companies. Personal guarantees can be given in the form of a deed or a contract. When given in the form of a deed, it must be in writing and conform with a number of statutory requirements to be enforceable.

Here are five things to consider before signing a personal guarantee:

## The extent of the guarantee

Review the total amount that must be repaid under the guarantee and be wary of any other costs that may be added to the debt. For example, the wording of the guarantee may include other amounts which may be claimed under the guarantee, such as mercantile fees, legal costs and interest. These additional costs can significantly exceed the original amount when the final amount is owed.

## How the guarantee will be released

The release of the guarantee will vary depending on the type of agreement. In some circumstances, the guarantee will not be released until an amount has been repaid in full or there is an expiry of a lease. On other occasions, the guarantor may be able to negotiate for an earlier release.

Company directors should be aware that ceasing a relationship with the company, i.e. resigning from their role, does not automatically

terminate a guarantee. The guarantor must obtain the consent of the creditor/lender, and potentially the debtor person/company, to be released from the guarantee.

## What happens if there is more than one guarantor

In cases where there is more than one guarantor, joint or several liability for the debt may be accepted. This type of liability may hold both or even just one guarantor equally liable for the debt. The terms of the agreement may hold one guarantor responsible for all the debt if the other guarantor does not meet their obligations. In addition, creditors may be able to selectively enforce the debt on one guarantor.

## Understand the terms and wording of the guarantee

Consider the consequences of the terms you are accepting and remember each guarantee is different. The wording of the guarantee will also dictate whether it is secured or unsecured, and what debts may be claimed. For example, an 'all moneys' guarantee means that you will be liable for all the debts and obligations of the company.

## Be aware of the legal and financial consequences

Make sure you understand who you are providing the personal guarantee on behalf of and the likelihood of the person/company not being able to pay the debt. Read the contract carefully and obtain independent advice before signing to understand the limit, extent and impact of the guarantee.

# Separation and super

Superannuation forms one of a couple's biggest assets. Splitting superannuation after a separation can become a complex process.

Superannuation is treated as property under the Family Law Act 1975 (Cth). Once a relationship ends, superannuation can either be split by agreement or court order. Generally, parties will try to negotiate an agreement between themselves before filing for a court order.

A 'superannuation agreement' can be reached by both parties involved which sets out how the super is to be split. If an agreement cannot be reached then the court can determine the settlement.

When negotiating an agreement, here are some approaches for splitting super:

- One party may receive their ex-partner's super as part of their settlement.
- One party may receive more super and less of the other assets such as the family home.
- In situations where one party has super and the other has little or none, the super may be split 50/50 along with the other assets.

If both parties do come to an agreement then the parties must formally record that agreement by way of Consent Orders through the court or by entering into a Binding Financial Agreement.

Failure to formally record the agreement may put both parties at risk that their former spouse or partner may make a

further claim against their assets, such as super, in the future.

