NEWSLETTER

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This newsletter is written to assist in recognising issues and developing strategies so as to maximise profits and minimise and / or defer taxes payable in the current and future years. Estate planning must be an integral part of that strategy and is sadly not integrated into most strategies when developed.

Taxes, superannuation, dividends, equities and properties all need to be considered, because they are all (including taxes) an integral part of your Family's wealth creation and can be designed to provide substantial tax savings if correctly structured and managed.

If the strategy is to work, all of the elements must be considered and kept in balance. It does not have to be in writing, but the elements should be clear and understood. You need to have wealth and tax strategy that deals with*:*

- ***increasing your return on investment;***
- *paying off your home with pre-tax dollars;*
- *lowering tax rates across the family's income spectrum; and*
- ***freeing up cash to invest and by such means increasing your wealth****.*

The strategy should be understood by the owners, operators and their advisers.

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Wills – not as simple as many would suggest. Beware of greedy beneficiaries and their legal advisers.

As you would have noticed the incidence of entrepreneurial risk-taking lawyers has dramatically increased particularly since the "no win / no fee" concept was introduced.

With the introduction of no win / no fee legal work, litigation by the public has increased. One of the very rapidly and expensive emerging areas where this is being practiced is in the Estate litigation arena.

Class actions have drawn non-litigants into the litigation arena where the public have come to accept that being part of a litigation process costing nothing is worthwhile.

Many lawyers would suggest they are very skilled when it comes to drafting Wills. Your local post office can provide you with a Will kit which is akin to giving a child a loaded gun when it comes to anything other than an incredibly simple Will. Some Wills, drafted by lawyers, are only slightly more sophisticated than a post office Will Kit.

Most people believe that their Wills cover themselves and all the assets they control which includes discretionary trusts. That is not the case.

A testator can ask that the ongoing trustees carry out the deceased's request, however they are not obliged to do so. The only thing that the deceased may control after their death is who is going to be the ongoing Appointor of the Trust. That position carries control and can remove Trustees and change deeds and add or remove beneficiaries.

If the person making the Will is appointor of a Trust, check the Trust Deed to see what happens upon that person's death. Often, the current Appointor is entitled to name a Replacement Appointer by their Will but does not.

If that is the case, then the replacement appointor nominated in the Will should, at the time of executing the Will, be made aware of the wishes of the testator and this should be confirmed in a document called a Memorandum of Wishes. The later document is attached to the Will, BUT does not form part of the Will nor is it enforceable by the beneficiaries.

It has become quite common to find relatives and or children arguing over the contents of Wills and making statements that the deceased made commitments to leave to them particular assets or amounts of money.

It is generally said that many Wills which can cost between $5,000 and $25,000 will give rise to $400,000 litigation when the party dies. We see numerous examples of Wills being drafted which when reviewed and discussed with the clients as to the practicality of what has been drafted they regularly express concern as to the cost and time they have spent in having something drafted that just won't work practically or is drafted in such as it invites challenge.

It is not uncommon to see Wills that do not deal with the power of Appointment in the Family Trust, have no Memorandum of Wishes and confuse the ownership of the assets of the Trust as if they were owned by the testator.

It is surprising how often a Will is drawn that deals with the children's entitlements differently from what would happen if the parents were still alive and this, more than most, is the issue around which most large cases are argued.

The reasons behind the exclusion of specific beneficiaries should always be documented in a Memorandum of Wishes but never in the Will as the Will becomes a public document on the grant of probate. If covered in a Memorandum of Wishes it is confidential to the Executor, except if the Will is challenged or there is an argument on a person's entitlement that ends up in court.

Wills, if they are to work the way the Deceased would want, should, as far as practical, replicate what would happen if the Deceased was still alive and dealing with their children on the basis that the testator would have provided for them should the testator had lived.

Most Counsel that practice in this area hate separate testamentary trusts because they are often inequitable and give rise to conflict between the beneficiaries.

This is most prevalent where some of the beneficiaries have left school and / or university and others are still in school or university, but each of the beneficiaries are given an equal share in the deceased estates assets.

The younger children complain, possibly not unfairly, that mum and dad have already paid for their elder sibling's education (and so the deceased estate has been reduced by that amount) but they have to pay from their own trust the cost of finishing their schooling.

Equally, consideration should be given that if the parents were alive and a child was sick or disabled then to the detriment of all others the parents would provide maintenance to the sick or disabled child.

If a child becomes sick or disabled before or after the parent dies, then surely it is not unreasonable for the child or their guardian to suggest that the maintenance of that child should come out of the capital of the deceased estate prior to any distributions being made to the other beneficiaries.

One of many simple solutions to this problem is, when dealing with the estate assets or the requests to the discretionary trust trustee, to direct that no major distribution of capital assets occurs until possibly the youngest child obtains the age of 35 years.

There can be a softening of this in that the Will or Memorandum of Wishes can state that in regard to each child's wish to buy a domestic residence, in which they must will live, that an advance of say 25% of the capital that was in the Trust at that date be distributed to that child as an advance.

However, from the date of that advance the child getting the advance would surrender 25% of the income that would have otherwise be annually distributed to that child. Those surrender funds would be applied to the other children and distributed accordingly.

You really need to identify lawyers who know what they are talking about and if you are close to your accountant who knows the family and your personal circumstances they should be involved in the drafting of your Will.

If your Wills are sophisticated and you are dealing with substantial assets either in your own names or held by the family trust, then we strongly suggest you to have those documents reviewed by Counsel prior to execution as they are expert in this area, know what the Courts are currently dealing within Estate matters so that the chances of others commencing litigation against the Estate are minimised.

Please be aware that if some litigant challenges the Estate then they are not obliged to pay for the cost of litigation. The law generally provides that the costs of **all** the parties will be paid for by the Estate out of its assets prior to distribution to the Beneficiaries.

On that basis you may understand why so many Wills are challenged and particularly where litigants are on a no win no fee basis with lawyers.

Is my investment policy based on income or capital growth?

With the tightening of regulations covering financial advisers many clients are being asked if that want the investment strategies to be based on:

- Income;
- Income and capital growth; or
- Capital growth.

Sadly, the terminology or descriptions are both confusing and misleading as all contain an element of both. In fact, the question really is how much ***cash*** you need to live on in a year and literally answering the above can give you a very wrong strategy.

In an income strategy there is minimal capital growth so in real terms as time goes on the capital value in real terms deceases because most assets in which the strategy is based have little or no capital growth.

In an income and capital growth strategy the portfolio is firstly going to be geared to satisfy the income side of the portfolio and the balance applied to capital growth investments.

On a capital growth strategy, the income is in the main small and the focus is on capital growth stocks which usually have lower yields that are also heavily franked.

In all strategies most investors will see within their portfolio takeovers, mergers, compulsory acquisitions or on advice from their financial adviser because not all stocks perform consistently sell at least a share that will by the sale produces cash.

Your portfolio should contain a cash reserve sufficient to satisfy rights issues and unexpected domestic costs not budgeted for, such as domestic appliances that breakdown or unexpected medical expenses.

We are seeing more clients and referees coming to us with a changing strategy and asking what has changed or for that matter asking them why they are buying certain types of stocks that are out of character with we understand to be their long-term strategy.

The answer is sadly always this is what I was advised to buy however in fact and quite inadvertently it is what you asked your adviser because when asked you changed the strategy quite inadvertently.

When completing these forms, if you are not a sophisticated investor, it is more than likely very prudent to seek advice from your accountants as to what you want because most of the forms your broker and / or financial advisor provide you with fall way short of describing what you may want.

Many financial advisors tend to prefer their clients to fall into one of the three categories, because most of the advice they receive falls into those categories. To do something different usually requires an effort beyond their capacity.

Interposed Elections and Family Trust Elections Revisited

Following on from our March 2018 Newsletter we again highlight the importance of having an accountant that takes the time to understand your structure and takes time to understand the rules of your trust deed.

We've noticed in more recent discretionary trust deeds that in order for a corporate beneficiary or another trust to be eligible beneficiary and thereby receive distributions, the trust or company must be nominated as an interposed entity or have a family trust election.

Without trying to restate the prior Newsletter, a family trust election must be made by any discretionary trust that wants to utilise income or capital losses from prior years or more particularly, wants to distribute franking credits to beneficiaries.

If an election is not made, then the Australian Taxation Office may disallow the offset of the losses and / or not allow the recipient beneficiary to utilise the franking credits to lower the tax payable on franked distributions received by them.

If a discretionary trust distributes to a company then **that company** must make an interposed entity election. This informs the Australian Taxation Office that between the Trust and an individual taxpayer, a company is interposed, and, by that election, the company is capable of passing the distributed income eventually to an individual either indirectly or directly.

We continue to note that distributions are made from trusts to companies where there has not been an interposed election and the election did not specify ***what year it commenced.*** *Quite often in subsequent income tax returns the election is noted BUT the year from which it commences is not reflected. In each subsequent year Family Trust Elections and Interpose Entity Elections must be reflected on the returns.*

The elections are simple. However, it has become apparent that by annually **ticking a box on a tax return** (as most accountants do and nominating in that return the year to which the election applies) **is not an election**. It seems frequently the tax office does not seem to get a complete electronic signal when the electronic lodgement occurs and even if they do they are quite at liberty to call for the documentation which is rarely completed by accountants.

It is our suggestion that all corporate taxpayers should check that the trust has a family trust election and with all companies that recipient's trust distributions have and hold election forms covering both companies and trusts and that they are completed, signed and dated.

If taxpayers want to be assured that they have complied with the legislation, then we recommend, even if done with hindsight, that minutes or ratification minutes be drafted and adopted for all the companies and trusts involved noting and adopting the elections.

Capital Gains Tax – Main residence changes (our thanks to Julian Peters of Aitkens Lawyers for this article)

Buying a home to live in is part of the Australian dream and has historically been supported by the government by allowing any principal place of residence held by an Australian to be capital gains tax (CGT) free. That allowance historically continued for a period of up to six years from the date the property is no longer a person's principal place of residence, provided the person did not claim another property as their principal place of residence.

That historical position started to shift in relation to foreign residents on 1 July 2016.

From that date when selling Australian residential land, if the sale price exceeded $2 million and the Purchaser was not provided by the Vendor with a Foreign Resident Capital Gains Clearance Certificate from the Australian Taxation Office (ATO), the Purchaser had to hold back from the Vendor 10% of the purchase price and send it to the ATO. These rules changed on 1 July 2017 so that they now apply where the sale price exceeds $750,000.00 with the amount to be held back and sent to the ATO increased to 12.5% of the sale price.

A new Bill proposing changes to the main residence rules for foreign residents has passed through the Lower House of the Parliament and is currently before the Senate. This Bill combined with the withholding rules set out above will have a substantial impact on foreign owners of Australian residential real estate. The Bill, if passed by the Senate, will apply to remove the capital gains tax (CGT) exemption on disposal of a main residence for individuals who are non-residents at the time of disposal.

If a home is sold while the owner is a non-resident then the sale would cause the new rules to apply on the disposal of the main residence with the entire gain subject to CGT, no matter what the previous residential status of the seller was for GST purposes.

There is some temporary relief for those people who are foreign residents. A transitional rule allows the CGT exemption to continue to apply for disposal of a home that happens on or before 30 June 2019, if the home was owned prior to 9 May 2017. After that grace period the CGT exemption no longer applies.

For example, If the owner of a home is overseas on assignment, not expecting to return before the 30th of June 2019, then that owner should consider carefully whether they wish to dispose of the home prior to the 30th of June 2019 to take advantage of the CGT status of the property. These changes will only apply if the owner of the home is a non-resident at the time a contract to sell the property is entered into.

A non-resident who inherits a resident's former main residence will also be affected by these rules. If as a non-resident you dispose of the inherited interest within two years after the date of death, no CGT will be payable, but if the interest is disposed of after the two-year period then the new rules will apply to you and only the period up to the date of death will qualify for the CGT exemption.

These rules also apply to joint holdings where one of the joint owners is a non-resident and a main resident owner dies while a non-resident of Australia.

As the rules currently apply to the foreign residence status of the owner at the time of disposal of the property the loss of the CGT exemption can be cured by change of the status of the owner of the property to be an Australian resident again at the time of the disposal of property.

If you are a foreign resident with property in Australia, you should consider carefully whether you are likely to return to Australia as a resident before your intended disposal of the property. If that is not the case, you should consider disposing of any Australian held property prior to 30 June 2019.

Similarly, if you are an Australian resident with beneficiaries of your Will who live outside Australia now might be a good time to review your Will to make sure the CGT changes will not affect your estate in when you die.

Claiming work related expenses

In regard to individual taxpayers this is the hottest topic on the agenda for the Australian Taxation Office. *The Commissioner has made it quite clear on so many occasions that his officers have been empowered to heavily audit these expenses incurred by an individual taxpayer where those expenses are out of kilter with claims made by taxpayers in the industry as a whole.*

If you want to claim an expense you have to have the documentation for all expenses over $300 in total. Equally if your claim is below $300 in total you must be in a position to justify why you say the expense incurred is related to the income produced. By way of example $250 claim safety boots would not be allowed to an accountant, even though the accountant may claim that some of his clients are in the building industry.

If you have expenses of say $500 then you need documentation for all the <u>$500 not just the last $200</u>.

If you have a car and you want to claim any part of it, you must have a logbook or very detailed diary notes of each trip. If the tax office is not happy with you, they can (and they have been known to) even insist that any claim for telephone be supported by bills and the business calls be separately identified from the private calls.

Regarding self-education expenses please refer to our Newsletter from March 2018.

Telephone books

As bazar as this may be, you may have noticed that you no longer get either a yellow or white pages telephone book. Although you thought your telephone account gave you the right to receive a telephone book that is not the case. If you think placing a listing with Sensis in either yellow or white pages gives you a right to a telephone book then you are wrong.

This clearly gives rise to why would you subscribe to a listing with Sensis in the printed version of the white or yellow pages when the public for whom you are advertising does not receive a copy of the listing. Equally as confirmed this morning, what you subscribe to will not necessarily be what is on the online version.

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