WEALTHMATTERS

YOUR PERSONAL GUIDE TO WEALTH CREATION

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INSIDE

Richards & Co

A DIFFERENT PERSPECTIVE

When a child requests a loan

It is easy to not to think twice when you want to help out your children.

But when it comes to loaning them money, parents should take into consideration what could happen if the arrangement goes sour.

It is natural for parents to want to support their children, even after they have up and left the nest to start their own life. Quite often, that support can involve providing financial assistance in the form of a loan. Many young adults seek financial help from their parents if they encounter difficulty securing enough money for a down payment on a new home, a business venture or some other major expense.

In many cases, parents are more than willing to help give their children a financial boost, and in most scenarios, these parent-child loans can go quite smoothly. However, loans that are not paid back as agreed by both parties can cause great anguish for a family, and result in relationship breakdowns.

Since quite a few tax traps and legal pitfalls can arise when a loan agreement doesn't work out, parents should carefully consider the implications of lending money to their children before doing so.

Proper documentation of a loan can avoid many complications. For example, if the child receiving the loan was to divorce from their partner, a written document identifying who handles the repayments can prevent the former partner from refusing to share the responsibility of the repayment.

For tax purposes, parents should also include a repayment schedule, repayment records and a plan that determines how the loan will be repaid as scheduled. If applicable, parents should also include proof that the child was credit-worthy when the loan was originally made.

Lending money to your children may have certain tax consequences for you as a parent, so it is also important to weigh up the likelihood of your child's follow-through. Parents need to think carefully before lending money for a risky venture unless they are prepared to part with it as a gift with possible tax consequences. It may also be beneficial for parents to consider seeking professional or legal advice before committing to the loan.

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Avoiding common property investment mistakes

Being aware of the common mistakes associated with property investment can help you gain the best possible value from an investment.

Property investment is a popular way to increase your wealth and secure your financial future. But changes in interest rates, fluctuations in supply and demand, and even emotional decision making processes can make managing an investment property a difficult task.

How an investor manages their investment ultimately determines whether or not they will reach their financial goals. Below are some common mistakes associated with property investment that should be avoided:

Repaying debt simultaneously

Attempting to repay all your debt at the same time is tempting. But not all debts are equal. There are certain kinds of debts that are more beneficial than others, such as those that include tax deductibility. Eliminating non-tax deductible debt (such as personal loans) before tackling tax-deductible debt (like the investment property loan) can minimise the debt that doesn't give you any extra cash at tax time, and maximise the debt that possibly can.

Ignoring the market

Investors often forget that the rental market moves at a different pace than the property market. Their rent is therefore often left unchanged for years, and by the time they choose to increase payments, they may have to do so with an amount that won't be well received by the tenants. To avoid this, investors may want to consider adjusting the rent amount by $10 - $20 every time the lease is renewed.

Favouring occupancy over return

Some investors can begin losing money because they refuse to adjust their ideal renting price. This approach can result in a property remaining vacant and a huge loss of income since no one is willing to pay that much money. Simply dropping the amount by $30 - $40 can attract a potential renter.

Managing your property

More and more investors today attempt to manage every aspect of their investment property. Dealing with tenant complaints and other management tasks can take up valuable time that should be spent elsewhere, on things like improving their overall investment strategy. Employing the services of a property manager can reduce risks such as safety requirements or other legislative changes.

Claiming your holiday house tax deductions

Leasing out your holiday house to others can make your beach shack or bush retreat property more affordable.

Because the principles that apply to an investment rental property also apply to leased or rented holiday houses, owners are entitled to claim expenses for the property based on the proportion of the income year when it was rented or available for rent.

Some deductible expenses include property insurance, interest on any funds borrowed to purchase the house, repairs and maintenance costs and capital works.

Owners who use the holiday house during the year cannot claim any deductions for the expenses that relate to private use. This extends to use by other family members, relatives or friends. For example, if the house is available to rent for most of the year, but two weeks are unavailable for personal use, then that two weeks must be ignored when calculating deductions.

Owners can also make claims for feasible travel costs if any travel is made to inspect, maintain or repair the holiday house. The provision is that travel must be solely for these purposes, and not combined with simply visiting the property to have a holiday.

Key pension issues for SMSFs

The ATO is now targeting SMSFs in pension phase as part of its SMSF compliance program.

It is critical for trustees to assess their current circumstances for any major risks relating to pensions for SMSFs.

The ATO has expressed concerns about SMSFs in or transitioning to pension phase that hold illiquid assets such as real property. Many funds move into pension phase but don't adjust their investment strategy to take into account the ongoing pension payment. This is becoming a major issue, especially when real property is the major asset of the fund.

In some cases, the ATO has found that the net rental income return on a fund's real property investment is insufficient to meet pension requirements. Not adjusting investment strategies as a pension drawdown increases can cause major issues. Generating sufficient rental income can also become particularly problematic in times of economic downturn.

Apart from property, there is also a more surprising issue that persists with SMSF pensions; lodging applications of the wrong pension drawdown percentage. Many people may make this mistake because they have turned a different age or they simply apply the same rate as the year before.

Nevertheless, getting a pension wrong can result in serious financial consequences, and with the tax office honing in on SMSFs in pension phase, trustees need to be aware of the significant tax consequences of even simple misunderstandings.

Claiming deductions for your property's depreciation

While depreciation can provide property investors with significant tax breaks, many fail to take full advantage of the notable savings available to them.

The majority of properties that generate income, regardless of their age, qualify for some level of depreciation. However, property depreciation is a tax deduction that is missed quite often because it is a non-cash deduction (investors don't need to spend money to claim it).

Property investors can claim two types of depreciation: division 43 capital works deduction and division 40 plant and equipment depreciation. Capital works deduction, also known as the building write-off, applies to items that are fixed to a property's structure, such as doors and windows. It also includes renovations. Plant and equipment deduction relates to what you can claim for items within the property, such as curtains, blinds or carpets.

To claim for depreciation, investors must first create a tax depreciation schedule. Hiring a quantity surveyor to complete this schedule can be of great benefit to an investor. A qualified quantity surveyor can identify a property's depreciable items and provide a reasonable indication of the amount of depreciation available. They are also associated with industry regulating bodies and can therefore provide investors with news, information and resources through their accreditations.

Maximising a property's depreciation can help put more money in an investor's pocket at tax time. Below are five depreciation tips to remember when claiming for deductions:

Your property's age doesn't matter

Both old and new properties can attract depreciation deductions. And if you haven't been claiming depreciation in previous years, your past tax returns can also be adjusted or amended to claim tax deductions.

Deductions are available for 40 years

The Australian Tax Office (ATO) determines that a building is eligible to claim capital work deductions for a maximum of 40 years, starting from the date its construction was completed. For investors, this means that they can claim up to 40 years of property depreciation on new buildings.

You can claim for previous renovations

Any renovations that took place on your property prior to your ownership can be estimated by your quantity surveyor, with any deductions calculated accordingly. This may include new plumbing, waterproofing or electrical wiring.

There are two types of property depreciation

Plant and equipment items are regarded as items that can be easily removed from a property. It includes items that are mechanically or electronically operated that may be fixed

to the structure of the building. These items include but are not limited to hot water systems, motors, blinds, ovens, furniture, cooktops and air-conditioning systems.

The capital works deductions are deductions for the structural element of a building including items that are fixed to the structure. It includes materials such as plaster walls, bricks, flooring, mortar, wiring and items such as doors, tiles, windows, toilets and guttering.

Use a qualified professional

Quantity surveyors are qualified under tax legislation and are one of the few professionals who specialise in providing depreciation schedules.

Securing the future of your family business

It is inevitable that a business owner will eventually leave their business.

Whether they sell, retire or leave due to health reasons, it is important to be prepared

for when that day eventually arrives.

Creating a succession plan is a simple and common sense approach to ensure continuity in a family business. Succession plans enable smooth transitions and decrease the likelihood of disruptions. Early succession planning can also maximise a business's value to help it meet future needs.

Family businesses account for around 70% of all businesses in Australia. But only 20% of these businesses have a succession plan. Although many of these family owned businesses in Australia are kept busy with daily business operations, putting off succession planning can create future problems and sever the ties of the strongest families. Here are five points to follow to ensure that your family business stays in the family:

- Hold regular meetings with the family to discuss the future of the family business and to ensure that there is no communication breakdown between all family members that are involved.
- Plan for the older generations' exit to make sure that they are well provided for. Failing to do this means you risk losing their support, making it harder to plan for the future.
- Seek professional advice concerning all financial issues. It is crucial for the success of the financial side of the business to talk to the family's accountant, solicitor or financial advisor.
- Always set dates for the next or future meetings so that discussions continue until a plan that benefits all family members is decided upon.
- Keep your plan current. Strong succession plans require revisions and updates to ensure that the plan stays relevant and suitable for members.

What happens to your super upon returning to work

It is important for those who re-enter the workforce after retirement to be aware of the technicalities when it comes to contributing back into their superannuation fund.

Today, it is quite common for Australians aged over 60 to return to some form of work after retirement. But those who are fortunate enough to acquire a job after leaving retirement must ensure that they address the technicalities of re-entering the workforce appropriately.

In terms of superannuation contributions, those who commence work again and are under 65 can contribute back into their super fund.

Those who are over the age of 65 must satisfy a 'work test' before they can begin contributing back into their super fund. The test involves working 40 hours within any 30-day cycle during the financial year the worker plans to contribute in. This aspect is an especially important timing issue for those engaging in part-time work with variable hours.

Returning workers can make two types of contributions: concessional and non-concessional contributions. Concessional or 'before-tax' contributions receive a 15% contributions tax when entering a super account.

Non-concessional (after-tax) contributions do not receive a contributions tax when entering a super fund since these contributions are already considered to be from an income that has already been taxed at some stage. Owners of small businesses may be eligible for special capital gains tax (CGT) concessions when planning for retirement.

There is also an important distinction in regards to the type of work that returning workers must perform. To contribute back into a super fund, workers must work for "gain or reward". In other words, they cannot engage in volunteer work and must be paid some kind of salary.

This working requirement does not affect employer superannuation guarantee contributions (9.5 per cent of a salary) and relates to workers making additional contributions through after-tax contributions or salary sacrifice.

Workers can make super contributions up to the age of 74. Once workers reach the age of 75, no more voluntary super contributions can be made.

There is also no need for returning workers to open a new fund. Their current superannuation fund should accommodate to their new accumulation account as well as their existing pension account. However, workers cannot add any new contributions to their existing pension account, which is why they need to have a separate accumulation account.

Personal circumstances need to be taken into consideration when determining whether there will be cash flow or tax advantages in ceasing the pension. There is no requirement to stop a pension, but it is best to seek advice in regards to this.

Returning workers who, after a few years of working, decide to exit the workforce again, will have their accumulation account built up from their most recent work. They can choose to start a new pension with their accumulation account (so they draw two separate pensions from their super fund), or they can stop their existing pension and add it to their accumulation account so only one pension goes forward.

An individual's circumstances dictate the decision to have one or multiple pensions. It may be worthwhile to maintain separate pensions, or simply leave the accumulation account as is and rely on the existing pension account.

Using a corporate trustee for your SMSF

Choosing between an individual and a corporate trustee is an important decision that arises when establishing an SMSF.

Despite this decision's significance, many SMSF members often appoint trustees without understanding the difference between the two.

It is important for SMSF members to understand the advantages and disadvantages of appointing an individual or corporate trustee. Although appointing an individual trustee is considered to be the cheap and easier option (that many SMSF members choose), this option can often prove to be a false economy.

Here are some of the benefits SMSF members can enjoy when choosing a corporate trustee.

Flexibility

No immediate problems will arise if there is a death of a member in a fund with a corporate trustee. This differs from when an individual trustee dies since immediate action needs to be taken to ensure that the individual trustee's SMSF doesn't lose its tax concessional status. Having a corporate trustee also helps when handling member incapacity or divorce situations.

Easy administration

The admittance of new members to the fund (such as children) and the acquisition or disposal of assets is much simpler with a corporate trustee. The legal ownership of the fund's assets also doesn't need to be changed every time a member joins or leaves the fund.

Lower penalties

Only one penalty applies to a fund with a corporate trustee under the new penalty regime for SMSFs. Individual trustees are penalised personally, and since there cannot be less than two individual trustees in an SMSF, an SMSF with individual trustees receives at least double the penalty rate.