Asset Protection

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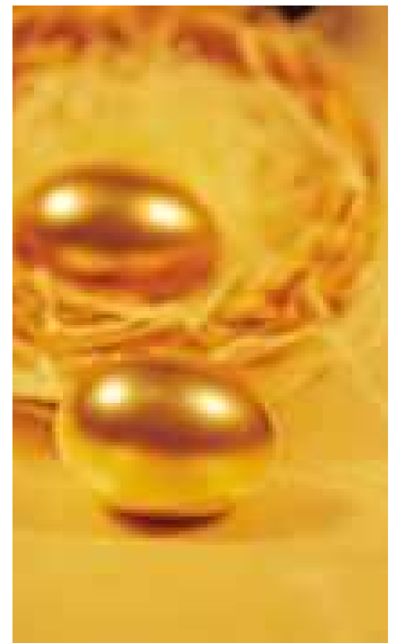
CONTENTS

Introduction 4

Considerations when structuring an investment 5

Common investment structures 7



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introduction

My name is Nicholas Moustacas. I am a Chartered Accountant and an Authorised Representative of Lifespan Financial Planning Pty Ltd. I am a Registered Tax Agent, Registered Company Auditor and a Justice of the Peace. I have also completed various training schedules in relation to risk insurance and mortgage lending.

I completed a Bachelor of Commerce at Wollongong University in 1989. I then joined a 5 Partner firm of Chartered Accountants in Sydney. I stayed there until 1994.

In May 1995, I established a 2 Partner practice in Wollongong called RM Chartered Accountants. My partner and I built that Practice up to employ 9 staff by June 2000. The highlight for our practice was winning the prestigious NSW Small Practice Award for Excellence in 1998.

I left that Practice in February 2002 to concentrate on investment structures and finish building my own new home in Sydney. Over Christmas 2002, Strategic Wealth Management was created. A new image and new vision to help investors structure their affairs to minimise tax and to protect their assets. I had spent a lot of time with professionals in this field and felt that there was a market for this type of specialty.

Since I decided to make a move out of traditional accounting and concentrate on investment structures, it has become quite obvious that there is a need for a simple yet complete guide for people to follow in relation to the type of investment structure they should choose.

We are always looking for a better way to do things. We have all seen many high profile individuals survive jail sentences, yet still manage to maintain their wealth.

In our day and age of litigation and high taxes, we need to ensure that our investment structure is solid from the outset. Saving tax is always a priority, however what point is there in saving tax if a creditor can come along and sue for the wealth you have created.

Asset protection should be the main focus of any decisions in establishing an appropriate structure. Tax minimisation should be secondary.

Your first priority in any asset protection strategy should be to minimise your risk of being sued and then being able to protect your assets should litigation be taken against you.

I hope to be able to assist you in ensuring your investment journey is a solid one that maximises your wealth and enables you to keep it.

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considerations when structuring an investment

The main considerations when structuring an investment are as follows:

Asset Protection

What is asset protection?

Asset protection is about minimising your exposure to risk. Being able to control assets that you do not own is one part of an asset protection strategy. Your first priority should be to reduce the risk of being sued. Prevention is the best course of action. Insurances should be in place to provide a layer of protection should we be sued. Thirdly, having the appropriate structure in place will protect our assets should it be outside the scope of insurance.

The increasing occurrence of litigation heightens the need to place assets out of the reach of potential creditors

Consider the actions of your business partner or your employees. You may be liable;

Consider Estate Planning issues if your spouse has willed everything to you;

Consider the Bankruptcy provisions if you are divesting yourself of assets;

Income Tax

Selecting the most appropriate investment structure means being able to maximise after-tax return. This will in turn lead to increased wealth and increased investment capacity.

Retirement Planning

Individuals and families must plan for retirement, as the living standard they set for that time remains until death.

It is imperative that you maximise your ability to draw a high net income in retirement. You need to consider your investment structure today. If the structure is wrong then you will pay greater taxes later thus reducing your wealth in retirement.

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considerations when structuring an investment

Family Succession

Passing assets from one generation to another is usually done with minimum planning and, consequently, beneficiaries suffer and family holdings are reduced.

Negative Gearing

Negative gearing is simply the term used when the income received from a property is not sufficient to cover the deductible expenses of that property.

An investment can create positive cash flow and still be negatively geared. Non cash expenses such as depreciation, borrowing costs and special building allowances can be beneficial in this regard.

There is a misconception that an individual cannot negative gear, if an investment is acquired in a trust.

Refinancing

This is the ability to refinance equity in an investment property and claim a tax deduction for the interest twice.

Other factors may include:

Is the structure easy to establish, understand and maintain;
Risk profile of the taxpayer;
Whether asset protection is an issue;
The taxpayer's general position, eg marital status, level of income etc;
Who will control the assets;
Treatment of the assets in event of a divorce;
Can the structure be dismantled if required.

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common investment structures

The most commonly used investment structures are:

- Own Name / Sole Trader
- Partnership as Joint Tenants or Tenants in Common
- Company
- Unit Trust
- Discretionary Trust
- Hybrid Trust
- Self Managed Superannuation Fund (SMSF)

To elaborate further on theses investment structures:

own name

Advantages

1. Inexpensive to run
2. Easy to understand
3. Taxpayer has total control and ownership
4. Income assessed at own tax rate (advantage if tax rate is low)
5. Assets can be negatively geared and the investor has access to 50% CGT discount.
6. Losses can be carried forward

Disadvantages

1. No asset protection so the taxpayers personal assets are at risk
2. No income splitting
3. Income assessed at own tax rate (disadvantage if tax rate is high)
4. Once a property becomes positively geared it creates a tax problem for thehigh income earner.
5. No flexibility to distribute income

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common investment structures

partnerships – joint names

Advantages

1. Consider implications of joint ownership vs Tenants in Common
2. Less costly to establish and maintain than a company or trust
3. Easy to understand
4. Income splitting between partners
5. Losses split between the partners
6. Assets can be negatively geared and the investor has access to 50% CGT discount.

Disadvantages

1. Partners are jointly and. severally liable. If Partnership property is not sufficient to pay the partnership debts then personal assets may be at risk.
2. A Partner may be personally liable for the negligence or wrong doing of his Partner.

   Eg.: Walker v European Electronics Pty Ltd (In liq) (1990)23 NSWLR U A partner of an accounting firm was appointed as receiver of a company. The partner misappropriated the funds of the company in receivership. The innocent partners were liable to compensate the company for the loss as the misappropriation was undertaken in the normal course of business of the Partnership.
3. No asset protection
4. Income assessed at personal rates
5. Capital gains assessable to each partner

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common investment structures

companies

Advantages

1. Shareholders can benefit from income-splitting and tax refunds for any excess franking credits. (An excess franking credit arises when a taxpayer on a. low marginal rate has insufficient other income to make use of the credit.)

2. Profits can be retained within the company, and be taxed at the 30% corporate rate.

3. Companies can provide excellent asset protection if shares are owned by a discretionary trust.

4. Companies use various techniques to direct dividends to shareholders with low tax rates. Either the taxpayers with low marginal rates have more shares than other shareholders or company's articles of association allow it to direct dividends to nominated classes of shareholders while withholding dividends from other classes.

5. Perpetual existence. ie can survive forever.

Disadvantages

1. Companies do not provide access to CGT discounts and cannot distribute tax losses to shareholders

2. Complex to administer

3. Regulated by Corporations Act

4. Costly to establish

5. Costly to run and maintain

6. 50% CGT discount not available

7. Cannot distribute losses to individuals

8. Division 7A applies in respect of loan to shareholders

9. Directors can be liable for the company's debts in some circumstances

10. If the shareholders are sued, then the assets of the company may be exposed.

It is not recommended to hold capital appreciating assets in a Company. In order to return the income to the shareholders tax may be payable up to 48.5%.

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common investment structures

unit trusts

Advantages

1. Asset Protection
2. Not regulated by Corporations Law
3. The 50% CGT discount is available
4. Trust is not taxed as a separate entity
5. Unit Holders are eligible for discount CGT but these do not, in themselves, provide a means of income splitting or asset protection.
6. Beneficiaries can borrow to buy units and benefit from negative gearing.
7. Income and capital distributions are proportional to the percentage of units held.

Disadvantages

1. Less people understand how they operate
2. Ultimate beneficiary statement rules apply
3. Cannot distribute losses to beneficiaries
4. Must be wound up within 80 years~
5. Distribution of tax free income and gains has CGT implications for the beneficiaries
6. Individual trustees can be personally liable for the debts of the trust
7. If the unit trust is funded by debt, rather than equity, the units owned by the beneficiaries will have a low cost base and this will cause problems where non assessable amounts are distributed
8. The general value shifting rules apply when issuing units to associates for below market value consideration
9. Unit holders have little asset protection

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common investment structures

discretionary trust

Advantages

1. Ultimate asset protection when it has a corporate trustee. Assets are owned by the trust not by the beneficiaries.

2. Less regulation than a company

3. Trusts are often called flow-through entities because the distributions flow untaxed through to the beneficiaries, who are taxed at their marginal rates.

4. There is no tax at trust level provided profits are distributed.

5. Access to income-splitting (a trustee of a discretionary trust can direct income and capital to beneficiaries with low marginal tax rates),

6. 50 % discount capital gains tax (CGT) applies

7. To negatively gear, trusts need more than one source of income. And trusts cannot distribute tax losses to beneficiaries.

9. From December 12, 2002 the government has introduced legislation to tighten and restrict distributions to companies.

10. Control can be easily transferred by changing trustee and/or appointer

Disadvantages

1. They can be complex and not many people understand precisely how they work

2. Costly to establish

3. Costly to run

4. Cannot distribute losses to beneficiaries. Losses trapped in Trust

5. Must be wound up in 80 years

6. No land tax threshold is available in NSW.

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common investment structures

hybrid discretionary trust

Has predominantly the same features as a Discretionary Trust.

The most flexible structure in the majority of occasions is the hybrid discretionary trust.

Allows an individual to negative gear their investment.

This type of trust is a combination of a discretionary trust and a unit trust.

Allows the refinancing principle to apply.

This type of trust allows for

- asset protection,
- quarantining of negative gearing,
- refinancing and flexible distributions of income and capital in the future.

Very few accountants are familiar with how this structure operates.

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This module can be very complex and one that should be discussed with your accountant or financial advisor depending on your personal financial position.

Below write out what you have learnt from this module.