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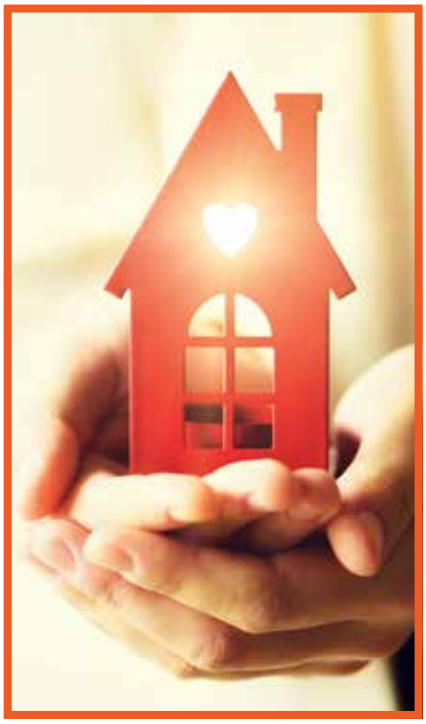
Protecting assets for beneficiaries



Baby boomers often joke about going SKling (spending the kids' inheritance). But for many who encounter unfavourable circumstances in later life, it is a case of saving and protecting the inheritance – and it's no joking matter.

It's generally thought that the best way to protect an inheritance following a divorce or relationship breakdown is to quarantine the inheritance within a testamentary trust. That is, a trust created by a Will.

The testamentary trust acts to keep the inherited assets separated from the couple's relationship assets.

However a court exercising power under the Family Law Act 1975 has extensive powers, and there have been cases where a Court has included assets within a testamentary trust as either property of the parties, or at least a financial resource of the beneficiary, which justifies the other spouse receiving more of the relationship assets.

But an inheritance protection agreement (IPA) can be used to exclude the inherited assets. For example from a bitter property dispute.

How does an IPA work?

The Family Law Act allows financial agreements to be made and can be made before, during or after the relationship or marriage.

Often these agreements are called 'pre-nups' and generally the pre-nup sets out how all the assets of the parties will be divided if the relationship fails.

However, a pre-nup does not need to cover all assets. An IPA is simply a financial agreement which deals with inherited assets only.

Requesting an IPA

How can I get my beneficiaries to have an IPA?

There are two ways, one of which is a simple request, and the other is a mandatory requirement.

1. Inserting in your Will a clause requesting any beneficiary to enter into an IPA with their partner (whether a current partner or a future partner). If you simply make a request, then the beneficiary does not have to act on the request. However, it does give the beneficiary a reason to raise the subject with any partner.
2. The alternative way is to place restrictions on the beneficiary if they don't have an IPA. The actual restrictions imposed by the Will maker are for each Will maker to decide, having regard to their level of concern. A suggested restriction is to appoint a Protector who has the role of protecting the inheritance from attack in a number of circumstances.

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HLB Mann Judd Association appoints new firms in Newcastle and Fiji

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Helping decode cryptocurrency taxation

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Bitcoin. Ethereum. Litecoin. Ripple. Until recently the average investor may have heard of these terms but may not have understood the tax considerations.

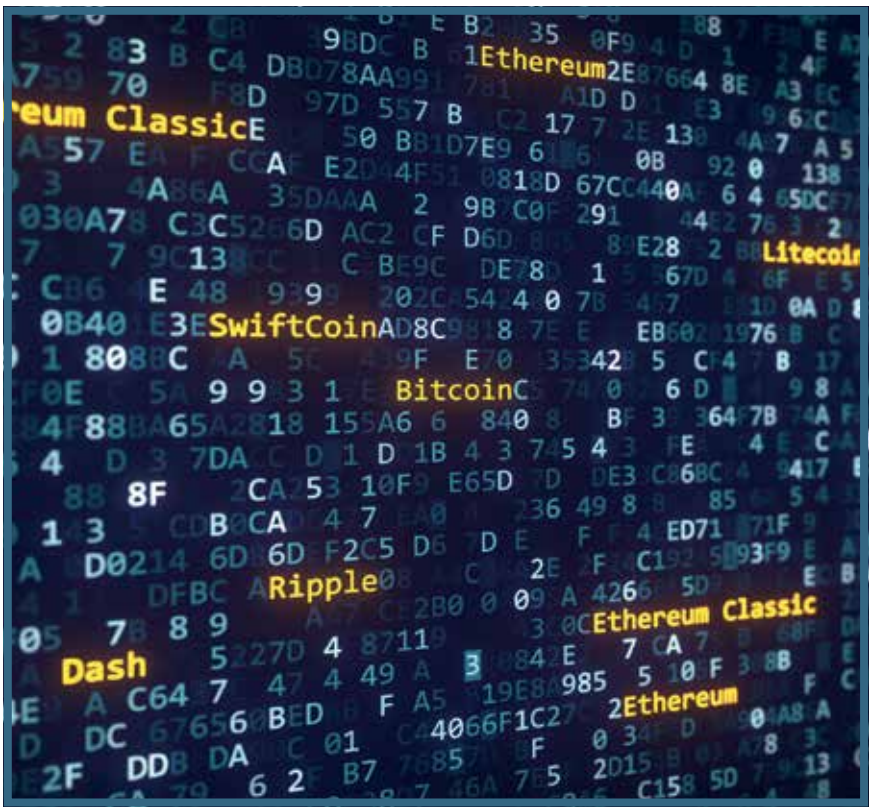
Now, these popular examples of cryptocurrency have entered the mass market vernacular and have caught the attention of the ATO. So, what do you need to know about the tax implications of digital currency?

Arguably, the most influential factor to date is the changes to Australia's anti-money-laundering laws which came into effect on April 3, 2018.

The changes specify that cryptocurrency exchanges will need to sign up to a Digital Currency Exchange Register, and transactions of more than $10,000 will need to be reported to AUSTRAC in line with existing rules for bank transfers and cash transactions.

The ATO is able to take its share of tax via several means:

- Investment purposes: if digital currencies are held as an investment, CGT will be payable on any profits when sold.
  If you are an Australian resident and hold the investment for at least 12 months then you will able to claim a 50 percent CGT discount, meaning tax is only payable on half of the gain



- Trading: if virtual currencies are traded for profit, the profits will be considered assessable income
- Carrying on a business: if cryptocurrencies are used to pay for (or are accepted as payment for) goods or services, the transactions will be subject to GST and treated as assessable income as if it were a cash receipt
- Mining: if Bitcoins or other digital currencies are mined, any profits are considered assessable income
- Conducting an exchange: if you are buying and selling cryptocurrencies as an exchange service, you will pay income tax on the profits and transactions will be subject to GST.

But if the digital currency is kept or used mainly to purchase items for personal use or consumption, and the cost is less than $10,000, there are no tax consequences.

As with all financial transactions, it's crucial to keep appropriate records for tax purposes. The ATO expects the following records to be kept:

- The dates of any purchases and sales of cryptocurrency
- The value in AUD of each transaction
- The identity of the other party (e.g. their cryptocurrency address)
- The nature and purpose of the transaction.

The ATO and other regulators are now able to track digital currency transactions, so understanding the tax implications, and record keeping requirements, is more essential than ever before. ■

> *"The ATO and other regulators are now able to track digital currency transactions..."*

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New legislation designed to create a single whistleblower protection regime under the Corporations Act 2001 will extend to the corporate, financial and credit sectors as Graeme Bailey explains.

Whistleblower protection shortcomings drive changes

When passed, the legislation will apply to protected disclosures made on or after 1 July 2018.

The Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017 will afford whistleblowers access to compensation and enhanced protection against victimisation after 1 July 2018, irrespective of when the disclosure was made.

The obligations will extend to all public and large proprietary companies who will now have to implement a whistleblower policy by January 2019 (public companies) and December 2019 (large proprietary companies).

Individuals and corporations who fail to set up a compliant whistleblower policy will be subject to penalties, and failure to comply with new confidentiality and victimisation provisions will be considered criminal offences.

The original legislation – Corporations Act 2001 (Cth) under Part 4AAA – had been in place for over ten years.

Recent high-profile examples, including the 7-Eleven underpayments scandal, highlighted deficiencies in the original legislation, including:

- The Act was silent on how ASIC should handle information from whistleblowers
- ASIC was not mandated or enabled to ensure the rights of whistleblowers are protected
- ASIC had difficulty legally resisting requests during litigation for whistleblower information including the whistleblower's identity.

In addition to harmonising existing protections, the new legislation is aimed at:

- A broader group of informants who fall within the protection regime, including former officers, employees and suppliers, associates of the entity and family members of employees
- Introducing new statutory protections for whistleblowers in relation to consumer credit laws and taxation
- Expanding current protections to take into account disclosures concerning corporate corruption, bribery, fraud, money laundering, terrorist financing or other serious misconduct
- Abolishing the 'good faith' requirement, effectively allowing anonymous disclosures and providing immunities to whistleblowers regarding the type of disclosure made.

Businesses should not only determine whether they are required or should have compliant whistleblower policies, but also consider what risk mitigation actions are required given the increased likelihood in the future of an action by a whistleblower. ■

Continued from page 1

The role of the Protector

In situations where the Will maker is happy for a beneficiary to have control over the testamentary trust holding the inherited assets, the Will maker usually allows the beneficiary to decide who will control the trust as trustee (such as the beneficiary themselves or another person or entity) together with the power of appointment, which allows the beneficiary to replace the trustee.

The Protector can be appointed by the Will maker as an additional layer of protection.

For example, if the beneficiary fails to have an IPA the ultimate control lays with the Protector who will generally be independent from the beneficiary.

In the event of a relationship breakdown the Court is most unlikely to include the inherited assets as the trust is ultimately controlled by the Protector, and not the beneficiary. ■

Shareholder loan account myth busting

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The use of shareholder loan accounts is a common practice in companies, but there are commonly held misconceptions that are worth debunking.

MYTH: An individual shareholder can take an interest-free loan from a company.

FALSE. When an individual shareholder takes money out of a private company without declaring a dividend this allows them to avoid paying the top-up tax which is the difference between the individual's marginal tax rate and company tax that has already been paid on company profits.

At the current top tax rate of 45 percent plus 2 percent Medicare levy, and assuming the company is a small business taxed at 27.5 percent, the top-up tax on a fully franked dividend represents 26.9 percent of the cash dividend paid to the shareholder.

This is the reason for the deemed dividend rules in Division 7A of the tax legislation, which will treat a loan as an unfranked taxable dividend unless it is made under a written loan agreement under certain terms including, in most cases, principal and interest repayments over seven years or if the loan is fully repaid by the due date for lodgement of the company's tax return.

MYTH: It is possible to repay a loan and then redraw the funds without triggering Division 7A.

FALSE. A commonly employed strategy to overcome Division 7A is to repay the loan balance in full before lodgement date of the company's tax return for the year in which the loan was made.

So far so good. The rules allow for this and it is recommended where possible. Where some people go wrong, however, is to then draw additional funds back out of the company.

There is a specific, often-overlooked, rule in Section 109R that allows the ATO to disregard a loan repayment where it is reasonable to conclude that the intention was to obtain a new loan that was similar to or larger than the amount repaid.

For example, take the case of Julie, who is a shareholder of Omega Pty Limited. At 30 June 2018 she owes Omega $50,000, which she repays in April 2019 before lodging the company tax return. She then takes out a new loan for $48,000 in June 2019, which is repaid in April 2020, and so on.

While on the face of it Julie avoids the basic Division 7A rules, the ATO would be able to use section 109R to ignore the loan repayment, and Julie would have a problem unless she takes other action.

MYTH: Paying interest on a shareholder loan will always be a bad thing.

FALSE. The interest paid on a shareholder loan is often a problem because the company is taxed on the interest received, while the individual shareholder cannot claim a deduction for the interest paid where (as in most cases) the funds have been used for private purposes.

This is not always the case, however, because where the funds are used for income-producing purposes such as to finance investments in direct shares, managed funds or an investment property, then the interest will be tax-deductible.

The private company becomes an alternative source of financing to borrowing from the bank, and this can be a fairly tax-effective approach in the right situation.

MYTH: Loans can be forgiven without any tax implications for the shareholder.

FALSE. In most cases, if a company forgives a shareholder loan this will also trigger Division 7A, and the shareholder will be taxed on the amount forgiven as an unfranked dividend.

The taxable amount is, however, restricted to the amount of the company's distributable surplus at the time of the forgiveness.

Broadly, this will be the value of the company's net assets less the amount of paid up share capital, and if the distributable surplus is less than the amount of the debt forgiven then the taxable dividend will be reduced accordingly. ■

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Despite several high-profile court cases involving disgruntled franchisees, the franchise model remains an attractive option for businesses, says Josh Chye.

Franchising a viable growth strategy for businesses

The annual total sales revenue for Australia's franchise sector is estimated at $146 billion – and growing – so it's little surprise that it continues to thrive.

But, how exactly does a business determine whether franchising is an appropriate model?

Which tax and commercial decisions should it make in order to attract the most suitable franchisees?

Business structure

When entering into a franchising business model, it's important to have an appropriate structure that provides both asset protection and tax efficiency.

Considerations include:

1. A company structure to operate the franchisor business which provides asset protection and allows profits to be retained and re-invested
2. The use of a family trust to hold shares in the company
3. Multiple companies may be considered to separate assets from liabilities
4. The use of a holding company
5. Land real estate used to operate any of the business activities may need to be kept outside of the corporate group to preserve the CGT discount.

Incentivising key employees

Issuing equity to founders and employees of a company will often be linked to the commercial objectives of that company.

However, it is important to consider the tax implications of any equity issues.

From a tax perspective, the default position of an Employee Share Scheme (ESS) is to tax an employee upfront on any value they get upon receiving shares, options or performance rights.

Tax laws allow start-ups to apply ESS tax concessions. If available, these concession rules provide the best tax outcomes, because:

- The employees will only trigger a tax liability once the shares are sold
- There is certainty on CGT discount for any capital gains made on the sale of the shares
- Companies have the ability to value the shares, options or performance rights on a concessional valuations basis.

R&D tax incentive

Franchisors in innovative industries may potentially have access to the R&D tax incentive which may provide 43.5 percent cash offset for eligible R&D costs. ■

> *"...it's important to have an appropriate structure that provides both asset protection and tax efficiency."*

Income tax a minefield for property investment

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The Winter issue of Financial Times covered the GST issues for property investors who subdivide. Now it is timely to look at the income tax issues involved.

Property investors who subdivide land face complex tax issues.

Purchasers of land can generally be divided into four categories:

1. A home owner who purchases land with the intention to live there
2. A property investor who purchases land with the intent to generate income from the rental
3. A property speculator who purchases land with the intent to produce a profit from its resale in the near future, with minimal input and
4. A property developer who purchases land with the intent to improve the value by subdividing the block or constructing buildings, then selling at a profit.

The home owner and property investor will be deemed to hold the land as a capital asset. Any gain realised on the eventual sale will be included in the investor's taxable income under the capital gains tax rules.

Taxing issues

The taxation issues to be considered will vary according to whether they are tax residents and include eligibility for the 50 percent discount for assets held for more than 12 months, cost base calculations and the main residence exemption for a home owner particularly where they own more than one residence, whether the property has been used at some time to derive assessable income or if the property is over 2 hectares.

It is important to note that land that is divided from the main residence and sold separately is not subject to the main residence exemption.

This compares to the property speculator and property developer who will both be deemed to be holding the land as a revenue asset, with the full amount of profit realised on the sale being included in their taxable income as ordinary income, regardless of how long they have actually held the land.

The taxing issues that arise include the expenses that can be claimed as a tax deduction when incurred and those that have to be included in the cost of the property, the allocation of costs to the subdivided property, the timing of recognition and calculation of profit as the subdivided property is sold.

Intentions

The distinction between the different categories of land purchaser is generally based on their intentions at the time of purchase.

Generally, if an investor merely takes the minimum steps necessary to subdivide, then sells the land, they will continue to be considered an investor, with the sale treated as a capital asset.

On the other hand, if a property developer were to demolish existing buildings, and subdivide the land, the profit would be fully taxable even if houses were constructed on the land and even if the houses are rented for a period of time.

A common situation is where the land holder's intention changes over time – perhaps due to the purchaser's circumstances and the property market.

This change in status will also result in the land changing from a capital asset to a revenue asset or vice versa. As of that date, there will be a deemed sale and acquisition of the property for tax purposes.

The deemed sale proceeds will be equal to the market value of the property at the time of the change in use for the property developer.

The investor is able to choose either market value or cost. Each choice has its own consequences.

Market value

If the investor chooses the current market value as the deemed sale proceeds, they will realise a capital gain equal to the difference between this value and the cost base. This capital gain will be eligible for the 50 percent discount, before being included in the owner's taxable income.

This market value will then be used as the purchase price when determining the profit realised on the property development. This profit will be calculated as the difference between the actual sale proceeds and the sum of the development costs and the market value used to calculate the capital gain. This profit will be taxed as normal income of the land owner.

Whilst the property owner will be able to crystallise the benefit of the 50 percent CGT discount by choosing this option, they will realise a tax liability that may need to be paid at a time when most of their cash is tied up in the property development.

Cost value

If the property owner were to choose the original cost of the property as the deemed sale proceeds, there will be no capital gain realised on this deemed transaction as the sale proceeds will be equal to the cost base.

Instead when the property owner ultimately sells the newly constructed houses, the taxable profit will be calculated as the difference between the sale proceeds and the sum of the development costs and the original purchase price. ■

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New rules allowing ordinary salary earners to claim a tax deduction for their personal superannuation contributions puts the $1.6 million retirement superannuation balance within reach, says Jonathan Philpot.

$1.6 million super ideal can be real

From 1 July 2017, standard salary earners have been able to claim a tax deduction for their personal superannuation contributions without entering into a salary sacrificing arrangement with their employer.

Now that a tax deduction is available for additional contributions, locking money away in superannuation until retirement has become more palatable for many.

The aim should be to build your super balance by maximising your annual deductible limit where possible so that the $1.6 million cap on superannuation balances becomes a reality.

The key is to not rely on the minimum superannuation guarantee contribution but start as early as you can to seek ways to increase contributions.

Take the example of a 40 year old with a super balance of $100,000.

If they commit to making the maximum concessional contribution of $25,000 a year, their superannuation balance would reach $1.3 million by age 65 (assuming an average real return of five percent a year, net of inflation).

In contrast, a 50 year old with the same opening balance of $100,000 would be significantly worse off, reaching just $661,000 by age 65 with the maximum contributions.

Previously, superannuation used to only be discussed when nearing retirement, and the old rules allowed significant super contributions. However, with lower contribution limits now in place, consideration to building up a large superannuation balance needs to start 10 years earlier.

Now that ordinary salary earners can claim a tax deduction for super contributions, it provides a very good reason to start putting more into super. ■

HLB Mann Judd Association expansion

The HLB Mann Judd Australasian Association has appointed two new firms, in Fiji and Newcastle, NSW, bringing the number of HLB Mann Judd firms to nine member firms and three representative firms, with 86 partners across Australia, New Zealand and now, Fiji.

HLB Crosbie & Associates will become a full member firm and change its name to HLB Mann Judd Fiji.

In Newcastle, Cutcher & Neale Assurance Pty Ltd, the assurance company of Cutcher & Neale, will join the Association as a representative firm.

Tony Fittler, chairman of the HLB Mann Judd Australasian Association, said that there has been strong links with the two firms over several years, with business synergies evident with both.

"Both firms have similar values and ethics as well as being dedicated to delivering the best possible service to clients.

"They are strong and well-established firms in their respective markets and will bring particular skills and experience to the Association in their regions," he said.

William Crosbie, principal partner of HLB Mann Judd Fiji, agreed that there is a strong cultural alignment between the firm and the Association.

"Delivering client service is particularly important to HLB Mann Judd Fiji, and the HLB Mann Judd firms have won numerous client relationship awards over the years.

"We have maintained a strong relationship with HLB Mann Judd for some time and believe it makes sense to become part of such a strong association as we work ever more closely with Australian and New Zealand-based clients," he said.

Mark O'Connor, head of Cutcher & Neale Assurance, said that with the growth in the audit client base, and the broader scope and diversity of audit and advisory services it is now providing to its clients, it made sense for the firm to have access to the depth of experience and expertise of the HLB Mann Judd Australasian Association to complement its own resources.

"We already have a solid foundation for a long-term relationship with the HLB Mann Judd Australasian Association, and we are pleased to be joining a network that shares our values, especially our strong audit practice," he said. ■

Positive signs for local IPO market

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The first half of the year has delivered a strong initial public offerings (IPOs) market, and is setting the scene for what is likely to be a positive second half for 2018.

While there were fewer listings in the first six months of 2018 compared to the previous year (39 compared to 57), this year has still outperformed the previous five-year average of 37 listings.

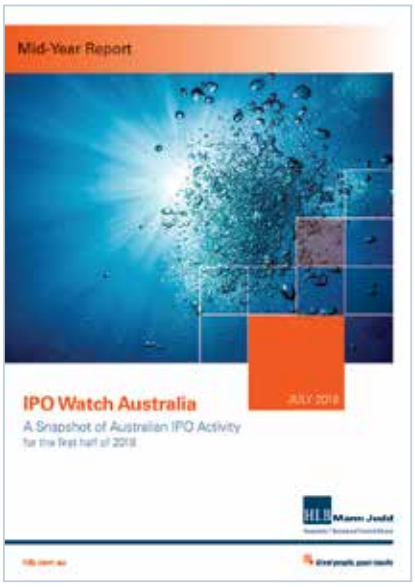
Usually, around two-thirds of listings take place in the second half of the year, so 39 listings in the first half of the year is a strong start.

The subscription rates achieved so far this year are also an indication of a well-performing market. In total, 72 percent of total subscriptions sought was raised, with 28 IPOs being either fully subscribed or oversubscribed.

The entire market raised $2.5 billion, which represents an oversubscription of 29 percent. This impressive result is largely due to L1 Long Short Fund Limited (ASX: LSF) which raised $1.3 billion after initially seeking $600 million. However even without this outlier, the market raised, on average, 88 percent of funds sought.

Looking ahead, small cap junior exploration companies in the resources sector appear to be the strongest contributors to upcoming listings.

On 1 July 2018, there were 35 companies that had applied to list on the ASX, and 11 of these are in the materials sector.



Technology stocks are also showing signs of improvement, with a further eleven companies in Technology, Biotech and Software & Services applying to list.

Overall, there is a broader range of companies planning to list in 2018, with Real Estate, Food, Beverage & Tobacco, and Capital Goods, each having several listings in the pipeline.

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Australasian Association

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