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Trusts: Their use and their structure

A major motivation for the setting up of trusts is asset protection. Valuable property and other assets can be moved into a trust to isolate them from being exposed to litigation, for example, for protection from creditors, or to maintain an estate until a beneficiary becomes old enough to have legal possession.

The use of a trust to protect assets will allow you to:

- protect your financial interests as well as that of your spouse, children, siblings and other beneficiaries from unforseen risks and liabilities
- significantly reduce taxes by strategically planning the distribution of income, capital gains and assets to your beneficiaries
- manage your assets more effectively during your lifetime, and
- create a legacy when you're no longer around and ensure your assets are passed on while minimising taxes and duties.

Separate control from beneficial ownership

A trust is simply an agreement whereby a person or company agrees to hold an asset for the benefit of others. The person who legally owns and controls the asset is known as the "trustee" and those who benefit are called the "beneficiaries". The assets held in a trust can vary – from property, shares, a business and business premises to works of art and so on. The person who creates the trust sets out the specific terms about how these assets are to be managed and controlled in a document called the "trust deed".

Assets that are transferred to, or bought for, a trust are not owned by the person concerned, but are owned by the trust and legally controlled by the trustee. However, one can control, via the wording of the trust deed, exactly how the assets are managed and how the investment earnings are dealt with and distributed among the beneficiaries. So regardless of what happens in one's circumstances outside of the trust, these assets can usually be protected.

Another prompt to consider a trust structure may occur if means or asset tests for government benefits are likely to figure in your financial future. Trusts can help here with the re-allocation of legal ownership without completely letting go of enjoying the benefits of the asset.

Securing assets for inheritance purposes may also be a consideration when people think about setting up trusts. If a prime asset is owned by a trust, for example a house with pristine beachfront, and the trust deed is specific in terms of selling and/or maintaining the beach house, future generations of the family will be able to enjoy the same asset without fear of having to sell it off due to some spendthrift relative.

There are pitfalls and challenges in getting the trust structure right. Asset safety and taxation can

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Welcome to Collison Accounting's client information newsletter, your monthly tax and super update keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics covered, please contact us.

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Trusts: Their use and their structure (cont)



sometimes be competing interests, and other trade-offs made to take advantage of a trust structure need to be considered. For instance, when selling your primary residence, one of the main requirements for this sale to be tax free is that it is held in your own name. This means trusts cannot generally sell a primary residence tax free.

But trusts can, if set up in the right way, help you legally minimise tax liabilities. It is a tricky area, and the taxman is always on the lookout to close perceived loopholes or an over-enthusiastic stretching of the scope for reducing tax. Specialised advice will be invaluable.

Types of trusts

Trusts come in many shapes and sizes, and there is no "one size fits all". The type of trust that will suit your purpose will depend on many factors particular to one's circumstances. There are various types of trusts, such as a discretionary trust, hybrid trust, unit trust, a fixed trust and many more, each with unique characteristics. A deceased estate is also a trust, being property and assets that are held and managed by the executor (the trustee) for those who will inherit them.

However the three most common types of trusts are:

- discretionary trusts
- unit trusts, and
- hybrid trusts.

Discretionary trusts

A discretionary trust is the most common type of trust used by families, small to medium size business owners, investors and many professional practitioners in Australia, mainly due to the flexibility they offer. Income can be allocated to beneficiaries at the trustee's discretion — hence the name. They are generally set up to hold assets and/or a business for the benefit of providing asset protection and tax planning for family members.

From a tax perspective the main advantage is that income generated by the trust from business activities and investments, including capital gains, can be distributed to beneficiaries in lower tax brackets to significantly reduce taxes. And the distribution is discretionary, which means no beneficiary is automatically "entitled" to receive income or capital. So if, for example, one beneficiary is sued, the trustee can decide not to distribute income to that beneficiary. Assets can also be transferred from generation to generation duty free and with greatly reduced tax liabilities.

Other types of discretionary trusts are testamentary trusts, child maintenance trusts, property trusts, special disability trusts and charitable trusts.

Unit trusts

These are trusts where the interests of beneficiaries are denominated by units, which can often be bought and sold in a way similar to trading in shares in a company. Unit trusts are used in many commercial arrangements, including managed investment schemes.

The number of units held determines one's entitlement to a share of income, to capital gains and voting rights. Units in a unit trust can also be categorised. For example you can have income units and capital units. Also unit holders can be individuals, companies or discretionary trusts.

The taxation benefits are generally not as flexible as a discretionary trust in that any income distributions must be distributed to unit holders as per their share of units. However as a discretionary trust can be a unit holder, this arrangement can also achieve the same flow-through tax benefits.

From an asset protection point of view, unit trusts may not provide the same kind of asset protection as a discretionary trust. If a unit holder is made bankrupt, then that person's units will be treated like any other assets and may be sold to raise funds to pay creditors.

Hybrid trusts

A hybrid trust takes the best features of a discretionary trust and the best features of a unit trust and puts them into one. This means that the trustee has the discretion to distribute benefits to beneficiaries (some of whom may be on lower tax rates) as well as have unit holders who are absolutely entitled to a portion of the benefits.

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Family trusts

A discretionary or hybrid trust can generally be a "family trust" for tax purposes if the trustee so elects, but distributions need to be restricted to members of a particular "family group" – only distributions outside this group will attract tax at the highest marginal rate (including Medicare levy).

There are a number of reasons to elect to become a family trust. Two key ones are that beneficiaries of discretionary trusts may not otherwise be able to take advantage of franking credits attached to share dividends received by the trust and passed on to the beneficiaries, and that the trust would otherwise find it a lot harder to use past year tax losses against current year income.

Fixed trusts

With a fixed trust, the beneficiaries' entitlement to the trust property or income (or both), and the way in which this is fulfilled, is fixed by the trust deed. The trustee has no discretion to alter the prescribed entitlement of the beneficiaries. Very few trusts (if any) are wholly fixed because the trustee generally has some element of discretion.

Deceased estates

A deceased estate is treated as a trust for tax purposes while being administered, with the executor or administrator of the estate taken to be the trustee. ■

Annual returns for newly registered SMSFs due soon

Trustees of self-managed superannuation funds (SMSFs) have been urged to prepare for the impending 2011-12 annual return deadline. If you belong to a newly registered SMSF – and assuming you lodge your returns with the help of this office – you will usually have a 2011-12 annual return deadline of February 28, 2013. To meet the lodgement deadline, you should have already had your financial accounts and statements audited.

If an SMSF has no assets set aside for the benefit of members and has not started operating, it is not legally established. In this situation, you can ask this office to write to the ATO to:

- have your Australian business number (ABN) cancelled if you do not intend to hold assets or operate as an SMSF, or
- apply for a "return not necessary" (RNN) concession if your SMSF meets all the following conditions:
  a) it was not registered in the 2011-12 financial year
  b) it was not operating by June 30, 2012
  c) it has not received contributions or rollover amounts by June 30, 2012
  d) it has actually received contributions or rollovers in the 2012-13 financial year.

Remember that a RNN concession is only available during your SMSF's first year of registration and if all the eligibility conditions are met.

Conversely, if an SMSF is in its second or subsequent year of operation, it does not have assets set aside for the benefit of members and it has not started operating, then it has not legally been established. Consult this office so we can write to the ATO to have your SMSF's ABN cancelled – just as above.

If an SMSF has previously advised that a return was not necessary but it is legally established and needs to lodge an annual return for the first time, the due date for the first annual return is February 28, 2013.

SMSFs must lodge an annual return for each year of operation, including the year in which the fund is wound up. Failure to do so may result in compliance action. Bear in mind that annual returns with no assets or no member account balances will not be accepted, unless it is a final return.

Consult this office if you need any help lodging your SMSF's annual return. ■

Same-sex couples' superannuation rights explained

The debate over same sex marriage in our Federal Parliament last year did not result in a change in the current status of same-sex unions. This does not mean, however, that same-sex couples have no recognition in existing law.



Same-sex couples are treated as equitably as heterosexual couples when it comes to superannuation. This became effective five years ago when in 2008 the law extended the word "spouse" – which traditionally only included opposite-sex partners – to include:

- a same-sex partner that one is in a relationship with that is registered under a certain state or territory law, or
- a same-sex partner who, although not legally married, lives on a genuine domestic basis in a relationship as a couple (otherwise known as a de-facto relationship).

Similarly, a Family Law amendment in 2008 broadened the definition of "de-facto" to include same-sex relationships and extended the definition of "child" to include the individual's adopted child, stepchild or ex-nuptial child, and a child of the individual's spouse or someone who is a child of the individual within the meaning of the *Family Law Act 1975*.

The reforms brought equality to areas of tax, social security, health, aged care and employment through key changes that focused on:

- superannuation contributions splitting
- superannuation spouse tax offset
- establishing and running a self-managed superannuation fund (SMSF)
- death benefits, and
- relationship breakdown.

Superannuation contributions splitting

Same-sex couples are now eligible for superannuation contribution splitting, which allows a same-sex partner to direct superannuation contributions into their spouse's account to boost their retirement savings. You can apply to split contributions regardless of your own age, but your spouse must be either less than 55 years old, or between 55 and 64 years old and not retired.

Superannuation spouse tax offset

Same-sex partners can make after-tax contributions of up to $3,000 on behalf of their spouse and be entitled to a maximum tax offset of up to $540 (18% of $3,000) if the sum of their spouse's assessable income – including total fringe benefits amounts and reportable employer super contributions for the financial year – is less than $13,800.

Establishing and running an SMSF

The broadening of the definition "spouse" to include same-sex partners has greatly affected SMSF trustees because:

- the eligibility rules for SMSF members have become a lot clearer for a same-sex couple wanting to run an SMSF together
- a same-sex partner is now considered a "relative" which means SMSF trustees cannot lend money to their same-sex partners as they constitute a "relative of a member", and
- anti-detriment payment rules now apply to the dependant of a same-sex partner.

Death benefits

In the event of the death of a spouse, same-sex partners and their children can now receive a death benefit from their partner's private superannuation fund.

Same-sex partners are also eligible for the same death benefit tax concessions that opposite-sex couples are provided when they receive a superannuation lump sum death benefit. If same-sex partners want to challenge a death benefit payment decision, they can do so now via the Superannuation Complaints Tribunal.

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In regards to public sector funds, if a same-sex partner dies and they were receiving a defined benefit pension from a public sector fund, their spouse and children now receive equal access to death benefits and reversionary pensions under public sector fund schemes.

Same-sex partners were entitled to their spouse's superannuation benefits prior to 2008 but they had to satisfy a special test confirming they had an "interdependent" relationship or a financially dependent relationship.

Before 2004, it was highly unlikely that a same-sex partner could even receive his or her partner's death benefits – and even if they did receive these death benefits, 31.5% tax was typically deducted from the benefit (as the recipient was not considered to be a dependant).

Relationship breakdown

Same-sex de-facto couples have the same rights as heterosexual de-facto couples in this unfortunate event. A same-sex couple can take superannuation assets into account when parting ways and benefit splitting is now permitted. You may wish to read the article in the December Monthly Client Newsletter entitled *Superannuation and relationship breakdowns: who gets what*. However, the rules that apply to de-facto couples – be they opposite-sex or same-sex – are still more complicated than the rules for married couples.

Same-sex couples can now also access the Family Court of Australia or the Federal Magistrates Court for property division or spousal maintenance matters as they are now covered by the *Family Law Act 1975*.

Consult this office if you wish to find out more about same-sex couples' superannuation rights. ■

Data matching, and how the ATO uses it

Tax in Australia is based on a system of "self-assessment", which means every taxpayer is required to provide all the information needed to complete a tax return. Under self-assessment, any information you give to the ATO is accepted as being accurate and complete, and the ATO does not take on the responsibility of completing people's tax returns — a task that is left to taxpayers or preferably their tax agent.

However, it is well known the ATO will check up on the facts when it can – details in tax invoices from a supplier, or the payment summary that you get from an employer for instance – to make sure everyone is meeting their obligations (or at worst is not engaged in out-and-out fraud).

This perennial tool that the ATO uses is called "data matching", which involves comparing information it has been given by taxpayers with data that others hold. This can help identify people who appear to be living beyond their means, where income is inconsistent with spending. For example, the ATO can compare a person's reported income to information from government licensing bodies for luxury cars or boats.

Information sharing

Other sources of third-party information are banks and financial institutions, which are required by law to pass on information, as well as welfare organisations and employers. This includes Medicare, Centrelink, WorkCover, land title offices and planning authorities, as well as property title transfers, tenancy agreements, share registers, managed investment funds, building contractors – and many more.

As a result, the ATO has access to investment data and all banking transactions and can detect who is either not disclosing all of their income or not meeting their obligations. So even if you haven't been buying lavish yachts and sports cars, the ATO can easily find out if you earned interest from a term deposit at the bank which you didn't report in your tax return. For some, data anomalies can trigger a tax audit.

Benchmarking

The ATO's data matching efforts sometimes uncover certain hot spots — a recent example being its discovery of undisclosed wealth in the thoroughbred horse market. The ATO has devised a list of "industry benchmarks" with average ratios and performance indicators for businesses operating in certain industries. If the data reported in a business's tax return does not fit within the expected range, this could raise an alarm bell (although not all industries are benchmarked). ■

Correcting BAS errors



There can be some confusion among businesses about correcting errors made on a business activity statement (BAS), with a good proportion of the lack of clarity centred on the distinction between errors that require an adjustment and errors that are straight-out mistakes. Whether or not there is then a requirement to amend a previous BAS can also be a perennial source of inquiry.

The distinction between adjustments and mistakes can be made clearer by remembering that adjustments will most likely be required due to a change of circumstances or facts. These can include:

- cancellation of a taxable sale or purchase
- change in price of either of the above
- GST-free export supplies that are not exported within the required time (and therefore become taxable)
- bad debts, and
- changes in creditable purpose.

Mistakes however are straight-out blunders, and include:

- clerical errors
- a mathematical inaccuracy or exclusion in calculations
- incorrect classification of GST status.

As adjustments relate to changed facts or circumstances, which will have an impact on the subsequent GST outcome of a transaction, the resulting error in need of an adjustment will generally have resulted in a business having either claimed too much GST, or not claimed enough.

Claiming too much GST

How does a business claim too much GST on a BAS? Whoever filled out the BAS could have:

- forgotten to include a sales invoice
- coded a sale as GST-free when in fact it included GST
- made an error in coding transactions
- included a purchase that is not actually tax deductible
- included 100% of a purchase that wasn't totally for business-use.

Not claiming enough GST

Some situations in which this might be the case include where a business:

- found some purchase receipts or invoices from previous periods after a BAS was lodged
- made an error in coding the transactions
- subsequently received advice that a purchase was actually tax deductible but it was not included in a previous BAS
- coded a GST sale as taxable in the BAS but it was actually GST free.

For businesses that do not claim enough GST, the law now imposes a four year time limit for claiming refunds, which is counted down from when the error was made (specifically, from the due date of the BAS that covers the period when the error occurred).

An adjustment can be accounted for in the tax period in which the taxpayer becomes aware of the event — which is therefore generally the current BAS. This is in contrast to a mistake, where the correction needs to be made for the tax period when the error occurred by revising the BAS for that period. However, in certain instances the Tax Office allows for the correction of mistakes to occur in the current BAS.

GST credits can be claimed on any BAS when the requirements to make the claim are met. This means that credits not claimed, despite entitlements to do so, can be claimed on any future BAS (within the four year time limit).

Corrections that reduce GST payable

Corrections that reduce the GST payable may be made on the current BAS subject to correction amount limits defined with reference to the business's annual turnover (more below). Note that the four year time limit also applies to such corrections, as the taxpayer is effectively claiming a refund of GST, albeit GST overpaid.

Making such corrections however has been given a deadline, with a business's annual turnover determining the number of months it has to review for GST errors. The following table from the Tax Office sets out these restrictions:

Annual turnover	Time limit
Less than $20m	Up to 18 months (18 monthly activity statements, 6 quarterly activity statements or one annual GST return).
$20m or more	Up to three months (three monthly activity statements)

So basically, with turnover less than $20 million and transactions that occurred within 18 months of the end of the BAS period involved, a business can include an adjustment in the current BAS.

Another thing to remember is that the errors and omissions must not be more than the "net GST effect" set out by the Tax Office in the following table:

Annual turnover	Correction limits
Less than $20 million	Less than $5,000
$20 million to less than $100 million	Less than $10,000
$100 million to less than $500 million	Less than $25,000
$500 million to less than $1 billion	Less than $50,000
$1 billion and over	Less than $300,000

Note that "net GST effect" is the total of all mistakes being corrected on the BAS — it is not calculated on a "per mistake" or "per earlier BAS" basis. Where the net GST effect of the mistakes exceeds the correction limit, then the mistakes must be corrected by revising the original BAS.

Corrections that increase GST payable

Corrections that increase the GST payable can be made on the current BAS, subject to the limits on the timing of the correction together with the amount limits detailed in the previous tables. Again, where the mistakes fall outside of the time or correction limits, then the mistakes must be corrected by revising the original BAS.

It should also be noted that these rules apply to the correction of genuine and reasonable mistakes. The Tax Office has been known to disallow adjustments where the taxpayer is deliberately manipulating their calculations in order to reach a better tax outcome. ■

Changes in the SMSF landscape for 2013

Managing your retirement savings and controlling an investment portfolio are two responsibilities that are stressful enough without having to worry about the minefield of potential compliance mistakes that can be inadvertently made. Here we have compiled suggestions as to what self-managed superannuation funds (SMSFs) should look out for in 2013.

Remember the changes to the SMSF levy

The government will bring forward payment of the SMSF levy such that it is levied and collected in the same financial year. This will ensure consistency with APRA-regulated funds, which pay the superannuation supervisory levy in the same financial year it is levied. The change in the timing of the collection of the SMSF levy will be phased in over 2013-14 and 2014-15 to give SMSFs time to adjust. Also, the SMSF levy will increase from $191 to $259 per annum from July 1, 2013 onwards.

Adhere to rules on investing in collectables and personal use assets

SMSF trustees who purchased artwork and upmarket collectables – including paintings, jewellery, antique possessions, wines or spirits, postage stamps, rare coins and manuscripts among other assets – before July 1, 2011 have until July 1, 2016 to ensure they adhere to regulations which govern the circumstances described below:

- "related-party" transactions made by an SMSF where collectables and personal use assets are

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Changes in the SMSF landscape (cont)



leased to members of the SMSF, their partners, relatives and their respective partners, as well as trusts and companies, that are members of the fund are now outlawed

- an SMSF must not hold assets in the form of collectables and personal use assets in the private residence of a trustee or member of the fund
- the definition of "private residence" has been changed s that it now includes land used for private purposes and buildings on that land, such as garages and sheds
- buyers will have to have storage arranged before they add a collectable or personal use asset to their fund's holdings. A written record of the decision related to storage, and the arrangement of that storage, is mandatory and needs to be kept for 10 years
- negotiations for insurance for collectables and personal use assets should occur before purchase. Anything that is not insured within seven days will result in a breach of the new regulations
- collectables and personal use assets can only be transferred out of an SMSF at a value that is to be determined by a qualified independent valuer.

Review fund investment strategy

Effective from August 7, 2012, SMSF trustees are required to review their fund's investment strategy on a regular basis to ensure it continues to best serve the purposes of the fund and its members. Evidence of these reviews – such as meeting minutes and other documents – should be kept to show that these investment strategy reviews are carried out on a regular basis. The Tax Office also advises SMSF trustees to consider insurance as part of their fund's investment strategy.

Value the SMSF's assets at market value

As part of the same set of rules that became effective on August 7, 2012, SMSFs are required to value the fund's assets at market value for the purposes of preparing financial accounts and statements.

The first time you will need to value an SMSF asset at its market value is for the 2012-13 financial year accounts and statements, when you will need to determine the market value of the asset as of June 30, 2013. Consult this office on the valuation guidelines for SMSFs.

Separate your money and assets of the fund

Trustees have always had an obligation to keep the money and other assets of the SMSF separate from those held by them personally, but in the last suite of measures introduced on August 7, 2012, this requirement to separate these assets is now an operating standard.

This effectively means the Tax Office has the power to enforce compliance. A person who intentionally or recklessly contravenes the standard may have to pay a fine of up to $11,000, or this may result in an SMSF being declared non-compliant.

Take note of the new penalty regime

A new penalty regime – set to apply from July 1, 2013 – will give the Tax Office power to issue administrative penalties, rectification and "education" directions to individual trustees who contravene the rules governing SMSFs.

The exposure draft from the government made clear that any penalties imposed under the new administrative regime are payable personally by the person who committed the breach, and must not be paid or reimbursed from assets in the SMSF. ■

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