Investing Insurance Lending Tax Legal Wealth Creation

THE Wealth Brief

The Wealth Brief is brought to you by

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In this issue

Who buries the body - brother or mistress?

Question: My dear brother passed away over the Christmas period. He named me as the executor of his Will. Unfortunately, my brother has questionable taste in women. For the past 3 years he kept around a nasty de-facto girlfriend. Although she isn't named as the Executor (or in the Will at all), she told me to butt out of the funeral arrangements. His girlfriend says that my brother never talked about being buried and she thinks he should be cremated. However, our parents brought us up as Catholic – I know my brother wanted a burial. What is the legal position?

Answer: My condolences to you - this must be an intolerable situation. I do have good news for you though: As executor of the estate, this makes you your brother's legal personal representative. Therefore, you have the legal right to make the arrangements – regardless of what his girlfriend thinks or tells you.

However, this situation is avoidable had there been a written direction on disposing his body in the Will. Realistically, a reading of the Will is generally not made until the funeral or cremation occurs. So while it is necessary for a written direction to be made in the Will, it is also imperative that there is also an open discussion about a loved one's final wishes. A comprehensive approach to Estate Planning with your lawyer goes a long way in preventing these sort of issues at a difficult time.

So who arranges the burial?

The person entitled to custody and control of the body is the person who is able to determine (within the bounds of what is legally accepted) how the body is disposed. If the deceased left a Will then the Executors nominated in the Will hold legal custody and control of the deceased's body.

Some argue that in Australia an Executor is not given rights in the estate until Probate is granted. This is not a view endorsed by many lawyers. This is because probate is only required for certain types of property held by the deceased. Probate is not required to hold the funeral. In many cases, probate is not legally required or obtained. Finally, a lack of probate does not prevent the Executor from accepting the appointment. It does not prevent the Executor exercising powers that do not require probate. Such powers are exercisable from the moment of death.

These issues were looked at but not decided in Robertson -v- Pine Grove Memorial Park Ltd (unreported) SC (NSW), Waddell. CJ in Eq. 5 June 1986 (Eq 1956/86) and Justice Martin's decision in the Calma -v- Sesar (1992) 106 FLR 446 case. However, only a court of law can finally end this debate.

Can the girlfriend challenge his Will?

Yes she can challenge the Will. It doesn't matter who you are - all Wills can be challenged by certain people. Potential challengers can only come from 5 types of relationships:

1. Your parents
2. Your spouse (including de-facto partners)
3. Your children (adopted children but not children born from sperm or egg donation)
4. Your grandchildren
5. Anyone that you are 'maintaining' (but not in all States).

You said that your brother's Will did not mention his de-facto – this is fraught with danger.

At Brett Davies Lawyers, we encourage you to expressly name any unintended beneficiaries (for example, a de-facto girlfriend) in your Will. This shows the Court that you have not merely 'forgotten' that person. This is a 'considered person clause'. This does not stop them from challenging, but makes it harder for them to be successful.

I've heard stories where sneaky people stop challengers by giving them $1 dollar in the Will.

Can I do this too?

Sadly, you can't stop anyone from challenging your Will. I've heard these stories too – but they are only successful in overseas jurisdictions (such as the USA). In Australia, if the challenger falls within any of the five categories above, then they have a right to challenge. Nothing you can do can take away this right.

For example, you can't say:

- "I give my de-facto $1 and she cannot challenge my Will".
- "I give $20,000 to my partner, but if she challenges my Will then the gift is void." (known as the Lang Hancock clause because he tried to use this in his Will – obviously without success).
- "I give the whole of my estate to my partner, but if she remarries then this gift is void"
- "I give the whole of my estate to my partner on the basis that she remains Anglican and attends church every Sunday".

All of these are void for public policy reasons. You can't use your Will to force someone to do or not do something. This is called 'ruling from the grave'. The Supreme Court doesn't like you trying to oust their jurisdiction like that.

What is the silver lining? Just because someone can challenge your Will, doesn't mean that they are successful.

Brett Davies, lawcentral.com.au

Service Trusts - tax planning, tax avoidance or neither?

Question: I was discussing service trusts with some of my accountant buddies. We all agreed that they are fantastic for saving tax. What we couldn't agree on is whether they showed good tax planning, tax avoidance, or neither? Are they too risky to recommend to clients?

Answer: Service trusts often polarise people. You either love them or are scared of them. I personally love them. Why? Because I believe that properly structured service trusts are neither tax planning nor tax avoidance. By every definition they are (and must be) legitimate businesses. There's nothing wrong with you running a legitimate business – so there's nothing wrong in choosing to structure that legitimate business through a trust (also called a service trust, or service company).

I have been setting up service trusts for 22 years as a lawyer. Not one has ever failed an ATO audit. However, we see service trusts that fall foul all the time – but they're never ours. Who are the people that get caught?

1. greedy people
2. people who don't take the advice of their accountant
3. smug people
4. people that use 'mark ups'
5. people that don't run the service trust as a stand-alone legitimate business

Clients need careful guidance by their accountants. So, how do you make sure your client's service trusts are ATO compliant? We have 4 service trust lessons that we live by:

Lesson 1: Know why you have a service trust

Assume you get audited (everyone does, at some stage). The ATO shows up at your door. They ask why you set up your service trust. So why did you do it?

(a) I did it to save tax

(b) I did it for asset protection

(c) None of the above (I only answer questions when my accountant is present)

If you chose (a) or (b), you need help from your accountant. Run, don't walk.

Why is (a) wrong?

Repeat after me: Your service trust is not there to avoid tax. Etch this into your brain before reading any further. It helps you fight the urge to sing like a canary when the ATO start interrogating you.

But can't I legitimately structure my affairs to save tax? If the dominant purpose is to save tax, then no. Remember, there is a fine difference between tax planning (legal) and tax avoidance (illegal).

The Part IVA general anti-avoidance provision hovers over every action. (Part IVA is under review and is expected to get tougher). If a reasonable person in your position believes the service trust exists solely for the purpose of avoiding tax – then good luck avoiding jail time.

Why is (b) wrong?

Cleverly (or so you think), you are adamant that your service trust is not there to save tax – you set it up for asset protection. And you're a man of your word – you say the same thing wearing a suit in court (when the ATO is grilling you).

Later on, your business goes bust. Here lies the problem. You now can't plead in the insolvency court that your service trust was there to save tax. The ATO transcripts where you swear your service trust is there for asset protection reasons, don't make good reading in the bankruptcy courts.

Why is (c) correct?

Firstly, don't talk with the ATO unless your accountant is present. (If your accountant deems it necessary, we can be with you). It is rarely wise to cite tax savings or asset protection as a reason for doing anything. Legitimate and proper purposes for the service trusts include: Business Succession Planning, Estate Planning, keeping your businesses separate, family law (to keep your spouse happy) and modern business structures.

Lesson 2 - Set up your structures properly

The last thing you want to do is hand the ATO the ammunition to attack you. Poorly drafted or incorrectly implemented arrangements are the kiss of death.

So how do you set up a service trust?

1. Make sure the core business structure is up-to-date. Update trust deeds and the Constitution.
2. Set up the new service trust vehicle: family trust, unit trust, hybrid trust or company. You now have your service trust (or service company – quite rare). The service trust provides as many services as it can to the main business: this includes cleaning, secretarial, serviced offices, book-keeping, chattel leasing, property leases etc.
3. Build a Service Trust Agreement. It only takes 11 minutes. This is the 'glue' between the core business and the service trust. You need this so you don't offend our preciously delicate friends at the ATO.

What are the other secret benefits of a service trust?

1. Asset protection – you hold riskier assets in your service trust. Use them to create services to the professional entity for a fee – hello tax advantages. Plus, if your professional business goes bankrupt or gets sued, creditors can't usually touch your service trust.

2. Income splitting – The person or business getting paid to provide services can be different to the business receiving the services.

3. Challenges to Wills – Family Trust assets can't generally be challenged by children and parents (only your spouse, mistress and defacto).

4. Modern Business structures – if you have an old $2 shelf company, then you are subject to over regulation in the Corporations Act. Trusts generally are less regulated.

Lesson 3 – Charge commercial rates

Remember those naughty people we spoke about at the start who got caught. Chances are they are:

1. greedy and charging more than commercial rates

2. lazy and failing to make the service trust arms length

3. using 'mark ups' – no business I know (think bricklayer, car mechanic and brain surgeon) charge on mark-ups.

The mantra is:

"My service trust always acts as though it is arms length and a genuine business"

Your service trust can't be a sham or non-commercial. Forget about "mark-ups". A commercial business doesn't charge "mark-ups". It charges what the market can bear. It can only charge what the market would charge in a normal arms length transaction. Not sure of what the market will bear? Then get some quotes from other businesses in that industry. Is your service trust providing exceptional quality administrative services? Then you can charge more – but only if the market would charge this amount anyway.

Phillips case is the most telling High Court authority regarding service trusts. In a subsequent tax statement the Deputy Commissioner of Taxation stated (correctly in my view):

"There may have been widespread use of service trust arrangements which involved payments that were grossly excessive in relation to the benefit conferred by the service arrangement."

The Deputy Commissioner is correct. Service trusts are completely legal – as long as they are on valid commercial grounds. But what are valid commercial grounds?

Ask yourself these questions. Be honest to yourself (and your accountant):

1. In all honesty, are the service fees you charge grossly excessive or disproportionate to the benefits you provide?

2. Would an outside business pay you the same money for the same product or service?

3. Is the distinction between the service entity and the business blurred?

4. Does the service entity make profits without actually ever doing anything?

5. Do you fail to keep good records of your service trust dealings?

6. Is the service entity assured profits without there being any explanation?

7. Are services provided without any consideration of their value to the professional entity?

8. Is there an independent contractor's agreement (or Service Trust Agreement, as we call it)?

Wrong answers make the Commissioner of Tax angry.

Lesson 4: Get professional help

Invest in help from your accountant. Their knowledge is invaluable and saves you more than just money.

Brett Davies, lawcentral.com.au

Are you turning your back on credit cards?

Households in Australia are saying no to credit card debt and in doing so have wiped off more than 10% of the debt they owe on cards and have also cut back on the number of cards they own. In fact recent figures from ING Direct show that the average household has slashed off 14 per cent off credit card debt and reduced the number of cards they own from 2.1 in the third quarter to 1.9 cards in the fourth quarter of 2010.

Victorians led the credit card debt reduction charge closely followed by the New South Wales households, according to the financial well being index. But South Australia bucked the trend compared with the rest of Australia and increased its household credit card debt from the third to the fourth quarter of 2010 by a huge 151 per cent.

It seems that the unexpected interest rate rise last November gave consumers the jitters and resulted in this debt reduction.

As for the number of credit cards per household over the same period, all states saw a drop or maintained the same amount of credit cards per household. With New South Wales experiencing the biggest drop from 2.1 to 1.8 cards per household.

The result of all this has seen many households turn away from debt and increase savings. In fact the same survey has found that fifty five per cent of all Australians have changed their saving goals since the global financial crisis, with many households opting to pay more credit cards off faster and reduce mortgage debt quicker.

The GFC has done the trick and made the average Aussie household think more about its long term future and less about whipping out the plastic.

Copper…. the new Gold of base metals??

We've recently seen record highs for this, non precious metal making the everyday investor as well as the rest of the world take notice.

Copper has come into its own since last June when world markets started tumbling fearing sovereign default in the euro zone countries such as Greece. In fact it's gained a staggering 60% since then.

So what's caused this monumental rise?

This is due to a number of factors as pointed to by Dennis Gartman of The Gartman Letter, financial correspondents. Firstly stockpiles of Copper aren't excessive and that global economy is still for the better and not the worse.

Secondly, due to a little political and financial unrest around the world, including the Middle East and a few murmurings in the euro zone, the dollar is robust and means copper is expensive for other currencies.

Then throw in a little constrained supply and a recovery in demand has given Copper its strong rise.

This increase in demand has come from faster than expected demand from China, as recent HSBC figures have shown, from its manufacturing sector. Figures also show an acceleration in manufacturing in both the euro zone and the United States, which has recently expanded at its fastest pace in nearly seven years.

Because of this countries like China, who account for 40% of the worlds Copper use, will limit their purchases in this runaway prices environment. However this may have the effect of pushing Copper past the high of $10,000 per tonne and even as high as $12,000 per tonne.

So Copper, in the short term, could be the new gold of base metals for some investors.

8 Lessons from Arguably the World's Best Investor

Warren Buffett has to one of the worlds most successful and well-known investor who creates and maintains much of his wealth through share investment. But the principles he uses to invest also apply to property.

So what are they and how can we use them in our own property investment.

1. Stick to a proven strategy.

Often Warren Buffett's success has been put down to his patience and being very disciplined and never changing from his proven strategy, even when faced with huge short term changes in the market place.

Patience and disciple in a proven strategy are two key areas that the property investor must adhere to. Unfortunately it's a weak area for many investors who start without any plan in place for their financial future.

This lesson is taught over and over again to investors who didn't plan, such as the investor who buys off the plan next to the property hot spot only to see the value of the property underperform.

2. Invest Counter Cycically

Meaning the opposite to the rest of the masses or as Buffett puts it "be fearful when others are greedy and be greedy when others are fearful"

In the property market this means take up the opportunities in a fearful market, the value you can pick up now at lower prices will reward you when times are economically more favorable.

3. Occationally just do... Nothing

Warren Buffett summarizes this as "when there is nothing to do – do nothing"

There is a temptation by many in the property investment game to want to do more or change, or, buy more or sell for no good economic reason.

This isn't always the smart move in an investment journey. Sometimes you just have to sit back and wait until the right time in the cycle to take up new opportunities.

If you have the temptation to do this and add to your property portfolio, look for a market that you can do something in especially with the Australian market, there are always opportunities somewhere.

4. Specialise

Buffett has mainly focused his investments in a small number of companies, choosing to be a specialist and not to diversify.

Buffett fully understands what he is investing and doesn't gamble by investing in things he has little understanding of.

This is the same in property, become a specialist and replicate your success.

5. Invest for Value

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price". This is how Buffett invests and how you can make your money when you buy property. You should make your money when you buy property, but not by buying a bargin.

Lock in your profit at the beginning by buying the "right" property, one that will outperform the average in the long term. Its not about price, its about value.Successful investors know the difference.

6. Long Term Investing

Warren Buffett is the first to say that he doesn't know how short term markets will move and believes that many others don't know either. So he takes the long term view of markets.

Much wealth has been created out of property and most of it from successful investors taking the long term view. However this isn't a case of buy and forget, your portfolio needs to be regularly reviewed.

Are you getting the best rent, paying the right mortgage, do you need to refinance and use the funds from equity gain to purchase another property?

7. Understand what you Invest in

Warren Buffett never invests in anything that he doesn't understand and the same should go for the property investor.

8. Risk Management is Key

Property investors should fully understand the risks associated with their investment and need to manage it correctly.

Many others fail to do this and don't have financial buffers in place or lines of credit ready for unforeseen circumstances, like having no tenant for a period of time.

Another risk management tip is to always purchase property in the correct ownership, this will ensure tax minimization and provide asset protection. Always seek advise on this.