The four golden rules to avoid tripping on super

WILL HAMILTON

The purpose of superannuation — and this especially applies to self-managed super funds — is to build capital and invest it in assets that can provide a robust income stream in retirement.

On that basis, holiday homes, your collection of rare wine or other enjoyable assets are under the spotlight. There are four outstanding things you should not do — ever.

1 Don't ignore the sole purpose test — the catch-all provision.

The sole purpose test requires that a fund is maintained for the sole purpose of providing retirement benefits to its members, or to their dependants if a member dies before retirement. If you don't meet the sole purpose test your fund is not eligible for the tax concessions normally available to super funds.

Many common SMSF breaches involve falling foul of the sole purpose test. Examples include:

a) Lending to members or related-party transactions.

b) Making investment decisions that are more concerned with present benefits rather than retirement benefits. A key example is buying a holiday house in your SMSF because you think you will be able to use it rent-free. Put simply, you cannot do this as this, too, breaches the sole purpose test. Recently there was a case where a fund invested in student accommodation and rented the accommodation to three students, one of whom was the child of the fund member. Accordingly, the ATO determined the fund breached the sole purpose test and that the investment was also an in-house asset. The court supported that view.

c) Mixing business and DIY fund issues. Be careful to ensure that if you run a business, your SMSF accounts do not get caught up with your business accounts. Although it may be accidental, this is technically a breach of the sole purpose test.

2 Don't forget the in-house assets rules.

An in-house asset includes a loan to, or investment made in, a related party. This can include the following examples that trustees need to be aware of as the limit for in-house assets is a hard cap of 5 per cent of the fund's value (not the investment's value):

a) A lease or lease arrangement between the fund trustee and a related party.

b) An SMSF cannot operate a business. However, it may, in certain circumstances, invest in an entity that operates a business. It may invest up to the in-house limits amount of 5 per cent of the fund value without concern.

3 Don't invest in collectables for personal use.

Don't buy collectables in the fund, such as art, wine, rare books or coins and then either hang them on the wall at home or put them in your garage. All collectables must be appropriately insured and stored offsite. Hanging art owned by your SMSF on the lounge room wall or keeping that classic car in the downstairs garage fail the sole purpose test as you receive a benefit from them now, even if it is just looking at them.

4 Don't contradict the fund's investment strategy.

And, yes, it needs to be in writing. Thinking of the previous point, if your strategy doesn't foresee investment in collectables then you can't invest in collectables. Your investment strategy determines the investments and how much the fund can invest. If it doesn't foresee the particular investment (which is a generally allowable super investment) you will need to review and alter the investment strategy accordingly.

As a member — and therefore a trustee — of an SMSF you have an obligation to ensure you operate your SMSF correctly. Be as aware of what you can't, as well as what you can, do.

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Tears, fears and estate planning

MY WAY

Anna Hacker is Australian Unity Trustees' director of estate planning. For a decade, she's been helping investors decide what to do with their money from the great beyond. More recently she has been immersed in some surprising situations reflecting the popularity of social media, not to mention cryptocurrency

RICHARD FERGUSON

STUART McEVOY

Australian Unity's Anna Hacker says 'people are talking about their social media accounts as a possession'

Most people either find estate planning really dry or really scary. How do you deal with that?

You have to learn to almost be like a therapist because clients can have such varied reactions. Some people are very disinterested and they see it as a dry, procedural matter. But I've had to deal with situations where people think someone in their family is going to challenge the will, or they need to provide for a child with a disability or an addiction. And there are some clients who you can't even discuss death with for cultural reasons, you just can't bring the word up. Those are tough conversations to have. We always have tissues in the room.

At what age should readers start thinking about their estate planning?

I always say it is a great 18th birthday present (laughs). You should start thinking about this as soon as you have any assets of significance and that can be really early.

Is it true that wills don't matter any more and it's all about superannuation these days?

I think that's an overestimation of the value of super. The family home, though, will be out of super, for example, and that's a pretty big asset. But the bulk of a person's wealth otherwise will be their super once they pass away and it's very important in estate planning.

What percentage of your clients have family trusts?

Probably a quarter, maybe up to a third, of our clients have family trusts and it's usually because they have their own business or more significant wealth. But we find 95 per cent of our clients choose a testamentary trust; it is the only way to ensure you get tax minimisation, asset protection and more flexibility than family trusts.

Has the introduction of same-sex marriage shaken up estate planning much?

There has been a slight change in that we just have to say to same-sex couples: "You need to think about what you do if you get married." Because if they get married, or divorced, then their previous estate planning documents may become invalid. We haven't been calling gay couples saying "remember about your estate documents" (laughs) but it is something we will have to talk about more with them because it just wasn't on the table before.

How about this brave new world of social media?

The biggest change is that people are talking about their social media accounts as a possession more than their old photo albums. They want to make sure someone has access, or, as is more the case, someone doesn't have access to their Facebook account when they die.

Tell me one big change in this area I should know?

Cryptocurrency is the big one. There's so much complexity in having assets that are ... where are they? (laughs) We're used to dealing with movables like a bank account or an immovable like a house. But where is cryptocurrency? Where is the registered office for it?

So is it a question of "where will my bitcoin go when I die"?

I'd love to say there's an easy solution but we're going to need the digital space to deal with protecting wallet details but still having enough protection so it can only be accessed when someone dies or loses capacity. There might also need to be more government involvement.

We usually ask about people's personal investments at this point but I have to ask ... what is your estate plan?

> That's what I see estate planning as: a prevention of later problems when someone loses that capacity so their wishes don't get abused

I've had a will for a long time and I've made sure my husband has one too (laughs). I realised early on I couldn't tell my clients to get a will if I didn't have one. I also made sure my parents got theirs done in case they lose their capacity. We've put structures in to protect assets and, most importantly, we've thought about the guardianship of our kids. But you can get caught up in the "what ifs".

How did you get involved in estate planning?

I was training to be a lawyer and I was really interested in human rights, and I took a particular interest in elder abuse. And that's what I see estate planning as: a prevention of later problems when someone loses that capacity so their wishes don't get abused.

What do you say to someone who's looking at embarking on a financial or legal career and thinks estate planning might be a bit dour?

It's so much more than writing wills and powers of attorney. You're dealing with family dynamics, personal crises and sometimes you are told people's deepest, darkest secrets.

You also really need that financial know-how to deal with tax implications and investments. It's a great combination for someone who's interested in both people and finance. But it's not for the faint-hearted.

Don't believe it can't happen here: soaring household debt points to looming mortgage crisis

ROGER MONTGOMERY

There is always one theme common to the vast number of crises the world has experienced; excessive debt accumulation.

Irrespective of whether it is by the government, banks, businesses or consumers, this accumulation of debt almost always poses greater systemic risk than it seems during the boom.

It makes banks seem far more stable and profitable than they are, while the injection of cash makes the growth that results look more sustainable than it really is.

Borrowing binges that precede a crisis are, however, often dismissed or explained away by policymakers and commentators.

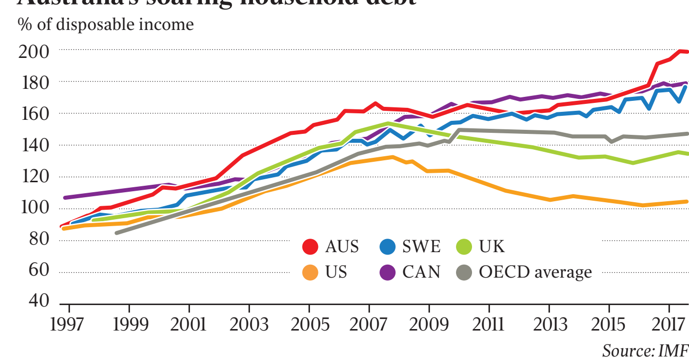
For example, in 2005 Ben Bernanke — who was later to become chairman of the US Federal Reserve — famously described the borrowing binge in the US as a product of a "global savings glut" with overseas capital finding the safest home in the hands of US borrowers.

More recently, highly respected AMP economist Shane Oliver reflected what many believe regarding Australia's record household debt-to-income ratio, noting; "Debt is a stock which is arguably best measured against the stock of assets or wealth [rather than income]", adding, "On this front, the rise in the stock of debt levels has been matched by a rise in total household wealth in Australia. Thanks to a surge in the value of houses and a rise in financial wealth, we are far richer."

Prior to the GFC, US policymakers were equally sanguine about the fact that the rise in asset prices was being fuelled by a relentless increase in the ratio of household debt to GDP. This ratio had been stable at 80 per cent of personal income until 1993 before jumping to 120 per cent in 2003 and 130 per cent in 2006. In Australia today, household debt to GDP is rising inexorably too.

Australia's soaring household debt

% of disposable income



According to Reinhart and Rogoff, authors of *This Time is Different*, empirical work conducted by Bordo and Jeanne (2002) and the Bank of International Settlements (2005) confirms that when housing booms are accompanied by sharp rises in debt, the risk of crisis is significantly elevated.

In the 1970s Australia's household debt was just 42 per cent of household disposable income. Today, it is near the highest in the developed world, and approaching 200 per cent. As a warning to those who suggest rising asset values provides protection against large debt burdens, Warren Buffet once noted, "It's not debt per se that overwhelms an individual, corporation or country. Rather it is a continuous increase in debt in relation to income that causes trouble." This is precisely what we have in Australia.

How the household debt picture resolves itself has significance for the Australian economy. One way or another the debt will be reduced. The smooth option is a stable economy and financial system that allows the debt to be gradually paid down. One version of this scenario provides for rising salaries to accelerate the repayment of debt. A less desirable outcome sees no increase to income, but rather, an erosion of savings eventually forcing consumption cuts too. Keep in mind, our troubled retail sector is the second largest employer in the country.

Finally, a much more volatile outcome adds rising interest rates, which adversely impact household balance sheets and budgets, producing negative equity, and returning heavy debt burdens to their rightful place in history ... that is, as a cause of a full-blown crisis.

As AMP's Oliver points out, Australia's household debt levels have indeed been matched by a rise in total household wealth, thanks to surging house and stockmarket prices over recent years. But if house prices have been fuelled by rapidly accumulated debt, can high house prices be sustained, and can investors take comfort?

In the US, lax lending standards prior to the GFC saw large loans provided to borrowers with no income, no job and no assets (NINJA and subprime borrowers). These individuals inevitably defaulted but, according to relatively recent research, they were not the sole cause of the financial crisis. In other words, the absence of a subprime cohort of borrowers does not preclude Australia from a housing and/or financial crisis.

Back in 2015, a US study by Wharton economists Fernando Ferreira and Joseph Gyourko, entitled *A New Look at the US Foreclosure Crisis,* revealed that the sole cause of the crisis was not the issuing of loans, by institutions such as Countrywide, to borrowers that could never repay.

Rather, the study reveals the crisis would have occurred even without home loans being granted to, for example, itinerant strawberry pickers. Importantly, they note that "traditional mortgage default factors associated with the economic cycle, such as negative equity, completely account for the foreclosure propensity of prime borrowers relative to all-cash owners", and add "race, initial income, and speculators did not play a meaningful role".

In Australia, despite a few anecdotes of "liar loans" and the falsification of incomes or expenses on mortgage applications, the vast majority of lending is likewise concentrated among prime borrowers, who I assume are equally exposed to normal default factors such as negative equity.

And with much of the lending policy reforms in Australia mimicking those in the US, and centred around increased scrutiny of mortgage lending practices, it appears Australia may be just as vulnerable.

Despite the RBA's reassurance as recently as last Wednesday that bank lending practice changes have taken the heat out of the market — and APRA's interventions — real estate, and the economy more broadly, are still at risk from rising apartment supply and declining auction clearance rates.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

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