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The ins and outs of a Binding Financial Agreement

Relationships can be fickle, especially when it comes to finances. One option that couples may consider when protecting their own assets upon separation is a Binding Financial Agreement (BFA).

A Binding Financial Agreement is the Australian equivalent of a prenup. It is used to agree in advance on how a couple's property and other assets would be distributed should their marriage or de facto relationship break down. The Agreement can cover financial settlement, spousal maintenance and any other incidental issues.

One of the drawcards of a Binding Financial Agreement is that it can be entered into at any stage of a relationship, i.e., before, during or after a marriage or de facto relationship.

Couples may consider entering into a BFA if one party has more property, assets or is expected to receive an inheritance at a later stage. They can also be used to preserve family or other businesses for future generations.

Properly drafted and executed BFA's are particularly beneficial for those who want to establish a level of reassurance that there would be a harmonious division of property and assets in the circumstance of separation or divorce without the need for stressful court action.

A BFA can also make both parties feel secure knowing that any property or assets accumulated before their relationship or marriage is safe.

However, couples should be aware of the limitations and risks involved with BFA's. The drafting of an Agreement can result in costly legal fees and the content may be complicated.

Couples also need to ensure that the Agreement is in fact binding. Both parties must sign the Agreement and receive independent legal and financial advice before doing so.

It is also worthwhile to evaluate the potential effects of the Agreement on the relationship, especially if it is considered unfair to one half of the couple.

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ATO to commence sending ETB Determinations

From January 2018, the Australian Tax Office (ATO) will be sending Excess Transfer Balance (ETB) Determinations to those SMSF members who have exceeded the transfer balance cap and have not rectified the excess.

SMSF members are reminded by the ATO if they receive an ETB Determination:

- If the SMSF trustee has not already reported information to the ATO for the member then they must do so as soon as possible. A member can request an extension of time if needed.
- A member will pay less excess transfer balance tax the sooner the member removes the amount set out in the ETB Determination out of retirement phase.
- The amount set out in the ETB Determination must be commuted from retirement phase. Removing it by making a large pension payment will not result in a debit in their transfer balance account, so they will still be in excess of their transfer balance cap.
- They do not need to remove the amount set out in the ETB Determination unless they are commuting a death benefit income stream. The excess can be kept in an accumulation phase account.
- The trustee must ensure that the minimum pension payment standards are met at the time they commute the income stream.

Pitfalls of going guarantor

Going guarantor might not seem like a big commitment at first - there' are no upfront costs, minimal time commitments and you are lending a helping hand. But beyond signing on the dotted lines, there are many pitfalls of going guarantor for a loved one.

Whether you have been asked to go guarantor for a car or home loan, it would be wise to carefully consider the following:

Unintended consequences

Guarantors must understand the responsibilities and repercussions of signing off as guarantor. If the borrower defaults on the loan, you will be liable for their debt as the guarantor. This can subject guarantors to a plethora of issues including a poor credit rating - making it difficult to receive credit for years, making repayments for the borrower and so on. Caution must be exerted when signing guarantees as open-ended guarantees may leave the guarantor exposed to more debt than initially understood.

Change of circumstances

Before going guarantor, take into account the implications that could arise if there is a change in circumstances, i.e., a relationship breakdown between yourself (guarantor) and the borrower, the borrower becomes divorced, your financial status is affected by unexpected health care costs or your business takes a plunge. Seek independent legal advice before signing as guarantor to ensure you thoroughly understand your obligations and risks.

Alternatives

Although you may feel obliged to go guarantor, especially for close family members, it is not always the most feasible or favourable financial option. Consider alternative ways of providing financial support such as contributing to a deposit instead or providing a limited guarantee to only secure part of the loan.

Changes to SMSF reporting

The Australian Taxation Office (ATO) has introduced new regulations for event-based reporting for self-managed super funds (SMSFs).

Currently, SMSF members use the SMSF Annual Return (SAR) form for reporting, which will change as of 1 July 2018 to the super Transfer Balance Account Report (TBAR) form. The TBAR allows the ATO to track and record balances on individuals' transfer balance caps and their total superannuation balance.

Before 1 July 2018, SMSF members will need to prepare detailed documentation for all income stream valuations and decisions for the 2017-18 financial year.

SMSF members need to report specific events to be compliant, including:

- income streams a member was receiving on 30 June 2017 that continued to be paid on or after 1 July 2017, and are in retirement phase
- personal injury contributions
- new retirement phase income streams, and commutation of retirement phase income streams
- limited recourse borrowing arrangement payments
- compliance with a Commissioner issued commutation authority.

SMSF members need not report:

- investment earnings and losses, or pension payments
- death of a member
- cessation of income stream due to interest exhaustion
- information already reported directly to the ATO, i.e., debit events, family law payment split, etc.

What to consider before signing a contract

When it comes to contracts, it is often the devil in the detail that can make the difference between a harmonious partnership and a costly legal battle.

All contracts must contain certain basic elements to be considered valid. Despite this, it can be quite easy to ignore or underestimate the importance of filling out these details correctly.

To avoid being one step away from a court battle, those entering a contract need to establish two key elements; who the parties are to the agreement, and who gets what and for how much.

Knowing and understanding who you enter into a contract with is crucial, because if a partnership turns hostile, you may not have a claim against who you think you do.

For example, when the individual Bob White entered a contract with LBD Pty Ltd, he identified himself as Bob White, Trustee of LBD Trust. When the partnership turned sour and LBD Pty Ltd wanted to sue Bob White, they had two choices: to sue Bob White, or to sue Bob White, Trustee of LBD Trust.

If LBD Pty Ltd sued the individual Bob White, it could enforce any judgment against Bob's personal assets. However, if LBD Pty Ltd sued Bob White, Trustee of LBD Trust, the judgment would be limited to the LBD Trust's assets.

This example highlights the importance of knowing the exact identity of the individual or business you enter a contract with.

For a contract to exist, something of value needs to be exchanged, with the terms surrounding the exchange usually forming the bulk of most contracts. However, since even the simplest of clauses can be open to interpretation, quite a bit of time may be spent trying to untangle who is supposed to get what. To avoid wasting time, businesses need to ensure that there is no misunderstanding between the parties prior to signing the contract about the terms of the contract.

Since simple misunderstandings about the terms of a contract can potentially expose those involved to a claim for damages, it is important to ensure that the terms of the agreement are suitable to you and that you have the correct understanding of those terms before signing a contract. Regularly checking all parties are cooperating once the contract is signed is also critical.

Questions to consider concerning power of attorneys

Appointing a power of attorney is something individuals do when, for various reasons, they are not in a position to control their own finances.

Allowing another individual legal authority over your finances can be daunting, particularly if you don't understand the ins and outs of what a power of attorney's role is. Below are a range of questions to consider when evaluating and nominating a power of attorney:

What power or control does a power of attorney have?

Essentially, a power of attorney is granted the legal authority to look after an individual's finances on behalf of that individual.

When would I need a power of attorney?

You may consider a power of attorney useful for a number of reasons or circumstances, including but not limited to:

- As a personal preference for those individuals who do not want the responsibility of managing their own finances and wish to leave it in the hands of a professional.
- For those who are partaking in an extended overseas trip and who choose to have someone make legally binding decisions on their behalf in their absence from the country.
- For those who come to a time in their life where they no longer have the mental capacity to take control over their own finances, i.e., elderly individuals who lose their independence.

How do I pick a power of attorney?

Once you have decided you are going to appoint a power of attorney, you will need to decide on who to appoint. While you can appoint an individual who does not have legal qualifications, you should ensure the individual you select possesses a number of traits, especially considering your finances are in their hands. These traits include:

- Trustworthiness: above all other qualities your power of attorney possesses, trustworthiness is the most important. You need to have faith in their ability to serve you and your best interests at all times.
- Neutral: you need to trust that they are working from a position of what is the most desirable option for you, not for anyone else. Your power of attorney should be someone who, if they are a relative, can remain neutral and keep their interests out of the equation.
- Understanding of your medical wishes: if the power of attorney is looking after the finances of an individual who is elderly or terminally/chronically ill, they should have a sound understanding of their client's wishes in regards to their treatment, as well as likely outcomes of specific surgeries and treatment options.
- Assertiveness: your power of attorney needs to be an individual who you are confident can carry out your wishes regardless of the resistance they may receive from possibly disgruntled immediate or distant family members.

I think someone I know needs to appoint a power of attorney, what do I do?

If you think it would be advantageous for someone you know, such as your spouse, parents or another family member, to consider appointing a power of attorney, you can contact your financial adviser to discuss the best way to go about doing so and the various options available.

Common myths surrounding inheritance

While receiving money from a family member who has passed away can sometimes be quite handy for those facing cash-flow issues, managing an inheritance is often emotionally and financially challenging.

Not only do individuals have to cope with the grief of losing a loved one they also face making crucial decisions when it comes to the deceased's finances, which can have lasting tax implications for the future.

Here are three common inheritance myths:

The family home is CGT-free

Principal places of residence are usually free of capital gains tax (CGT), but a principal place of residence can be subject to CGT when a beneficiary inherits it. The way homes are treated depend on whether they were purchased before or after September 20, 1985. If a deceased's house was purchased before September 1985 and is sold within two years of the date of the owner's death, then it is CGT free. If the home is sold after this time, then it is subject to CGT. The only exception to this rule is if the inheriting beneficiary used the home as their principal place of residence, which would incur no CGT.

A Will cannot be changed

A person with the capacity can make as many changes as they want to their Will to create a document that fulfills their wishes. But once a person loses their capacity and their Will is not changed, things can become quite complicated. In cases like these, it is the responsibility of the executor of the Will to ensure the document is valid, binding and is the last official Will of the deceased. Even though it can cost money to make changes to a Will, it is certainly worthwhile in the long run to get it right.

Beneficiaries receive the cash equivalent of any gifts

Those who are set to receive an asset (e.g. the family home) that is sold before their parents pass away are not entitled to the cash equivalent if the parent's Will has not been changed. It is quite common for a person to sell their home to enable them to move into aged care, but problems can arise when homeowners die and the proceeds of their house are divided according to the estate. Unfortunately, the general principle is that if a particular gift has been made to a beneficiary but the gifted asset is not owned at the time of death, then that gift fails.

Commercial vs residential property

The debate over whether it is better to invest in residential or commercial property continues to divide property investors and real estate professionals. Some favour residential, since it is the least risky of the two, while others say that commercial is the safer option thanks to its cash flow potential.

Choosing which one to invest in can be tricky, however, smart investors should not only consider the advantages and disadvantages of each property type but also how each investment would fit their current portfolio.

Commercial advantages

Higher returns on investment: The average rental return for residential property in Australia's capital cities is around 3.6 per cent. For commercial property, it is not unusual to get anywhere between 8 per cent and 12 per cent.

Longer leases: Normal residential tenancy turns over every six to 12 months, whereas a standard commercial tenancy can last anywhere between three to 10 years.

No rates and other outgoings: Landlords of residential properties are liable for paying rates, such as council and water, whereas commercial tenants pay these outgoings for the owner.

Commercial disadvantages

Property is sensitive to the economy: In a strong economy, businesses flourish and the demand for commercial property usually rises. In an economic downturn, this demand usually decreases.

It takes longer to find a tenant: It is not uncommon, unfortunately for commercial properties to have long vacancies and landlords have to cover all costs during these periods.

Property value can drop sharply: The value of commercial properties closely correlates with the lease on the property. If a commercial property becomes vacant, or the lease is about to expire, the value of the property would generally be expected to fall.

Residential advantages

Taxation: Considerable tax advantages exist for those who own residential property, e.g., those who own a property for more than 12 months can apply the 50 per cent capital gain discount when they sell.

Capital growth: Since the bank provides most of the funds to purchase residential property, you have considerable leverage and your capital growth returns can be substantial.

Vacancy rates: The vacancy rates for finding tenants for residential property are generally much lower than commercial property rates,

meaning you will have a more steady source of income.

Residential disadvantages

Costs: The costs associated with buying and selling are quite high for residential property. Stamp duty, mortgage registration and agent costs all need to be taken into account.

Rising interest rates: Increases to interest rates will increase your repayments and decrease your disposable income.

Locality risk: Buying in the wrong area or location is a serious risk for residential property. Wrong location can significantly affect an investor's return over the long term.

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