ROB BALANDA

ASSET PROTECTION:

A Guide for all Australians

THE 10 COMMANDMENTS YOU NEED TO FOLLOW

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LAWYERS

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There is no substitute for proper advice.

About the Author

Rob Balanda is a partner of McDonald Balanda & Associates, a four partner medium size legal firm based on the Gold Coast, Queensland. He practices principally in Business Law, Property Law and Body Corporate Law.

He has prepared these notes as a resource and educational work to assist all Australians better understand asset protection.

Rob has produced a number of resource and educational works including:

Clauses Made Simple	Book
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Introduction

Any Australian who has any assets is at risk of being sued by someone just looking to have a go. People involved in a business, profession or service industry have long lived with the fear of being sued by a greedy client or consumer, but now that concern is shared by many more Australians.

There's always the thought that because of your financial misadventure, your business might fail and you'll be forced to sell your family home to pay your debts.

Adding further to this widespread risk is the fact now that lawyers openly advertise "No win, no fee" arrangements. The risk is, of course, that you'll lose your assets because of a successful lawsuit against you personally.

You might think "This will never happen to me." Most people think that – until it happens.

Picture yourself in some of the following scenarios. What happens, for example, if a burglar enters your business at night and falls over your dilapidated balcony at the back of the premises where customers never go? Or maybe you're a middle-aged male who has finally had it up to the ears with your 16-year-old female employee and, after going through the whole three-notice process, you terminate her employment, only to find she brings a claim against you the following month in the Anti-Discrimination Tribunal for sexual harassment. Your insurance won't cover you there.

Perhaps you're just having a garage sale at home one Sunday, it starts to rain as someone walks up your drive. They slip and fall and break their leg. Oh no!

Or perhaps you're just filling in as a nominee director in your son's company following his divorce from his wife (his company needs two directors); he's taken his eye off the ball because of the divorce and 12 months later you get a visit from the Australian Taxation Office advising that the employees' taxes haven't been paid. Your son is looking at going bankrupt and you're now responsible for paying these taxes because you're a director.

Every week we read stories such as these in the newspaper. So why do we all think, "It will never happen to me?" Let me tell you, it can happen to you at any time!

And don't automatically assume that your insurance policy will cover you. We've all heard of situations where insurance companies won't honour the claim in these circumstances, and wrangle out of the obligation to do so over some minor technicality.

“Oh well, if all else fails I guess I can go bankrupt and start again,” you might think. “After all, Bondy did it." Think again.

Going bankrupt is no fun at all and not what you would call a glamorous experience. You’ll have to give up almost everything you own and your life could be put on hold for up to five years.

What can you do about it?

There’s plenty that can be done to protect your assets. But it has to be done before trouble begins, when all is quiet on the home front and there are no dark clouds looming. The thrust of asset protection strategies is to protect your assets by putting shields between your personal assets and your investments and business affairs to reduce any personal liability that you may have, to the extent legally possible.

There are pitfalls to be avoided and there are often trade-offs. For example, you might have to pay a bit of stamp duty and perhaps the asset will become liable for capital gains tax.

There’s plenty that can be done to protect your assets. But it has to be done before trouble begins, when all is quiet on the home front and there are no dark clouds looming.

Most of the strategies involve a balance between ownership of assets versus having control over them, but they’re well worth the effort. After all, what’s the point of working hard, becoming the best investor you can and then having these assets taken away from you by someone who is “having a go?”

Understand, too, that the process of structuring your assets should be a constant one and not just something you do on an ad hoc basis to ensure you minimise your exposure to the risk of losing your assets.

Who needs asset protection?

The threat of litigation is real for everyone who has any net worth. You need to quarantine your personal wealth from life and business risks.

The ideal position is to have no assets in your personal name and to have all of your assets owned by companies/trust structures, which you control. You become the ultimate beneficiary of the company/trust structures, but this doesn’t give you a fixed interest in them which can be attacked by predators. Consider for a moment how such a person operates.

Anyone looking to take court action against you would go to their solicitor who would make the usual enquiries at the Titles Office, Business Name Registry and Corporate Affairs Office to see if you own any properties or assets in your own name. The first barrier protecting your assets has now appeared. The solicitor will tell their client that the searches show that you have no real estate holdings and will ask them if they're aware whether that person has any other assets. The solicitor might say "Look, I'd like to help you, but how are you going to pay my fees for taking court action against this man? It looks like there's no point in chasing him because we can't be satisfied that he's got any assets."

They might probe some more and return to the solicitor with the address of the house in which the person they want to sue is living. The solicitor will do a search on that property and will find that a company acting as trustee for a family trust owns it. Up jumps another barrier. Their action is against the individual and not the trust.

Trading in your personal name or in partnership offers no such asset protection. Operating in a plain company without a trust underneath it doesn't give you much protection either, as a person is usually the shareholder in that company, so these shares are an asset that can be taken if you're successfully sued.

However, there is a stumbling block to this strategy. Most of us need to have at least one asset in a personal name for a number of reasons:

1. Immediate saving of no or minimal stamp duty that applies where a property has been purchased as your principal place of residence;
2. No capital gains from the increase in value of your property because a home in your personal name is capital gains tax (CGT) free. A family home owned by a trust is not exempt from CGT.

Having the family home in your name

Despite the compelling reasons noted above to buy one property in your personal name, Australians are often still anxious that they haven't protected their major asset – the family home – because it's still in their personal name. To alleviate this concern the property can be transferred to a company acting as trustee for a family trust. But people usually shun this strategy because of the loss of tax concessions from the state and federal governments and this strategy also usually attracts a large stamp duty bill.

Here are a couple of alternative strategies that can be adopted if you find yourself in this position:

Mortgage to your trust

Acquire the family home in your personal name but with a mortgage in favour of a trust controlled by you. What occurs here is that a discretionary trust borrows money to finance the purchase of your family home and then lends that money to you personally to finance the purchase. The property is acquired in your own name personally but with a mortgage over it in favour of the trust for the amount of the purchase price. As time goes on the trust loan from the bank is repaid but the loan from the trust to you stays in place. This strategy asset protects the original purchase price of the house, but as time goes on the increase in the value of the property creates an ever-growing equity in your personal name, however it's a strategy that should be considered. You might ask where the money comes from to pay off the loan by the trust from the bank. Usually the owner of the home makes gifts to the trust over time to pay off this loan.

Lease to a related trust

This strategy involves giving a lease over your home to a tenant, which will be a trust controlled by you. This will be a long-term lease running for years and should be registered over the property. Anyone undertaking a search on the property will uncover it and it will, on the face of it, make a sale of the property by your creditor an unattractive proposal. Why would someone buy such a property from your creditor when it has a lease running for years at a low rental?

Consideration could be given to coupling this strategy with the grant of an option to buy the property in favour of the trust for a price equal to the amount of the loan over the property. The benefit then of any increase in the value of the property over the amount of the loan, if the option was exercised, will flow through to the trust rather than fall into the hands of a creditor selling the property.

Contractual wills

This is a strategy that appeals to some people because it doesn't involve the payment of stamp duty or CGT (it doesn't involve the transfer of a property). A simple version of this arrangement is as follows:

You enter into a contract with your spouse or one or more of your children that in the event of your death you will leave them your interest in the property. This arguably creates for them an interest in the property, which arguably overrides and is greater than the interest of the creditor seeking to sell the property. Your relative will claim that the property belongs to them because you've contracted to leave it to them in your will and hopefully this defeats the creditor's claim.

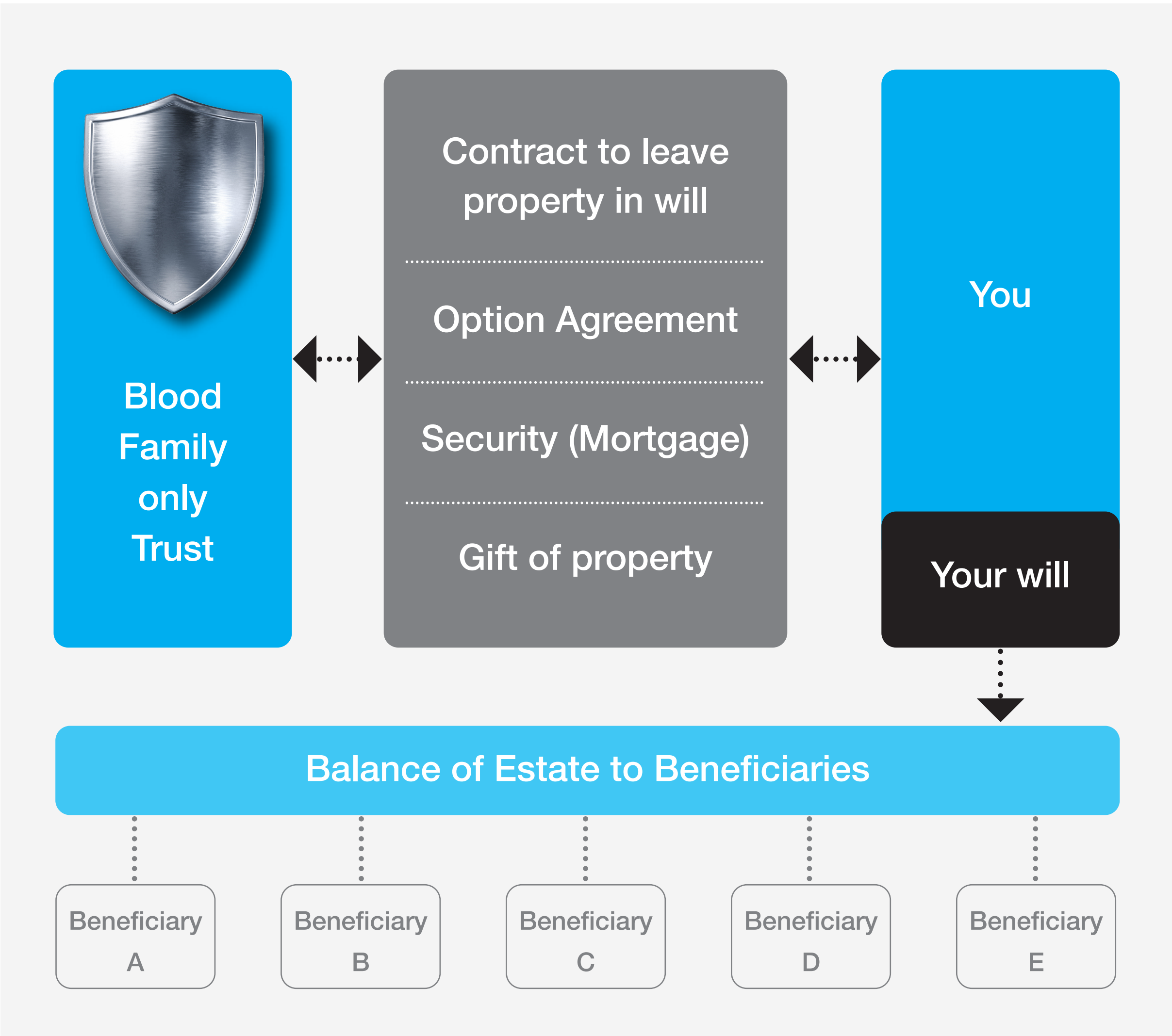
But there are a number of downsides with this strategy. Firstly, the fact still remains that as the property is in your name, a creditor or greedy litigant still may make a claim and you may be left to fight an expensive court action defending their claim (with no certainty of the outcome). The chances of a litigant proceeding with action are much less where the property is held by a trust. Secondly, what if you fall out with your children or your spouse? They still have the contract with you to leave the property to them in your will.

Another more complicated arrangement is where you enter into a contract to leave the home in your will to a Blood Family Trust (this is where the only beneficiaries are 'blood members' of your family). This trust is established and, as extra security that you will honour your contract, you also enter into an option agreement with that trust, giving it the right to acquire the property from you if you don't eventually leave it to them in your will (with a mortgage as security) for $1. Your will then leaves that asset in your will to the discretionary Blood Family Trust to complete the transaction.

This strategy isn't simple, but it's worth considering if you want to put a barrier in the way of others looking to have a go at you and quarantine one major or expensive asset. Its big benefits are that there's no CGT, GST, or stamp duty payable, and all it would cost is the preparation of documentation.

Here's a snapshot of how this all looks:

Figure 1. Contractual Will



Before we look at asset protection strategies in more detail, it's important to understand that there isn't a case of 'one size fits all'.

Decisions about what structure to hold a property in have long-term financial implications. It's important to get this right from the beginning – typically at the time an asset is acquired – as transferring assets can incur substantial costs (stamp duty etc.). Also, the best structure for one person may not be the best for another. For example, a person at high risk of litigation (say, a medical specialist) may favour ownership structures which maximise asset protection, even if such structures incur costs such as loss of tax benefits, stamp duty concessions etc.

Someone with a lower litigation risk may prioritise things differently, and thereby use different techniques and strategies.

The general issue of protecting your assets in a tax-efficient manner is a complex area of law and taxation. The optimum solution varies greatly and is quite specific to an individual's own unique circumstances, priorities and goals. Therefore, it's vital to seek professional advice about your own particular circumstances before making any decisions.

Finally, you should understand that there are three situations where these strategies generally don't work. They are:

1. The Australian Taxation Office (ATO). Whatever your structure at the end of the day, the ATO requires you to pay your fair share of tax as the controller of it.
2. You can't 'asset protect' against your lender as they will almost always require you to provide personal guarantees, whereby you personally guarantee, whatever structure you use, that the loan will be repaid.
3. Finally, these strategies aren't effective against your spouse as the Family Court will look behind all of these structures and regard any interest that you have in them as a 'matrimonial asset'. It will take this into account when dividing up your other assets. So for heaven's sake, love your spouse because no one will protect you from them!

Let's take a closer look at the '10 commandments of asset protection'...

Commandment 1

Own nothing, but control everything

This essentially means that any assets that you own or any business that you run should be in a company/trust structure. It should be a company in which the risk-taker in the relationship is the sole director and shareholder in that company. That company then acts as trustee for a family trust in which neither of you have a fixed interest which can be attacked and taken from you following a successful court action.

So aim to own your property and other assets in the name of company/trust structures and own nothing, or as little as possible, in your own personal name.

Commandment 2

Hold a one per cent interest

If you must have a property, say your home, in your own name and you're married or have a life partner, then place that property in the name of the person who has the least risk of being sued.

But is the other person protected in case of a divorce or parting of ways? In the case of a married couple, they certainly are. *The Family Law Act* and the Family Court will protect them as it regards all assets owned by either of the parties or the companies/trusts controlled by them as being 'matrimonial assets' to be divided up between the parties at the breakdown of the relationship.

But what if you've already been through this and had to go through lengthy, expensive court action to enforce these rights through the Family Court? If you've been burnt, you can protect yourself simply by transferring or buying 99 per cent of the property in the name of the risk averse person with the other person (risk-taker) holding one per cent of the property. The major owner of the property therefore can do nothing to mortgage or dispose of it without your written agreement. Your one per cent interest will protect you.

Should I now transfer my assets, business and properties to a company/trust structure?

There will usually be substantial stamp duty and legal costs involved in transferring a property now and also the possibility that it may trigger the payment of land tax and incur a CGT liability. GST may also be payable or the timing may be wrong (you need to hold the property for another six months to qualify for CGT concession.) Each case needs to be considered on its merits and the costs involved may not justify you taking steps now. In many cases it may simply be a case of being aware of these risks. When you move forward then into the future and you sell that home, buy your next home in the sole name of the risk averse person, or likewise, when you buy your next investment property, buy it in the name of a family trust. Have a strategy of avoiding the acquisition of new assets personally and buying them instead in low-risk entities.

Someone is threatening to sue me now; should I transfer all my assets out of my name?

Unfortunately once the dark cloud of litigation starts looming then you're at risk. It's always too late. More will be said about this later.

Commandment 3

Draw on equity you have in properties in your own name

While the property is owned by you personally there's always the prospect that you could be sued for some unexpected event. A sound strategy would be to draw on any equity you have in that property. That is, borrow against it to "seed" purchases of other assets and thereby reduce the equity you have on this property.

Ideally the strategy is to move yourself into a position as soon as possible where you have no equity in any property that you own so that you appear, on the face of it, to be worthless, thus discouraging any potential legal action against you.

Can I still borrow money if I don't own real estate because I'm the risk taker? How do I get credit facilities to run my business?

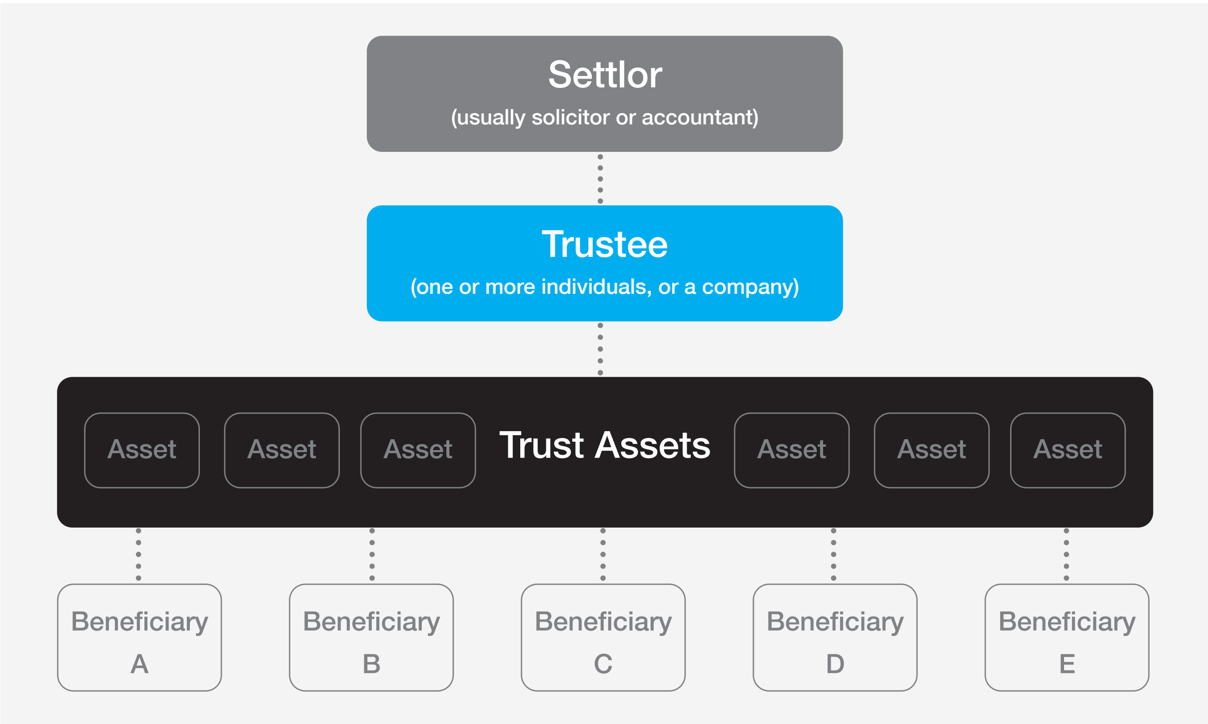
Lenders will still lend to you if you don't own any real estate, however they'll require your spouse to put up property that they own as security for the loan. Life still goes on.

Commandment 4

Hold everything else you acquire and run any business in a trust structure

A trust is effectively a separate vehicle that acquires and operates your business and a low-risk entity which you use to acquire assets and property. The assets, business and properties aren't owned by you personally, but are controlled by you personally. There are a number of different types of trusts, but I'm referring here to a family trust or a discretionary trust. A typical trust arrangement is set out below:

Figure 2. Typical trust arrangement



The main players in a trust are as follows:

The 'Settlor'
This person's name will be on the front page of the document and the last page where they sign. Their job is to simply establish the trust. Typically they pay more than $10 as the first asset to be owned by the Trust, to be held in trust for the beneficiaries. Once these monies are paid and the Settlor signs the trust document then they have no further involvement in the trust. Usually the Settlor is a solicitor or an accountant.

The ‘Trustee’

The Trustee is the actual owner of the property on behalf of the trust and deals with the property on behalf of the beneficiaries (that is, you and your family). The Trustee has the day-to-day control of the trust and its property and can be an individual, two or more individuals, or more commonly a company. If it’s a company then the risk-taker will usually be the sole shareholder and director of that company.

The ‘Trustee Company’

While it’s possible for you to be the trustee of the trust personally, this can still lead to an argument that you’re personally involved and personally own the asset. It’s normally advisable to have a company as trustee of the trust. A company is a separate legal entity to its shareholders and directors and separate legal existence of a company gives it advantages for commercial purposes. In addition, the company will be what’s regarded as a $2 company, (i.e. a private company with two $1 shares giving it a total asset base or share capital of $2).

In all other aspects though it operates as though it were a natural person, however the trustee’s liability is limited because it’s a limited liability company. So the company itself is a separate legal entity that exists separately from the directors and the owners (the shareholders). The company is divided into two shares or portions having a value of $1 each. Basically the directors are in control of the company and it’s the shareholders who own it.

Litigants can sue the company if they believe it has some legal responsibility or obligation to them or has done the wrong thing by them. But generally the directors can hide behind the ‘corporate veil’. Even the company itself can say it was acting at all times as trustee or agent for the trust and if some legal obligation has been broken then the company at all times acted as agent of the trust. Generally the directors can’t personally be attacked unless they’ve broken their director's duties (eg. they haven't acted honestly or in good faith towards the company and its interests, have exercised their powers for some improper purpose, or put their position in conflict with the position of the company).

Cost and time to establish a trust

A company and a trust can comfortably be established in less than 14 days and the cost varies. It’s usually not more than a maximum of $2,000, depending on your particular requirements and the time spent with your professional adviser seeking advice. Think of the cost as a premium for a long-term insurance policy. The company and the trust can both last for more than a lifetime and both have continuity of legal existence, despite the death of the shareholders and directors.

The contrarian view

The creators of new products and seminars on asset protection (myself included) promote the belief that there’s no point creating all of this wealth when someone can just come and take it from you. They advocate protection of these assets by putting shields and barriers in the way, essentially by acquiring assets in the name of a company acting as trustee for a trust. “Own nothing but control everything” is their mantra.

The contrarian view is that this is all just marketing hype designed to get you to buy companies and trusts from these people. The reverse advocate advises to just keep it simple and buy property in your name personally and protect yourself by having proper insurance coverage.

If you’re swayed by this contrarian view (or just don’t want to spend the money to establish a company/trust structure) ask yourself these questions before you buy, say, an investment property or shares in your own name.

1. What flexibility do I have about the distribution of the rental or dividend income from this property or shares? The answer is none. All the income is credited to you personally and depending on your other income you could end up paying tax at the highest possible rate (or at a much higher rate than you would have otherwise done if you’d used a company/trust structure).
2. What flexibility is there in relation to distribution of any capital gain made from selling the asset? The answer is none. All the capital gain will flow into your hands and be taxable income in your name.
3. What exposure do I have to people looking to ‘have a go’ at me personally? The answer is total exposure, as you own the property personally.

What do you think of the contrarian view now?

Acquisition of an asset, however, in the name of a company as trustee for a trust allows you maximum flexibility in relation to distribution of income and capital gains.

These can be distributed to the beneficiaries of a trust who, at the time, are on the lowest tax rates, or, in the case say of a negatively geared property, who are on the highest income (and thus achieve the greatest tax deduction for the loss created).

“We’ll sort this out later”

Clients frequently say to me: “You worry too much. Let’s buy this asset now in my name personally and if anyone ever sues me, I can transfer it to some other entity such as a company/trust structure then.”

What are the risks of going down this path? One unfortunate Australian taxpayer not too long ago found out and ended up spending two years in prison contemplating the risks of this approach. The taxpayer was a director of his own company and became exposed personally to a taxation liability to the ATO. The company’s assets were sold but the proceeds weren’t enough to discharge the liability to the ATO. As the director had a personal liability to the ATO, he transferred his interest in a property in his own name to another party to avoid the trustee in bankruptcy getting at this asset (the ATO bankrupted him over the tax liability).

The strategy appeared to be: “Let’s transfer the property and see if the trustee in bankruptcy goes to the trouble and expense of attempting to recover the proceeds of the sale”.

What this debtor and his adviser probably didn’t realise was that such a transfer constitutes a criminal offence under the *Bankruptcy Act*. The Act provides that when a person has become bankrupt and has disposed of any property within the previous 12 months with intent to defraud that creditor, they are guilty of an offence which carries a prison sentence of up to three years. The taxpayer was convicted of this offence and was sentenced to two years in jail.

One entity for one business

It’s important to understand that an entity which, say, owns and operates a business can itself be sued and therefore, because this entity is at risk, it shouldn’t own any other assets. In particular, it shouldn’t own any other business assets (see later under ‘Service Trusts’) or any other passive assets or investments. In particular, if you own a group of businesses or your family owns a group of businesses, then each business should be owned and operated under a separate entity so that the assets of one business aren’t exposed to the risks of another.

So if you’re the owner then of the freehold of property on which you conduct your business, the building should be owned by another entity and not the company/trust that owns the business. The entity that owns the building would then usually lease that property to the business operator and thus that asset would be protected in that way.

Contrast this with, say, operating a business by a partnership of individuals. Partnership Law means that each partner is personally liable for the debts of the other partners in the partnership operation and thus partnerships of individuals offers no asset protection at all. A partnership, however, of companies or trusts can offer a level of asset protection in line with the strategies that we’re discussing in this report.

Becoming a trustee personally

“Should I personally be a trustee of my trust?”

This is a perfectly sensible question. After all, they cost around $700 to acquire and involve annual charges payable to ASIC (Australian Securities and Investments Commission) and usually additional accountancy fees.

I don't recommend this approach for two reasons. The first reason is that trustees run the trust and are entitled to an indemnity from whatever assets the trust owns, but if the trustees are individuals then they expose themselves personally if there's a shortfall in the trust assets to meet any liability. Contrast this with operating as a director of a trustee company where there's no personal liability as the director and no exposure of your own assets unless you as a director allow the company to trade insolvent.

The second reason isn't as obvious. When I discuss this matter with lawyers who act for potential litigants, they advise me that where a person acts as trustee for a trust it sends a clear message to them that they may be vulnerable because they're so cost sensitive. They will seriously then discuss with their client the possibility of bringing an action against that person, just to put pressure on them so that they'll make an offer of money just to get the problem to go away. The lawyers' experiences are that these people will be so worried about the cost of defending the action that they'll be likely to make an offer to pay some money just to get you to go away.

In essence, then, a company/trust structure still looks like ownership, smells like ownership and feels like ownership, but doesn't have that sting in the tail of having personal liability. A company/trust structure means you can deal with the assets as if you own them, but without any personal liability or exposure.

Understand the structure

I took a phone call from a new client who'd been to a high-powered property investment seminar and heard a wonderful presentation on asset protection by an accountant who specialised in establishing companies and trusts. He jumped in after the seminar and immediately purchased a company and trust.

His next call to me was to make an appointment and at that appointment he asked, "Could you please explain what I've just bought and how it works? Most importantly, could you please tell me what name I should put on the contract as the buyer of this property that I wish to acquire, now that I have this company/trust structure? Should I show the buyer as just the company, or the company as trustee and do I need to specifically mention the name of the trust?"

The client could be forgiven once for such naivety but I was appalled that a professional could allow a client to acquire such a structure without understanding how it operates.

If you find yourself in this situation as an investor insist that the adviser/accountant/lawyer spend time with you so that when you leave their office you understand what you've just acquired. Otherwise there'll be GST consequences, CGT consequences and other undesirable outcomes such as drawing cheques from the wrong accounts. These could be very difficult or even impossible to undo at a later stage.

And where are you as an investor when you find yourself in this position? Lost is the answer.

It's time to go back to basics – understand the structure.

Fine tuning your asset protection

One aspect of Commandment 4 that is often not given the attention it deserves is, who are the directors of the company?

In making this decision careful consideration should be given by the couple to which of them is personally involved in the higher risk activities. For example, if one of them is, say, a nurse and the other a stockbroker, stockbroking is obviously a much riskier activity and it's that person who should become the sole director of the trustee company. The person in the low risk activity (eg. the nurse) should have no involvement as a director in the company. And why is this so important?

The reason is that there are many hundreds of pieces of federal, state and local government legislation and regulations that actually impose personal liability on company directors. That's on top of the duties that the *Corporations Act* imposes on directors of companies.

It's a little known fact, for example, that the Income *Tax Assessment Act* provides that a director will be personally liable for failure by the company to make payment of taxes. In those circumstances all the ATO needs to do is issue a director's penalty notice giving the director 14 days from issue of a notice to pay the tax, or have an administrator or liquidator appointed to the company.

If neither of these occur within the 14 days the ATO can pursue the director personally for the outstanding tax.

Not only might the director be personally liable for the tax, but they'll probably also be liable for any other debts incurred by the company at a time when they should have known the company wasn't able to pay its creditors or pay its debts as they fall due.

This is called insolvent trading under the *Corporations Act*.

Wow! So give careful thought to this issue when utilising a company/trust structure to protect your assets and make sure the person in the low risk job has no involvement as a director of the trust company.

Commandment 5

Use multiple trusts

In the case of business and property acquisitions, as any business assets or property owned by a trust will be at risk themselves if, say, the business fails or the property owner becomes exposed to some financial liability, any subsequent businesses or properties (eg. owned by a family group) should be bought in another entity (another company/trust) so that the assets of one structure aren't put at risk by the activities of another. By now readers will already have the message that asset protection doesn't reduce all risks and only minimises it.

So likewise, when it comes to your property assets, buy two or three properties in the name of the first trust before moving on to establish another company/trust structure for the next two or three properties. By adopting this strategy, even if the trust is held to be liable for someone's financial loss or to compensate them for some unforseen event, the trust is only liable to the extent of its assets which will be limited to two or three properties.

For example, in the United States the Yellow Cab Company in New York has approximately 3000 yellow cabs. It has set up 1000 trusts, with three cabs owned by each trust. I'm not sure what the value of a New York yellow cab is but let's assume it's worth $1 million. So, if someone sued the Yellow Cab Company they would only be suing the trust that owned that cab with a total asset holding of no more than three cabs, let's say $3 million. The total potential extent of the loss to the Yellow Cab Company would be an unfortunate $3 million, but **<u>not</u>** $3 billion.

It should also be appreciated that with this strategy, when the properties are purchased on a buy and hold basis, over time, say on average seven or eight years, the value of the asset holding will double. You might have $1 million of assets in that trust at the time you buy your second or third property but at the end of the seven or eight years that would be worth $2 million; in 15 years' time $4 million. On balance, therefore, it's probably best not to place any more than three properties in any one trust.

Once again, the overall strategy is that you own nothing, but control everything.

Commandment 6

Asset and service trusts

If you're in a business or a profession, for example doctor, vet, chemist, town planner, lawyer, accountant etc., then this strategy involves having all the assets of your business or your professional practice in one trust (an asset trust), then establish another trust (a service trust) that carries out all the administration work for your business or practice. It pays the staff, sends out accounts, pays accounts, organises and pays for leasing of assets and then invoices the trust that owns the assets for those services.

Basically, therefore, the asset trust leases off to the service trust all the assets for, you could say, rental. If someone has a go at you then it will be the service trust that's effectively operating the business, with the first trust simply owning the assets. The service trust, therefore, will most likely be attacked. And as this has no assets, this is another shield against someone taking your hard-earned assets from you.

Commandment 7

Cross-collateralisation (but use with great care and discernment)

As mentioned earlier, one approach with the acquisition of property is to fund the purchase of subsequent properties by drawing down on the equity on the very first property that you own in your own name. This provides the "seed" money for subsequent purchases and encumbers the equity in the property you have in your own name so that on paper you're either worthless or as close as possible to being a 'man of straw.'

As time rolls on, however, and you acquire more properties, the equity you have in the prior purchases will increase and you need to have a strategy that 'eats up' the growing equity on those properties. Rather than providing seed money from the property in your own name, the prior purchased properties are given to your lender as security for the subsequent purchases. Your lender will take security, therefore, over the latest purchase and prior purchase and this is called cross-collateralisation. Anyone undertaking a search of the interest in each of these properties will discover that while you might have purchased the prior property for, say $250,000, it will have a debt, that is a mortgage, over it in the order of, let's say, $300,000.

This is a strategy which doesn't involve any big stamp duty bills which will be incurred if you actually transfer properties into newly created trusts. You'll also avoid any CGT issues.

Discernment should be used with this strategy, however, as the downside to it is that all of your properties can be tied up with one lender. If their lending practices change they can then put pressure on your whole portfolio of assets. So for most of you then it's a strategy that you won't employ, but must be aware of as lenders will suggest it to you to improve their security position. The only time I would consider implementing it is where you have multiple lenders so that if one of them changes their lending practices you can fall back on your relationship with another.

Commandment 8

Purchase property in the name of your super fund

Your self-managed super fund is a special type of trust and its purchase of a property will stand alone, like the purchase of a property by a discretionary trust. Of course, self-managed super funds can now borrow money and the fund won't need to have all the money to acquire the property. So it's worth implementing as part of your overall asset protection strategy. A super fund, too, is a special type of trust that's almost bulletproof to attacks by greedy litigants. Unless there have been unusually high contributions to the fund, its assets can't be touched, but remember a super fund can't operate a business.

Be aware, though, that the purchase of property by the super fund will lock that property up in the fund until your retirement, but that's the case anyway with any superannuation investment. It should also be appreciated that your super fund can enter into the joint ventures, perhaps with a trust established by you or another super fund. If the super fund doesn't have enough money in its own right to acquire property then this possibility should be investigated with your accountants.

Commandment 9

Insurance

Make sure you have full and proper insurance over yourself, your business/practice and assets that you own. At the end of the day almost all of your insurances will be tax deductible (even your life insurance, if paid by your super fund, will be tax deductible to the fund on the basis that the life policy is needed to protect the interest of the other members of the fund should you die). Insurances that should be considered therefore are:

- Professional indemnity insurance, if you're in a profession
- Insurance for you as a company director or a senior executive
- Key man insurance, if you're the key person in your business or profession
- Public liability insurance, for any rental properties
- Building contents insurance for real estate assets
- Workers compensation or work cover insurance for people who come to your house to carry out cleaning or gardening. The cost of such a policy is small and will protect you in the event that your cleaner slips down your stairs, injures themself, then claims they were your employee rather than your independent contractor.
- Comprehensive insurance to cover vehicles used in your business which are driven by employees.

Insurances should also be reviewed every few years to make sure they keep pace with increasing values and inflation.

Carefully look, too, at the extent of your cover and exactly what things it does cover. Does your business insurance, for example, cover you against a claim for assault? From time to time, especially in accommodation businesses, for example hotels, motels and management rights, a principal of the business or employee will get involved in a physical altercation, and this will bring on a claim for assault. Your policy should cover this possibility.

If you're running a home business, then you'll have more people visiting your home than usual and you should insure that you have proper public liability insurance.

Commandment 10

Keep a property mortgage free

Once you've established a property portfolio, aim to keep one of the properties mortgage free – usually the cheapest one, say a small unit in a country area worth around $150,000. Over the fullness of time some financial or personal emergency or tragedy could befall you or one of your family.

For example, you might get an unexpected margin call on your share portfolio. Or it could be that one of your children has to have an emergency life-saving operation overseas.

About $100,000 will usually go a long way to solving the drama for you.
When that black storm cloud bursts, you simply pull the title deed for that property out of your bottom drawer and give it to a security lender (a lender that advances the money solely on the basis of the security provided). The lender will then give you a cheque for $100,000 and the crisis is averted.

What is bankruptcy?

Bankruptcy is the legal process in which the financial affairs of an insolvent person is administered. A trustee in bankruptcy is appointed to administer these affairs. The laws on bankruptcy are set out in the *Bankruptcy Act*, which is administered by the Insolvency and Trustee Service of Australia (ITSA).

What it means to go bankrupt

- Except for certain personal property, all property on the date of bankruptcy or that you acquire during bankruptcy is collected and sold to pay debts.
- You may keep tools of trade (up to a value of about $3000) used to earn an income and some basic furniture including a TV, fridge, washing machine, clothing, personal effects and motor vehicle not worth more than a certain sum.
- You're expected to make regular contributions from your income to the trustee where your income is more than approximately $36,000 per annum. Fifty per cent of your income above this amount is paid to the trustee in bankruptcy.
- This figure varies if you have dependants and the trustee can, in calculating the income threshold, treat non-cash benefits such as a car allowance, rent and food assistance packages as income.
- You'll be required to deliver your passport to the trustee and not be allowed to travel overseas without their permission which you'll need to get well in advance.

- Gifts, transactions or monies received during the previous five years will be examined closely and the trustee has power to recover money or property from creditors in a whole range of circumstances. If action is taken to recover monies or property then you're required to give evidence in court along with other family members or associated parties.
- You can't obtain credit for more than approximately $4000 or draw a cheque for that amount without disclosing you're a bankrupt. Your credit rating is shot too.
- You're prohibited from managing a company.
- If you jointly own a matrimonial home, then the trustee may take possession of it and sell it, pay your spouse their share, with the balance being used to pay your creditors.
- You can still be pursued for breaking the law, for example debts arising out of fraud, maintenance payments and the monies owed to the Department of Social Security and for HECS.
- The ATO may also claim tax refund credits to reduce tax debts during bankruptcy.
- If you owe money for essential services such as for electricity, telephone or gas, the supplier of these services may require you to lodge a bond to keep the services connected.
- Your bankruptcy and personal details are recorded on a public National Register and various credit databases.

How long will bankruptcy last?
It usually lasts for three years and at the end of that time you're discharged from bankruptcy, unless the trustee has objected and extended the bankruptcy to either five years or eight years (in exceptional circumstances). This will usually occur where you fail to cooperate with the trustee, for example you fail to disclose all of your debts and assets or fail to honour your obligation to make income contributions.

Guarantors
People who have guaranteed loans on your behalf should be aware that your bankruptcy doesn't stop the creditor from making claims against them under the guarantee and if that occurs your guarantor will simply become a creditor in your bankruptcy for the amount they paid on your behalf under the guarantee.

The benefits of going bankrupt
The main advantage is that it removes the immediate pressure of dealing with the individual creditors, as they must communicate and lodge claims with the trustee rather than you. Once you go bankrupt unsecured creditors aren't allowed to take legal action against you to recover the debt. They must lodge a proof of debt in your bankruptcy and share in whatever the proceeds of the sale of your assets achieve through the trustee. Secured creditors such as banks can still pursue property over which they hold security in, but if there's any shortfall, once again, they also become a creditor in your bankruptcy for the shortfall.

Oh, and going bankrupt is free to you personally. That is, there's no fee payable to you to apply for bankruptcy.

What about your father's Victoria Cross Medal or your mother's Commonwealth Games silver medal?
Bad luck! Both these form assets of your estate and will be claimed by the trustee and sold. If you personally have been awarded a Victoria Cross or even a gold medal at the Olympic Games, the trustee may also claim these items as assets of your bankrupt estate. However, you have the right to ask the trustee to allow you to keep them and it may do so at its discretion. Your expensive jewellery is gone too.

Take action before the financial crisis hits
There's nothing illegal about implementing strategies to protect your business and assets against potential future risks or just because you think you might go bankrupt. As long as there are no claims against you at the time that you implement these strategies and the horizon is clear then they can't be attacked. After all, Alan Bond's family trust wasn't able to be attacked by the trustee in bankruptcy because it was set up decades before he found himself in financial trouble. Once dark clouds start appearing it's too late.

If you take action after the event then you also run the risk of committing a bankruptcy fraud, which is a criminal offence. Any solicitor or accountant who assists you to take action in these circumstances will be aiding and abetting you in committing this fraud and they'll also most likely commit an offence.

A solicitor, for example, has an overriding duty to the Supreme Court in the state in which they practice to uphold ethical values. They might therefore be able to provide you with general advice about your position and the ability of the trustee in bankruptcy to avoid some of these transactions that you're proposing to implement now, but they legally can't assist you to implement these strategies as they're committing a bankruptcy fraud, or are an accessory to such a fraud. The lesson therefore is to put these strategies in place when the sun is shining.

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