InvestorOne

Asset Protection Issues

1 – Negative gearing v asset protection

Many people want to protect their assets from creditors. The major problem is that the person who is most likely to be sued is usually also the high income earner. It is therefore almost impossible to establish a structure that will receive the negative gearing benefits allowed while also protecting the asset should someone sue. Following the repayment of the loan then the asset may be moved to a vehicle (i.e. discretionary trust or self managed superfund).

Many promoters have allegedly developed products that achieve both negative gearing and asset protection. These are untested and will not hold up. Investors should avoid these at all costs.

2 – The Bankruptcy Provisions

The most important provisions of the Bankruptcy Act 1966 are sections 120 and 121. These govern Undervalued Transaction (s.120) and Transfers to Defeat Creditors (s.121). These should both be read in their entirety before any asset protection strategies are put into place. The main points are listed hereunder:

Undervalued Transactions (section 120)

- Transfers made less than 5 years before bankruptcy for no consideration or less than market are void,
- Despite above transfer not void if made to related party more than 4 years before bankruptcy and transferor can prove he or she was solvent at time of transfer,
- Despite above transfer not void if made to non-related party more than 2 years before bankruptcy and transferor can prove solvency at time of transfer,
- If no books or records exist at the date of the transfer the transferor is presumed to have been insolvent,
- If the transaction is void any consideration paid to the transferor has to be refunded.

Transfers to Defeat Creditors (section 121)

- Transfers are void if the main purpose of the transfer is to put the property outside the reach of creditors and that was the main reason for the transfer,
- In determining the transferors main purpose for the above, it is taken to be the main purpose if at the time of the transfer the transferor was, or was about to become, insolvent
- If no books or records exist at the date of the transfer the transferor is presumed to have been insolvent,
- If the transaction is void any consideration paid to the transferor has to be refunded.

It is important that sufficient records are maintained at the time of any transfer, especially where it is done for little or no consideration, to prove that the transferor was solvent at that time.

3 – Using discretionary trusts

The most common way of protecting an asset is to have it held on the terms of a discretionary trust. This means that in effect no one owns the asset however the income and capital gains flowing from the asset may be enjoyed by beneficiaries of the trust. If the trust owns a property a beneficiary may also live in the property rent free.

Care must be taken as unpaid distributions are effectively loans to a beneficiary and expose the trust's assets to claims made against a beneficiary. Transferring assets into a discretionary trust also has to be done with great care as income tax, stamp duty and the bankruptcy provisions all apply.

4 – Superannuation

An individual's superannuation account is protected from their creditors. The only time this would not be the case is if a person started to make large superannuation contributions after they were made aware that they would be unable to pay all their creditors. Apart from this their super is safe. Like any transaction a large contribution made to a self managed superannuation fund needs to consider sections 120 and 121 of the Bankruptcy Act 1966.

5 – The family home

One of the largest assets we own is the family home. It is therefore important that some planning goes into who owns the family home in terms of asset protection. As the mortgage on the family home is not deductible then there are no concerns as raised at point 1 above.

The most common form of ownership is as joint tenants or tenants in common. This offers the least amount of protection. It is better to acquire the family home in the name of the spouse that is less likely to be sued. An alternative to this is to acquire it 99% in the name of the spouse less likely to be sued and 1% in the name of the spouse likely to be sued.

If there is no spouse then a trust may be considered. Any deposit or loan from parents should pass through a trust and be subject to a mortgage.