

# PERSONAL FINANCIAL STRATEGIES

YOUR PERSONAL GUIDE TO WEALTH CREATION



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## New gearing rules for SMSFs

The Federal Government has recently enacted laws allowing Self Managed Superannuation Fund (SMSF) trustees to borrow in order to purchase assets. The move reverses a decision by the Labor government, which in 1999 limited unit trust borrowing.

The amendment, which became effective in September 2007, means that borrowing possibilities are wide. For an SMSF with a good asset base, the opportunities for leverage are significantly increased.

### New borrowing rules

The superannuation laws have now been amended to allow the Trustee of a SMSF to borrow in the following circumstances:

1. The asset must be one that the super fund trustee is permitted to acquire;
2. The borrowing is in the name of the SMSF Trustee;
3. The legal title of the asset is held in trust on behalf of the fund. The Trustee of the SMSF makes payments into the trust to obtain beneficial ownership and full legal ownership once the asset is fully paid for. Any income that accrues such as dividends, rent or interest does so for the

benefit of the SMSF Trustee;

4. The lender is an individual or commercial lender. Borrowing is non-recourse (rights of the lender are limited to the rights of the asset). At the end of the loan period, full legal title is transferred to the Trustee of the SMSF.

### Advantages of SMSF borrowing

**Leverage.** The new rules increase the wealth effect in the SMSF in times when assets of the fund are rising.

**Lending.** Members and related businesses can act as lenders provided that all lending is at arm's length.

**Funding.** Member lending increases the flow of non-contributions funds into the SMSF which fall outside the excess contributions tax rules.

### A word of caution

Whilst the government has taken steps to increase investment flexibility with SMSF, it also warns trustees of the risks associated with improper practices. Ensuring trustee compliance forms a significant proportion of the ATO compliance program and the new rules are certain to catch some trustees out.

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We can help you keep your personal finances and wealth creation strategies on track. Call us now and we'll arrange a meeting to discuss:

- Tax effective saving strategies
- Planning for retirement
- Minimising capital gains tax
- Property ownership
- Asset protection
- Selling your business

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## SMSF borrowing strategies

New rules have created some interesting strategic opportunities for SMSFs.

1. Purchasing large assets – borrowing enables the Trustee of an SMSF to obtain leverage to acquire assets that normally would be outside of their financial capacity. New options place such purchases as: farms, property developments and commercial property within the reach of many SMSFs.

2. Member financing – by taking advantage of the new borrowing rules a member may now be able to transfer securities or real property that they own, into the fund. In this scenario, the member acts in the capacity of trustee of the borrowing trust in addition to being the lender. Any repayments made by the SMSF to acquire those assets may then be used as a contribution back into the fund by the member (subject to the contribution rules).

3. Increasing asset contributions – the contributions rules cap the dollar amount of contributions that may be contributed to a fund. Since investment in the SMSF borrowing arrangement is generally measured in terms of net assets, the effect of a member contributing assets is to enable more to be achieved with SMSF borrowing.

If you are planning to use a borrow and invest strategy for your SMSF, take extreme care as the ATO has signalled its intention to crack-down on any breaches.



## The clock is ticking

**W**hen it comes to tax and financial planning, we would all like to have more money, and to pay less tax. The beginning of the year is always a good time to start with a clean slate and give some thought to your individual tax and wealth creation strategies.

We would welcome the opportunity to discuss tax and financial strategies that could help you, your family and your business get into shape for the new year and beyond.

In preparing your tax and wealth creation strategy, we suggest you consider following these guidelines:

- Before you begin, you need to consider your present position. You also need to consider your personal and business financial goals, and how they interact or even conflict.

- Make sure your planning is comprehensive, covering all your immediate family and associated businesses and trusts.

- Don't make hasty decisions just to save tax. Before taking any tax-saving decisions for your business, make sure they are personally and financially justified.

- Beware of tax savings 'schemes' that sound too good to be true – they may be exactly that. You could face financial risks and investigation by the ATO.

- Do some research. Before embarking on an investment or even getting the advice of a professional it is always worthwhile to be armed with a list of ideas, concepts or even questions to enable you to take full advantage of any advice you may receive.

## MONEY TALK

### What is “ex dividend” and “cum dividend”?

Every dividend for listed companies has a record date which is the date a company views its share registry to determine which shareholders receive the current dividend. The ex dividend date occurs four business days before the record date and is the cut-off date to determine which shareholders are registered to receive the dividend.

Shares purchased after the dividend date are said to be purchased “ex dividend”, which means the previous owner of the shares is entitled to the dividend.

If shares are purchased before the dividend date they are referred to having been purchased as “cum dividend” – the purchaser is entitled to the recently announced dividend.

Share prices typically rise “cum dividend” and fall when they are “ex dividend”.

# Property versus shares

**T**he decision to invest in property or shares is often made based on the misdirected advice of a well-meaning family member. Before investing, consider some of the merits of each case.

## The case for shares

**Low entry costs** - Small investors can start a share portfolio easily, with access to online trading and \$1000, an investor can be on their way.

**Easy reinvestment** - Many shares have dividend reinvestment schemes attached to them. This means that an investor can increase their portfolio in small increments with little effort.

**Visibility** - Shares have a price that in many cases fluctuates daily and that price is easily monitored. It is a simple exercise to calculate the value of a portfolio at any time.

**High long term returns** - Just like property, shares have historically provided high long-term returns, particularly in comparison to fixed interest and cash.

**Liquidity** - Shares are easily converted into cash as required and because of the nature of shares, part of a share holding can be sold to raise a small amount of cash.

**Low transaction costs** - Buying or selling shares involves lower transaction costs than property. Property on the other hand involves stamp duty, inspections and legal costs.

**Low ongoing costs** - Shares involve substantially lower ongoing costs than property. In fact, direct share ownership does not involve any ongoing costs whereas property can involve body corporate fees, insurance, land tax, letting fees, maintenance costs, management fees, rates, and repair costs.

**Diversification** - Lower price of a share relative to a property makes it possible to obtain greater diversification by investing in shares. For instance, if you have \$20,000 it is possible to spread the investment across four parcels of \$5,000. For an equivalent amount of money, you would be unlikely to purchase even one property without gearing.

**Tax efficiency** - Many Australian shares provide franking credits with their dividends that may be used to offset the investors other tax liabilities. Put another way, the dividend income from a fully franked share provides tax-free income to a share investor on the 30% marginal tax rate.

## The case for property

**Control** - Investing in property provides the investor with a greater level of control over their investment. Decisions about the property can be made with complete control. Control over an investment in shares is dependent on holding (generally very small) and only exercised by the level of voting power.



**Simplicity** - Property investment is generally more easily understood than share investment.

**Tangibility** - Property is tangible. It can be more satisfying viewing an investment property compared to reading online about the value of your investment.

**Potential to add value** - Property provides the opportunity to improve its value through renovation or development.

**High gearing** - Property is a favoured form of security for financial institutions and in some circumstances may be fully financed. Shares on the other hand are generally financed at a maximum of 70% share value through a margin loan.

**Low volatility** - Property values are generally less volatile than shares.

**Tax efficiency** - Many shares provide franking credits with their dividends that may be used to offset other tax liabilities of an investor. In other words an investor receiving dividend income from a fully franked dividend effectively receives a tax credit of 30% - equivalent to the tax that the company has already paid.

**Deductibility** - Property allows the deduction of a depreciation component for building write off, plant and equipment which improve the after tax return.

## Conclusion

Property or shares? The decision is one which is based on personal circumstances. If you are unsure as to how some of these aspects may affect you, please call our office before investing your hard-earned money.

## Property vs. shares summary - factors to consider

Factors to consider	Property	Shares
Entry costs	✗	✓
Long-term returns	✓	✓
Ongoing costs	✗	✓
Potential to add-value	✓	✗
Tax efficiency	✓	✓
Control	✓	✗
Simplicity	✓	✗

# Providing for loved ones

The Christmas holiday season is a period when many spend time with those they care for most and also an occasion when many reflect upon how they may provide for the on-going care of those people. Despite the best intentions, many fail to act. Now that the year has started in earnest, consider creating a tangible plan of some of the things that have been in the back of your mind over previous months.

## Get a will

A Will is a legal document that lays out the distribution of a person's property in the event of their death. In order to be valid, a Will must meet certain prescribed requirements which are set out by the Wills Act in the person's state.

When a person dies and the will is straightforward, and assets easily distributed within a short period of time (for instance where there is simple asset holding or few beneficiaries), a will may be the most appropriate vehicle.

## Testamentary Trusts

Where asset holding is more detailed, or the person has a specific wish to plan for the ongoing use of personal assets, a testamentary trust may be used with a will. A testamentary trust may be created by a will, where the



will directs that instead of distributing all of the assets of the testator on their death, specific assets of the testator are to be held in trust. This might be for the benefit of the testator's children, spouse or some other person.

Planning for loved ones is often a task that is charged with emotion and delayed. It is also an area, that if not dealt with properly, may have the undesired effect of penalising the ones that are cared for most. Some planning strategies take time to implement, and consideration and discussion with family members are often part of the process.

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.

## What is a testamentary trust?

A "trust" occurs where one person holds the legal title of a property for the benefit of another person. A "trustee" is the person who takes the ownership in "trust" for another person, known as the "beneficiary". "Testamentary" is a term meaning that which relates to the making of a will.

A "testamentary trust" is a trust created by a will to appoint a trustee to use property for the benefit of the beneficiary according to the terms specified in the will. It does not come into effect until after the death of the person making the will.

From an estate planning point of view, testamentary trusts are flexible and provide long-term financial protection including:

- Significant taxation advantages (income splitting, franked dividends);
- Financial protection of the bequeathed assets (protects assets in the event beneficiary becomes divorced or bankrupt);
- Providing for beneficiaries who are unable to control the distribution of capital after death (due to physical or mental disability).

## The Bookshelf

### The Pig and the Python: How to Prosper from the Ageing Baby Boom

Author: David Cork (Stoddart Books)

This book is about investment strategies, with a specific focus on ways to take advantage of the financial implications of the ageing of the baby boomers. The pig of the book's title is the baby boomer generation, and the python is the rest of society, which struggles to cope with this monstrous bulge as it moves along through the years.

The author presents their financial advice through an interesting device: a husband-and-wife who are faced with difficult times in terms of their job and financial situation, and as a result have just moved into a different neighbourhood and are renting a house. They have a series of conversations with their new neighbour, who just happens to be an expert investment counsellor, specialising in baby boom-related investments. The neighbour gives them a series of mini-lectures over several weeks, through which he imparts a number of financial anecdotes and pieces of advice.

The proposition of the book is that the baby boomers, the huge generation born between 1947 and 1966, now comprising one-third of the population, invariably impacts most of what happens in the country as a consequence of its sheer size. The influence of boomers as they age and move through society (that pig pushing its way through the python) is and will continue to be tremendous.

Whilst largely based on the Canadian economy, it provides a simple explanation on the fundamentals affecting every investment, and some useful tips on how a basic understanding of demographics can assist making sound investment decisions.