EQUITY FINANCIAL SERVICES
AUSTRALIA PTY LTD
HORIZONS

Spring edition 2009

Is this a good time to buy? by Run Meretz

Over the last 22 years as a financial adviser I have had a lot of people ask me the following: Is this a good time to buy?

This question has applied to Property, Managed Funds and Direct Shares. Many have also asked which one of these will do better?

Some also ask about which type or sector, meaning what type of company shares should I buy – mining, banking, etc.? Or what suburb should I buy in, should I invest into a house or apartment, is old or new a better way to go?

Some believe they can do it all by themselves so they have more control and save on costs. They treat the costs of managing an investment as an item they can save on without compromising quality and standards, as if it was a sandwich that can be prepared at home and therefore one could save a few dollars.

I have met many people who invest in direct shares and boast that their returns are higher than most of the professional fund managers. But

when one takes a closer look you find the results are usually short term and they have rules of their own such as holding only 4 or 5 shares and 1 of those shares can represent 80% of their funds invested.

The same questions are also raised about selling. Is the property market at a peak and should I sell now? Is the stock market too high so should I sell?

We have newspapers and so called commentators advising us on how to invest. Then they participate in six week competitions in which individuals try to choose shares that increase in value and for the fun they add a dart board and astrologist to see who is the best investor! Have they no shame?

On the front pages they teach people not to gamble, not to invest for the short term and to understand that markets can be very volatile in the short term. Then on the back pages show us what shares they buy for 6 weeks! What message does this tell the readers; people can buy shares for 6 weeks and make money? Yes that can happen but it's usually called gambling. Unless you are a professional day trader you should stay away from that type of thinking.

Then in the Property section of the newspaper we now have big headlines that declare the following; find out what your house is worth this weekend as we show you the average house price in your suburb. What nonsense! It doesn't tell you how much your house is worth, all it does is give you an average price based on recent property sales. All of those sales could be totally irrelevant to what you own as they can be of various sizes and quality. So for example, if someone sells a house for $1.5 million on an acre and another person sells a house on 300 square metres for $500k does the average price of $1 million apply to my 500 square metre house?

The funny thing is I don't think anyone has ever asked me what they have to do to be financially successful.

Many haven't realised that it's not the vehicle that is the most important (shares, property, etc.) as people have done well financially with all of these. It is deciding to take action and having the reasons to do so. This means have goals and being serious about them. It is understanding sometimes investment values drop! Meaning do not be surprised that when you go swimming you can get wet, it's part of life!

It is taking action but being careful.

It is being disciplined.

It is to diversify.

It is seeking professional advice and guidance.

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Reduced superannuation contribution caps: a cause for concern

From 1 July 2009 the reduction in the concessional contribution caps could have an impact on your superannuation retirement savings planning. Most importantly, you will need to ensure you do not exceed the cap otherwise a total penalty tax of 46.5% will apply.

The concessional contributions cap includes employer, salary sacrifice and personal contributions claimed as a tax deduction from 1 July 2009. Until 30 June 2012 two caps exist and these have been halved from 1 July 2009 as shown in the following table.

	2008/2009		2009/2010	
	Over age 50	Under age 50	Over age 50	Under age 50
Concessional contribution cap	$100,000	$50,000*	$50,000	$25,000

*The indexed concessional contribution cap for 2009/2010 financial year had previously been flagged to be $55,000.

Why should I be concerned about this change?

You should be concerned about this change for two main reasons.

How to minimise tax on superannuation death benefits

With about $1.3 trillion (that's 1.3 followed by 12 zeros!) invested in super funds in Australia the likelihood of people receiving substantial inheritances from their parents' superannuation is enormous – and growing.

However, as the following example shows, the strategies employed by the superannuation fund member can make a big difference to the amount of tax payable when death benefits are paid to non-dependants.

A sad tale . . .

Triplets Tom, Dick and Harry all retired from their family business at age 60. At retirement they each had a superannuation balance of $750,000, consisting entirely of taxable (taxed) element. By their 65th birthday their super had grown to $1 million each.

Tragically, on the way to their favourite fishing spot, their boat sunk. There were no survivors. Their superannuation death benefits were paid out to their sons, Huey, Dewey and Louie, all of whom were financially independent.

Tom hadn't drawn on any of his superannuation. When he died it comprised only taxable (taxed) element. As a result, the death benefit paid to Huey was taxed at 16.5%, creating a tax bill of $165,000 leaving him with a net benefit of $835,000.

Dick took a different approach and withdrew all of his super just after he retired. As he was over 60 the withdrawal was tax free. Over the next five years he made non-concessional superannuation contributions of $150,000 a year. When he died his superannuation death benefit comprised a tax-free element of $750,000, plus $250,000 in taxable (taxed) element. Only $250,000 of Dick's death benefit was subject to the 16.5% tax, so Dewey received $958,750.

Just before the trip, Harry was diagnosed with a terminal illness. With only six weeks to live, his financial adviser had recommended he withdraw all of his superannuation as a lump sum. This withdrawal was tax-free to Harry and when it passed to Louie through his will, he received the full $1 million.

The moral of the story . . .

Despite apparently similar situations, the results for the three beneficiaries were quite different. As these cases show, a little bit of forethought and the use of simple strategies to alter the tax components of a superannuation benefit can make a significant difference to the net position of beneficiaries.

Death benefits paid to dependants, including spouses, are tax free, so these strategies are only relevant where the beneficiaries are not financially dependent upon the deceased member.

This is obviously a generic and simplified case study which does not cover all of the issues associated with implementing an effective strategy for minimising tax on superannuation death benefits. Your financial adviser can help you establish a strategy that is appropriate for you. Make an appointment today!

1. If you have been sacrificing your salary into super you may need to adjust the amount to remain within the contribution caps

For example: Jack is age 48 and he has been salary sacrificing $25,000 p.a. into superannuation in addition to his employer's contribution of $7,500. From 1 July 2009, he needs to reduce his salary sacrifice to $17,500 to remain within the $25,000 concessional contribution cap. Otherwise he will pay $3,487.50 in tax which is made up of excessive contributions tax of $2,362.50 (as shown in the table below) and contributions tax.

Exceeding the concessional contribution cap

	No change (FY 2009/2010)	Change (FY 2009/2010)
9% SG contribution	$7,500	$7,500
Salary sacrifice amount	$25,000	$17,500
Total concessional contributions	$32,500	$25,000
Contribution cap	$25,000	$25,000
Excess contribution	$7,500	$Nil
Excessive contributions tax (excess contribution x 31.5%)	$2,362.50	$Nil

2. The amount of money you can tax effectively contribute into super via salary sacrifice contributions or personal contributions claimed as a tax deduction may be reduced

As shown in Jack's example, the amount that he could salary sacrifice without exceeding the contribution cap has reduced. This also means his personal income tax has risen and his total superannuation contributions have reduced.

Talk to your financial adviser

It is clear you need to try to avoid exceeding the superannuation contribution cap and the maximum penalty tax of 46.5%. Before you make any changes to your retirement savings strategy however, make an appointment with your financial adviser to understand the impact any changes may have on your end benefit.

Setting up a SMSF

Many people have established a Self Managed Super Fund (SMSF) with the aim to have more control over their retirement savings. Here's some information that can be considered in order to help investors work out whether SMSFs are appropriate for their circumstances.

What is a SMSF?

A superannuation fund is a SMSF where:

- there are fewer than 5 members (i.e. a maximum of 4);
- all members are individual trustees or directors of the corporate trustee;
- there are no trustees or directors of the corporate trustee who are not members;
- there are no members who are employees of other members (unless they are relatives); and
- no trustee or directors of the trustee company of the fund receives any remuneration for his or her services as a trustee.

What are the main benefits?

Increased control: A SMSF provides investors with an opportunity to make the decisions over investment choices and allocation of funds. There is increased flexibility to alter the fund's investment strategy as and when required to meet the changing needs of the members or any changes in the economic climate.

Investment choice: One of the major benefits of a family super fund is the ability for the members who act as trustees to control the investments. The law provides broad investment powers to the trustee. Each member may have their own investment strategy and can invest in numerous assets including shares, warrants, bonds, property, managed funds, private equity, direct mortgages and fixed interest.

The trustees formulate and implement the investment strategy, usually with the assistance of a specialist adviser. Some notable investment restrictions are loans to, or investments in, members or individuals or entities associated with members or the acquisition of certain assets from members such as residential investment real estate.

Before deciding to set up a SMSF

Before deciding to set up a SMSF, it is important to recognise that the person setting up the SMSF would become a trustee which is an important role. The trustee(s) of the fund who are also members hold and invest the fund's assets for the benefit of the members' retirement. All trustee(s) are responsible for the running of the fund and making decisions that affect the balances of each fund member.

The trustees or directors need to comply with the superannuation and taxation laws to ensure the fund retains its complying status and is entitled to superannuation tax concessions whilst protecting all of the members' accumulated balances.

When operating the fund, the trustees need to:

- act in the best interests of all fund members when making decisions;
- manage the fund and the assets within it separately from their own personal financial affairs; and
- ensure the money in the fund is only accessed where the law allows it.

The Australian Tax Office (ATO) regulates SMSFs and trustees must

Capacity to borrow:

A SMSF now has the capacity to borrow funds provided specific restrictions are complied with. Used prudently this can allow you to achieve a number of wealth creation outcomes. Apart from enabling the SMSF to acquire an asset of a greater value than would otherwise be possible it is a useful mechanism for individuals to lend to their SMSF thus introducing their own capital in excess of the contribution caps.

meet the following requirements when running their fund:

- save only for retirement;
- have an investment strategy and invest responsibly;
- keep proper records;
- maintain super assets separately;
- do not lend super money to members or relatives;
- be aware of the rules when buying assets from a related party;
- do not allow in-house assets to exceed 5% of total assets;
- buy and sell assets at true market value;
- make sure contributions are allowable;
- do not allow disqualified people to be trustees;
- do not take money out early; and
- meet lodgement and payment obligations.

What happens if the rules are breached?

All decisions and responsibilities associated with managing a SMSF rests with the trustee. In addition, all superannuation funds have to comply with rules and deadlines. The Trustee is responsible for making sure the fund meets all requirements on time.

In some instances trustees breach the rules without even knowing it. It can be as simple as providing financial assistance in the form of a loan to another person who is not a member of the fund or even acquiring an investment (such as an investment property) from a member.

Failure to comply with the superannuation and taxation laws in addition to administrative requirements could lead to severe penalties imposed by the ATO. Some of these severe penalties can include:

- the trustee(s) can be suspended or removed and an acting trustee appointed;
- the fund can be declared non-complying meaning the fund's income and/or capital is taxed at 45%; and
- the trustee(s) can be prosecuted with fines up to $220,000 and up to 5 years jail.

Trustees of SMSFs are encouraged to engage SMSF professionals to complete certain acts or tasks on their behalf (e.g. engaging the services of an accountant, superannuation fund administrator, tax agent, financial planner, etc.). However, the Trustee is:

- bound to retain control over the fund; and
- unable to hand over the responsibilities associated with these tasks.

The ATO has released a guide explaining the roles and responsibilities of trustees when operating a SMSF. The guide is entitled *'Running a Self Managed Super Fund'* and can be found at www.ato.gov.au/superfunds.

Who are SMSF's suitable for?

As a general rule, a SMSF may be suitable for people who:

- need to have more control and responsibility for their own retirement planning strategy;
- have an interest in investing, monitoring investments and fund administration;
- have at least $250,000 in superannuation; and
- are comfortable being a trustee, completing the role and accepting the responsibilities.

The ATO has released a six step guide to assist people in working out if managing a SMSF is right for them. The guide is entitled *'Thinking about a Self Managed Super Fund?'* and can be found at www.ato.gov.au/superfunds.

How to get started

When setting up a fund it is important to recognise it is a trust which needs to be established and then the Trustee needs to ensure that the fund qualifies as a complying superannuation fund. This will involve a number of important steps as outlined below.

1. **Obtain a trust deed –** This establishes the rules of operation of the fund. The Trustee needs to make sure it's prepared by someone qualified to do so such as a solicitor or legal service company. A financial adviser could also assist with this task.
2. **Appoint Trustees –** All superannuation funds are required to appoint trustees. All trustees and directors need to consent in writing to being appointed.
3. **Complete the Trustee Declaration –** All new trustees and directors of corporate trustees of a SMSF must sign a declaration, in the approved form, stating that they understand their obligations and responsibilities as a trustee of a SMSF. The declaration must be signed within 21 days of becoming a trustee or director of the corporate trustee.
4. **Elect to be a regulated fund –** A trustee must elect to be regulated by the ATO under superannuation law if the fund wishes to receive concessional taxation treatment. This must be completed within 60 days.
5. **Apply for a TFN/ABN –** The trustees of a SMSF must obtain a TFN and ABN for the fund.
6. **Set up a bank account for the super fund –** The trustees need to open a bank account in the fund's name. This will allow the trustees to manage the fund's operations and accept cash contributions and rollovers of super benefits.
7. **Create a written investment strategy –** A trustee of a SMSF is required to prepare and implement an investment strategy for the fund. This involves taking into account risk, liquidity, diversification and fund payment profile.
8. **Making a contribution or rolling over super to an SMSF –** the following steps should be considered:
   - notifying all contributing employers of the new superannuation fund details so that they can commence paying superannuation guarantee and any other super contributions into the SMSF. This can be done by completing a super choice form.
   - Rolling over existing superannuation funds into the SMSF to ensure that the opportunities provided by the fund are maximised.

If you are thinking about setting up a SMSF, we recommend that you speak to a SMSF expert.

A licensed and qualified financial adviser can help you assess your options and which one suits your financial situation. They can help you to understand the rules and responsibilities and assist with ongoing management of a SMSF fund.

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