

THE Financial Intelligence

The Financial Intelligence is brought to you by



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In this issue

Starting a DIY superfund – step by step1	Top 7 investment tips for 20113
The Widow, Business Partner and Dead husband.....2	Get Super tax free to children?.....4
Protect Your Most Important Asset in 20113	Laying the foundations for successful investing in 20114

Starting a DIY superfund – step by step

So it's time to take the plunge and set up your own DIY super fund. We've got a few helpful pointers on what you need to do to get started.

This process comes down to some basic steps, which you can discuss with your financial advisor or accountant to help you set up, these steps include:

- establishing the fund and preparing a trust deed
- appointing trustees of the fund
- formulating an investment strategy, which again can be with the help of your financial advisor or accountant
- meeting ongoing management, administration and reporting requirements in accordance with super and tax rules

Establishing the fund and preparing the trust deed

This is the first thing you must do. Set up your DIY super fund as a trust and prepare a trust deed. This is where professional advice is needed to prepare the deed.

The trust deed will set out how the fund will operate and will cover:

- who the trustees are and how they are appointed or removed
- trustee powers
- eligibility for fund membership
- how contributions are accepted and members paid
- how the fund will be wound up
- how to value the assets

All DIY super funds are regulated by the Australian Taxation Office (ATO).

Trustees must notify the ATO via a 'notice of election to be a regulated superannuation

fund' and request a Tax File Number and Australian Business Number within 60 days of commencing the fund.

To become a regulated fund, and qualify for tax concessions, the trustee/s must ensure the trust deed either appoints a corporate trustee (who is subject to the Corporations law), or states that the sole or primary purpose of the fund is to pay old-age pensions.

Trustees must open a bank account for the fund. This is vital as it separates the fund's assets from personal and/or business assets.

Appointing trustees of the fund

DIY super funds differ to other superannuation funds as all members must be trustees. It's important to remember that members are responsible for running the fund. Their responsibilities include investing the funds' assets, paying benefits and meeting the administrative and compliance requirements of the fund. Trustees must also consent in writing to their appointment as a trustee.

DIY super funds must only have four or less members. If the trustee is a company, all fund members must be directors of the trustee company. Other requirements also include:

- no person other than a member can be a trustee or a director of the trustee company. Similar rules with slight variations apply to single member DIY super funds.
- trustees cannot receive any remuneration for their services and cannot be employees of the other members unless they are related.
- you must be 18 years old or over (although people under 18 can be members of DIY super funds once established), have no criminal convictions relating to dishonest behaviour and not be an

undischarged bankrupt.

Formulating your investment strategy

As the trustee for the DIY super fund you will have to prepare an investment objective and choose a suitable investment strategy. This strategy must reflect the fund's purpose and circumstances and must detail how it will:

- maximise member returns, within an acceptable level of risk
- diversify across a range of assets (for example, shares, property, fixed interest)
- pay benefits and fees as required

The Australian Taxation Office has strict guidelines on what DIY super funds can and can't invest in. So remember that the sole purpose of your DIY super fund is to save for your retirement.

Management, administration and compliance

These are some of the requirements for running your own DIY super fund:

- keep accurate and accessible accounts for the fund
- prepare annual operating statement and annual statement of the fund's financial position
- maintain minutes of all trustee meetings
- retain copies of all annual returns and reports given to members for a period of 10 years
- report all contributions made to the ATO by specified dates each year

Your DIY super fund must also appoint an eligible auditor to conduct annual audits of the fund's financial accounts and statements.

Speak with your financial adviser / Accountant about DIY super

The Widow, Business Partner and Dead husband

The widow stood at the graveside as the coffin was slowly lowered. She looked across at her late husband's business partner.

"I'll make that bastard pay double if he wants my husband's half of the business," she thought. The business partner caught the widow's mournful eye, "I'll offer her one tenth. She wouldn't know what it is worth. Anyway, without me it is worth nothing".

Did you know that for 2 male business partners both aged 35, the probability that one will die or become totally and permanently disabled before aged 65 is 52%. For 4 partners the risk increases to 77% and with 6 partners 89% Women on the other hand statistically make for a better risk.

Business succession planning is not about insurance, legal documents or detailed financial plans. It is about developing a strategic plan to ensure a smooth and trouble free hand over following a trauma event, disablement and death.

How is Business Succession Planning best achieved?

Protecting your business and your family

Business owners think they do not need or are too busy to get around to creating their Business Succession Plan. The spouses generally don't know the risk their business spouse is taking in not planning for disasters.

Let me give you an example:

Not so long ago I saw "John" in our office. John runs a small, successful real estate company with his business partner Keith. Shortly before I saw John, Keith had developed cancer and died. He left everything in his Will to his wife Nicole. Nicole inherited Keith's interest in the real estate business.

Nicole had never been involved with the business. Not only did Nicole not want to have anything to do with the business, she told John she would camp on his doorstep until he purchased Keith's half of the business from her. In the meantime, she wanted Keith's usual wage. She needed money to support herself and the children. John would have been happy to pay her half of the value of the business IF:

1. He knew what the business was worth;
2. Nicole agreed with the value (and wanted to sell); and
3. He could find the money to pay her

To compound the problem the bank wanted additional security for the business's overdraft. Was Nicole willing to go as a guarantor to the business overdraft to replace her husband? John was frantic. Would he have to sell the business (his life's work) at a fire sale?

Why was this?

It is NOT well known that in the majority of any Banks fine print clauses on security for a Business loan, the death or disability of a guarantor or co-surety to a business is an "event" of default. This means that if any person, who is a party to a Bank's security dies, becomes disabled or suffers a traumatic event, the Bank is able to seek repayment or re-negotiate the loan facility. The answer here is proper Key Person Insurance (as distinct from insurance for a Business Succession Plan).

What is the answer?

John and Keith together with their Adviser, Accountant and Tax Lawyer could have prepared a Business Succession Plan which is an agreement between the business partners to deal with a principal:

1. dying;
2. becoming disabled;
3. retiring;
4. divorcing;
5. resigning;
6. being convicted of a criminal offence;
7. becoming bankrupt, and;
8. taking unauthorised absences from the business

Nicole could then have required John to purchase her half of the business for a predetermined price. Alternatively, John could have required Nicole to sell her half of the business for the same predetermined price.

How can you afford to pay the purchase price?

Even with a Business Succession Plan, to ensure the transfer of a business interest upon death, all problems are not solved. The remaining partners need money to buy out the deceased's family.

A number of funding mechanisms are available. The most successful funding method is a combination of life policy, trauma policy and total and permanent disability policy. We suggest you contact your financial

planner to discuss the many products out there.

What about tax?

Yes, you have to be very careful to structure your Business Succession Plan so that you avoid unnecessary tax.

1. A properly prepared Business Succession Plan ensures that only nominal stamp duty is payable when you sign the Business Succession Plan.
2. Capital Gains Tax can be triggered on the "disposal" of the business (that is when Nicole sells to John). There are many avenues available to you to ensure the assets are transferred without the expense of capital gains tax provided you take the proper precautions before entering into the Business Succession Plan. Exemptions in The Income Tax Assessment Act (such as section 160ZZI) give further protection.
3. Some of the business assets can be income producing for the taxman (e.g. trading stock). Proper mechanisms can circumvent this problem.

How do I create a Business Succession Plan?

Put and Call options are the easiest to set up and explain. Let's look at an example of how this works using John, Nicole & Keith.

John gives Keith the "right" (option) to purchase Keith's interest in the business following the occurrence of any of those specified events listed above and Keith gives me the same right. To make the arrangement even more secure, we each grant both "put and call options".

The protection for John is as follows:

Assume Keith has died; John may exercise the option to "call" upon Nicole, as the Widow, to sell Keith's interest in the business to John at a predetermined price.

The protection for Nicole, the Administrator of Keith's estate is as follows:

Alternatively, Nicole may have the option to "put" to John that he must buy Keith's interest in the business.

The Put and Call Agreement

Arguably, the most tax effective way of structuring an agreement to embody your objectives is through an option agreement.

A Risk Adviser, the business's Accountant and a Tax Lawyer when acting in concert together can achieve proper tax effective Business Succession Plans for their clients.

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Protect Your Most Important Asset in 2011

Many people believe because they are employees they will automatically receive an income if something should happen to them. In most cases they are wrong! The reality is that the majority of disabilities come from illness related conditions (over 80% at age 40) and only a small portion of accident claims are work related. Work cover has some major limitations!

How would you survive if the income for your family suddenly stopped? Could you afford to pay for your mortgage, your car repayments or feed the family? In many cases the answer is no.

If you are a 40yr old earning \$50,000 a year and looking to retire at 65, you are putting over \$1,500,000 of future income at risk by not insuring your income!

We all insure our cars which could be worth \$30,000 or our homes that may cost \$250,000 to replace, however we neglect the very asset that enables us to enjoy our cars, homes and lifestyles.

By arranging an income protection policy you can protect your future income. The cost of the insurance will vary on your age and occupation however in many cases the cost will be a lot less than you think, and the premiums are tax deductible.

You can rely on your family, the Government or friends to provide for all your future financial needs. Or you can be independent, by arranging income protection insurance and you will ensure your financial future, quality of life and self esteem.

In assessing the best policy for you it is necessary to look at the conditions of a policy. Some important points to consider are:

- Level of income to insure (normally 75% of taxable income)

- Agreed or Indemnity contract (is the benefit a guaranteed amount)
- Rehabilitation Benefits
- Offsets in event of claim
- Waiting Period (how long before you are on claim)
- Maximum benefit Period (how long you get paid for)
- Cost is tax deductible

Taking out income protection could be the smartest decision you make in 2011!



Top 7 Investment Tips for 2011

Nobody has a crystal ball to predict what will happen with markets over 2011. However, there are underlying principles that have always applied and we believe always will. Successful investment means having long-term strategies yet being able to adapt to take advantage of opportunities along the way.

Before investing in 2011, there are four critical issues to consider:

- Over what time period are you prepared to commit money?
- What level of risk are you comfortable with?
- How will you diversify your investments?
- What are your financial goals and are they realistic?

Over a longer period there will be peaks and troughs in all markets and your strategy needs to take advantage of these cycles. Your focus should be on the whole portfolio. Don't panic if returns for fundamentally sound investments suffer in the short-term.

Tip 1. Research before you invest

Share and property markets are not fully efficient and some assets are under-valued but have potential capital growth. Continual research will identify the time to change the

balance between different market sectors and take advantage of economic cycles.

Tip 2. Focus on fundamentals

A unique business model, a strong balance sheet, and exceptional management are criteria to look for in a company. Location, access to amenities and uniqueness are critical for a successful property investment. In the long term, it's the fundamentals not the rhetoric that counts.

Tip 3. Select good fund managers

Fund managers can apply far greater time and resources into selecting assets and monitoring them than you can. Unless you have the time and the ability leave it to the professionals.

Tip 4. Adopt a counter cyclical approach (The Warren Buffett way)

Following the herd is a sure way to lose money. For instance, in a booming property market there are going to be very few good value buying opportunities. Alternatively, a fall in shares prices as we are currently seeing can make many quality blue chip companies good value. There is no bell that rings at the bottom of the market? So buy quality and never sell, just like Warren Buffett

Tip 5. Manage your gearing

Borrowing to invest remains an excellent strategy to build wealth. Whilst interest rates

are low, it is tempting to increase exposure to more debt. However, be aware of the risk to your overall portfolio from an increase in rates and the financial pain of margin calls if your gearing falls outside an agreed limit.

Tip 6. Consider small companies

Some smaller companies will grow much faster than the general market in the next ten years. But many will fail. Intense research and diversification is vital in this sector as well as Choosing an expert fund manager or advisor.

Tip 7. Be open to alternative investments

The financial services industry is dynamic and new opportunities are always emerging. "New" doesn't necessarily mean successful so care and research is required. For example, "absolute return" funds and leveraged investments are becoming more sophisticated and less risky. The use of capital protected or put options can give you peace of mind.

However, there are two other issues to consider. Firstly, use the most appropriate tax structure for your investments. Superannuation is still probably the most tax effective investment vehicle for a lot of investors. And last review your portfolio regularly with your adviser to look for buying opportunities that will improve future performance.

Get Super tax free to children?

Question: I overheard at bingo that adult children get their hands on our Super when we die - tax free.

I've always told my adult children that when I die, the tax man gets more of my Super than they do.

I don't attach much weight to what I hear at bingo - but in this instance, I'd be more than happy to be proven wrong.

Answer: Listening carefully to the bingo numbers is as important as eavesdropping - both require luck. This time you were lucky - what you overheard could be correct.

When you die death tax is often paid on your Superannuation up to 31.5%. There are 4 ways of getting around this tax. One way is 'interdependency' between the dead person and the person lucky enough to get your super. The notion of interdependency relationships was introduced about 5 years ago. Before interdependency the only people entitled to inherit a superannuation death benefit tax-free were:

1. a spouse
2. a child under 18; and
3. a person who was financially dependent on the fund member.

I know what you are thinking. What are the interdependency rules and how do you prove them?

Interdependency rules have extended the tax-free entitlement to virtually anyone with

a close personal relationship with another person. The fundamental element is that a relationship of love and affection must exist.

Two persons (whether or not related by family) have an interdependency relationship if they have some of the following characteristics:

- they have a close personal relationship
- they live together
- one or each of them provides the other with financial support
- one or each of them provides the other with domestic support and personal care

SISR Regulation 1.04AAAA says that you look at all of the circumstances of a relationship to determine whether an interdependency relationship exists. These circumstances can include:

- the duration of the relationship
- whether or not a sexual relationship exists
- the ownership, use and acquisition of property
- the degree of mutual commitment to a shared life
- the care and support of children
- the reputation and public aspects of the relationship
- the degree of emotional support

- the extent to which the relationship is one of mere convenience
- any evidence suggesting that the parties intend the relationship to be permanent.

Further, 2 persons have an interdependency relationship if each of them provides the other with support and care of a type and quality normally provided in a close personal relationship (rather than by a mere friend).

Examples of care normally provided in a close personal relationship rather than by a friend are:

- Significant care provided for the other person when he or she is unwell
- Significant care provided for the other person when he or she is suffering emotionally.

What about establishing financial dependency?

To establish financial dependency, there can be a binding obligation to provide:

- finance (cash)
- consideration of a financial nature such as nursing care, cleaning and gardening and other services that will incur financial loss to the survivor because the deceased will no longer be able to provide these services after the member's death.

Brett Davies, lawcentral.com.au.

Laying the foundations for successful investing in 2011

The foundations of a strong portfolio rely on four key 'pillars' or investment principles... quality, value, diversity and time.

"Don't put all your eggs into one basket"... we hear time after time, meaning to diversify your portfolio, but that is only one investment pillar. The other three are equally important... in fact, forget about just one and you are setting yourself up for a very bumpy ride!

Let us briefly explain why all four pillars are crucial to your investing success, particularly in the current volatile environment...

If we look at the first two pillars, quality and value, it's obvious this means to look

for assets that are expected to provide high returns relative to their risks. Applying this to shares, quality companies will have a sound basis to their operations and growth, that is, their earnings are not driven by fashion. This, however, might mean that they take time to deliver promised returns. But remember, investing in the sharemarket is a long-term strategy.

Quality and value do not always go hand in hand. Quality stocks may trade at such high prices that they offer low initial value, or expectations for these companies are sometimes placed too high. However, the key here is quality...

the expectation is that they will be around for a long time, not just a good time.

This takes us back to diversity... diversity acts like the scales in a portfolio, providing balance. True diversity in a portfolio gives the investor the opportunity to take advantage of "hot stocks", whilst balancing out the risk with quality stocks. It provides insurance against mistakes in assessing value because nobody gets it right all of the time. A well-balanced portfolio can cope with occasional losses.

And finally, one of the most important pillars is time... because it applies to all three, giving you the best chance of success. Every market will suffer periodic downturns, however, over time the upturn will always return. The golden rule is don't panic and refrain from getting caught up in the fear and greed cycle.



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