

THE Financial Intelligence

The Financial Intelligence is brought to you by



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End of Year Tax Tips for 2010 / 11

The end of the tax year is getting closer, If you haven't planned how you will maximise your income and save some tax, we have outlined some action steps below!

The most effective strategies are often the simplest and can be applied before 30 June this year whilst others should be considered for next year. Here are both lists to consider:

Action Pre 30 June

- Defer non-essential income until the new financial year.
- Review your investment portfolio prior to 30 June to determine whether investments should be sold to offset any capital gains or losses made throughout the year.
- Ensure you get capital gains tax concessions by holding assets for more than 12 months.
- Maximise tax deductions through super contributions. Alternatively, make a contribution into super for your spouse – this could provide you with a tax offset.

- Borrow to invest through home equity loans, margin lending or protected equity loans and possibly pre-pay the interest.
- Ensure you review income distributions from family trusts. You can lose franking credits in some circumstances if a family trust election is not made.
- Consider paying some insurance policy's yearly instead of monthly if you have sufficient cash flow. You will be able to claim the full premium this financial year for policies like income protection and life cover superannuation.

What about next financial year?

- Make sure you hold assets in the most appropriate tax structure. Individuals, companies, trusts and super funds are all taxed differently on their capital gains and income.

- Use franking credits to reduce tax on lower taxed entities like super funds and lower income earners. Remember that excess franking credits are refundable.
- Income split wherever possible to take advantage of the progressive tax system.

Take care with "tax-effective" investments

The golden rule when considering any investment is to focus on the quality and prospects of the assets and treat any tax advantage as a bonus. Remember that over time a good investment will be much more valuable than a tax break this year.

In an ever-changing tax and investment world, seeking professional advice can help you make the right decisions.



You wouldn't perform your own brain surgery - so why write your own Will?

Question: My New Year Resolution was to write my own Will. I thought it would be easy.

However, I have come to realise that Will writing is far more complicated than I first thought. I asked my financial adviser for some help. She almost spat her extra-skinny, organic, soy, decaf-latte (obviously her New Year resolution was to be more health conscious) at me in shock. Apparently, my idea was 'ridiculous'.

I am not perturbed. I'd like some hints. What are some of the essentials of a good Will?

Answer: Congratulations on making a Will a priority. However, your suggestion to write your own Will is giving me heart palpitations. If I had an extra-skinny, organic, soy, decaf-latte, I would be doing the same thing as your adviser.

Many people underestimate the complexity of their affairs. Even if you just have your family home and a car, you still need a Will that is drafted clearly and correctly. Add in complexities such as superannuation, investment properties, blended families, ex-spouses – and the importance of a good Will increases exponentially. Otherwise, you may as well name the tax-man and your ex-husband's new mistress as your main beneficiaries.

Wills are complicated legal documents which require a high level of precision and thought. Only instruct a specialist lawyer to prepare your Will for you. Please do not attempt to write it yourself. Although it may appear simple and clear to you, I guarantee your beneficiaries and the Probate Court will see it differently. Using your "simple self-drafted" Will, your beneficiaries may be tied up for years and spend all of their inheritance on legal fees to figure out who gets your assets. Unfortunately, I have seen this happen.

At Civic Legal, we have solicitors that only practice in tax, superannuation and estate planning. Our Wills are 3 Generation Testamentary Trust Wills – these protect your assets from vultures, protect your beneficiaries from squandering their inheritance and they also save tax.

Here is a short list of questions to ask yourself before meeting with your lawyer to prepare your Will:

1. Who should be the Executor?

The best Executors are those people getting the proceeds of the Estate. This usually means the spouse in the first instance and then all the children once Mum and Dad both die.

What if the children don't get along? We hold firm our view that even where this is the case, the best Executors are still all the children. This is because the Executors hold a subservient position. Their prime duty is to pamper and obey the whims of the beneficiaries.

It is often forgotten that the naming of a person as an Executor is simply an invitation. It is not a mandatory appointment. If a person who is named as an Executor is unable or unwilling to act they can renounce (give up) the position. The Executor clause in your Will could be improved:

- if it does not appoint the surviving spouse at first instance
- it only appoints one child as Executor once Mum and Dad die - it is appropriate to appoint all of the children as Executors

2. What should be done with the home?

There are two ways of allowing someone to live in your home at death without giving them ownership of the property: Life Estates and Rights to Reside. Life Estates and Rights to Reside have adverse tax consequences – potentially triggering Capital Gains Tax. They generally lose the principal place of residence CGT exemption.

3. Superannuation as an 'Estate Asset'

Superannuation does not automatically form part of the estate. It often does not go into the Will.

4. Why is tax planning essential at death?

Capital Gains Tax, Income tax and transfer duty are the silent insipid de-facto death duties. Your Will can benefit from a Three Generation Testamentary Trust:

- A Testamentary Trust is designed to minimize tax. That is, it is designed to allow the beneficiaries to wash out the de facto death duties
- One of the advantages of a Testamentary Trust is that the tax payable on the income earned on the estate or Capital Gains Tax payable is paid to family members on low tax rates.

- Each Primary Beneficiary controls their own Trust by becoming the "trustee" of their own Trust. For tax purposes, they control the assets. They do not own the assets.
- The Primary Beneficiary is often the person in complete control of the Estate assets in their own Testamentary Trust.

5. Protecting beneficiaries?

Simple Wills do not protect any beneficiaries who are bankrupt. This results in the beneficiary's inheritance passing straight out of their hands to the Trustee in Bankruptcy. Effectively the beneficiary's inheritance is lost.

A 3 Generation Testamentary Trust Will from Civic Legal gets around this unfair situation by including Protective Trusts.

A Protective Trust keeps the wealth in the family. A Protective Trust is an instruction to the Executor to not make a gift to a beneficiary if certain criteria are true for that beneficiary – for example the beneficiary is bankrupt, lacks mental capacity or is under age.

The Protective Trust is there to protect the beneficiary and not deny them of their inheritance. Once the beneficiary is out of bankruptcy, mentally sound and has attained the age of majority they are entitled to their inheritance.

6. Who might challenge my Will?

Where there's a Will – there's someone who can challenge it. There is a strong blood line relationship which defines who can make an application to the Supreme Court to challenge a Will. The class of people who can challenge your Will include, your:

- parents
- spouses – including de factos, mistresses and gay partners
- biological and adopted children (but not step-children)
- biological and adopted grandchildren
- anyone that you financially maintain (but not in all States).

To reduce the chance of anyone challenging the Will, we always recommend a Considered Person clause. A Considered Person clause names those people who you don't wish to make provision beyond what is stated in the Will. There's no need to air out your dirty laundry. When you die, your Will becomes a public document. Best not to give Ms Busybody next door any ammunition. A Considered Person clause does not prohibit a person challenging the Will, however it makes it harder for them to be successful.

So How Do You Become Wealthy?

While the Global Financial Crisis has meant that many of the rich have become less rich (it's really a bit of a stretch to say they are becoming poorer); those who have grown their wealth through property have done comparatively much better than most and in fact many have substantially increased their wealth over the last year by buying distressed property at bargain prices.

Examining the Rich 200 List we can see that more of Australia's wealthiest people have made their money through property than by any other means, and interestingly many of those who initially make their money in other businesses still invest their money in property.

Are there any shortcuts to get into the BRW Rich 200 list?

The answer is yes and here they are:

Choose your parents very carefully. Many of the people in the rich list are there because of the wealth accumulated by their parents.

If you don't have wealthy parents.....

Marry somebody who is already wealthy...

and then the trick is to stay married. Or...

The Magic of Compounding:

One lesson to take from the millionaires and billionaires who have used property

to accumulate their wealth is that most are long term investors. They buy well located assets and add value, often through development, and use the power of leverage and compounding to grow their asset base. They do not try to trade or speculate their way to wealth.

Invest Counter Cyclically:

Many of those who have become very wealthy in Australia, and around the world for that matter, are at times considered a bit crazy because they don't invest when everyone else is investing; more importantly, they invest counter cyclically when everyone else is saying it's the wrong thing to do.

We can learn a lot from Australia's richest people, so let's quickly look at some of the common traits of the people in the BRW Rich 200 list;

1. When they have made their millions they don't go off and spend their money, but tend to reinvest it in their area of expertise.
2. While many of the Rich 200 took big risks early on in their investment careers, once their wealth was established they stopped taking risks and preserved their wealth. Interestingly, others who kept on speculating or taking risks lost a significant portion of their wealth.

3. In general the wealthy do not over diversify. They have one good idea and repeat it, or specialise in one business or investment niche.
4. They tend to invest in growth assets (more than for cash flow.)
5. They are good at picking trends or cycles. They know when not to invest, they hold back near the peak of booms. And they also understand the power of investing counter cyclically when properties or shares are "on sale."
6. They recognise that it is harder to achieve wealth on their own, and have attracted a team of good people and trusted advisors around them.
7. They are confident and "just do it."

One of the major lessons I believe you should take on board is that of counter cyclical investing. Buying at or near the bottom of a cycle. Buying when people are saying you're mad to buy.

But of course, you don't buy just anything. You need to buy extremely selectively and need the ability to see beyond fads and fashions. You'll need to analyse and model long-term potential and probability of a capital gain.

Your Financial Planner & Accountant can help on the road to wealth creation.

Commercial property into SMSF - what do I get out of it?

Question: I read your article last week and I am intrigued. I also own commercial property. They make great returns for me. Excellent cash-flow. Why should I surrender my personal income to my SMSF? What do I get out of it?

Answer: I see your point. Why would you surrender the champagne lifestyle now, just to live it when you're 57? The reason is your SMSF is the most tax effective investment vehicle around. Nothing else is taxed as low. Further, upon reaching your preservation age, you generally take the Super tax free.

Speak to your accountant or adviser about the financial benefits. They have wealth creation strategies – both now and for retirement.

What is the first consideration? It is whether you hold an 'eligible interest' in 'business real property'. The ATO requires:

1. entity holds an eligible interest in real property; and
2. underlying land satisfies the business use test.

The 'business use test' requires the real property is used 'wholly and exclusively in one or more businesses' carried on by any entity.

An 'eligible interest' is defined in SMSFR 2009/1 as:

1. freehold interest in real property
2. leasehold interest in real property
3. an interest in crown land that is capable of transfer or assigning provided that it is not held as an interest of a beneficiary in a trust estate.

Provided it is in your SMSF's best interest you can:

1. sell or gift your business real property into your Superannuation Fund; and
2. buy business real property from a third party.

Who can you lease the business real property to?

- yourself
- one of your entities
- a non-related third party

Advantages in renting the business property in your SMSF to yourself? There are tax advantages for your Fund to own the business real property:

1. the rental income is taxed at 0% (if pension phase) or 15% in the SMSF. (A company suffers a 30% tax rate: a human suffers up to 46.5%).

2. your business gets a full tax deduction for paying the rent.

Things get better when we tackle Capital Gains Tax (CGT)

When your SMSF sells the business real property – the capital gain is concessionally taxed at a maximum of 15%. However, if your Fund held the property for over 12 months the rate is reduced to a mere 10%. The rate is a fantastic 0% if you are in pension phase.

Compare this to a human owning the property. Sure mums and dads get the 50% reduction in CGT (if you hold an asset for more than 12 months). However, the SMSF pays less CGT.

Consider you and your SMSF each disposing of CGT assets for a gain of \$100,000. The SMSF pays up to \$13,000 less tax. Crunch the numbers and the strategy with your accountant and adviser to see if it works for you.

Brett Davies, lawcentral.com.au

Income!... Your greatest asset?

Whether you're employed or self employed you should take steps to protect your greatest asset with income replacement cover.

What are the benefits?

- Receive up to 75% of your pre tax income if you are unable to work due to illness or injury.
- Maintain your family's lifestyle without the added financial pressure while you recover.
- You can select from a range of waiting and benefit periods to suit your budget
- The premium you pay for this cover is tax deductible.

How does it work?

Income replacement allows you to protect what is potentially your greatest asset, your ability to generate income. If you are unable to work for an extended period due to illness or injury how will you meet your mortgage repayments and other bills and expenses.

Rather than putting your family's lifestyle at risk, income replacement could pay you a monthly benefit of up to 75% of your income to replace your lost earnings.

Most policies will offer a range of waiting periods from 14 days up to 2 years. There are also policies that can pay a claim on accident after a few days and are especially suited to anyone doing manual work.

You can also select from a range of benefit periods with most companies offering paid benefits for 2yrs, 5yrs, to age 65 and some policies paying up to age 70.

What is your future earning capacity?

The table below gives you an indication of what you could earn by the time you reach 65, and how much financial risk you are taking by not insuring your income.

Call your risk specialist or financial advisor to discuss further

CURRENT INCOME (pa)	AGE NOW			
	25	35	45	55
\$40,000	\$3,020,000	\$1,900,000	\$1,070,000	\$460,000
\$60,000	\$4,520,000	\$2,850,000	\$1,610,000	\$690,000
\$80,000	\$6,030,000	\$3,810,000	\$2,150,000	\$920,000
\$100,000	\$7,540,000	\$4,760,000	\$2,690,000	\$1,150,000

Assumes salary will increase by 3% pa and no employment breaks.

Thanks for your support in 2010/ 2011 Tax year!

Thank you again to everyone who has referred their family, friends and business associates to us in the last 12 months.

We really appreciate your support and confidence in us.

We are always looking to improve in the delivery of our services to you, and want to make sure you are getting what you want from us and would appreciate your feedback.

Please take a minute and consider if there is anyone you know who would benefit from our services in the new financial year.



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