

THE Financial Intelligence

The Financial Intelligence is brought to you by



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ATO hit list for 2011/12... Are you on it?

Question: Hi Brett, I saw one of those examples of television journalistic brilliance that the ATO has a new compliance program for next year. I hate always getting letters from the ATO just because I run a small bar and have 13 family trusts.

Can you tell me who's on the hit list for the coming year? Am I going to be in the firing line again?

Answer: The ATO revealed its hit list for the 2011-2012 financial year. Not surprisingly, the ATO is focused on personal services income, small business benchmarks, overseas income, cash economy, work-related expenses, superannuation early release, and self managed superfunds.

It is best to start your tax planning as early as possible. Speak to your accountant and advisers about structuring your affairs to stay under the radar. The last thing anyone wants is to have the ATO doing a midnight raid on your house at Christmas.

High Wealth Individuals

Individuals with high net worth – between \$5 million and \$30 million are generally found by the ATO to meet basic taxation obligations. However, the ATO intends to contact 2000 people about outstanding tax issues. Alert: 2,660 high wealth individuals – individuals who effectively control \$30 million or more in net wealth – are being monitored by the ATO right now. The Tax Office raised more than \$800 million in income tax adjustments from high wealth individuals. However, most of that is in dispute. This year, the ATO is completing over 380 risk assessments and reviews and over 60 audits of high wealth individuals.

Personal Services Income (PSI)

The ATO is targeting sham contracting. This is where an employee is incorrectly classified as a contractor to save on employee entitlements. The ATO says its field work has gathered evidence of sham contracting

arrangements. The ATO also reports it received 16,300 employee complaints last year.

The ATO says it's consulting with industry representatives about new tax compliance measures. Those measures require businesses to report annually any payments they make to contractors in the building and construction industry.

The ATO is also targeting individuals streaming their PSI through another entity. The ATO is concerned those individuals might incorrectly split their income with an associate (such as a spouse or child) on a lower tax bracket.

Do you have a company?

The ATO is after directors and highly paid individuals.

Individuals earning over \$1 million and their use of closely held entities will be reviewed. Do you use charitable trusts and self-managed super funds? Unfortunately, you are in the spotlight. People from medical practices to football codes are all in focus.

Over the past 4 years the ATO has reviewed 2,000 highly paid individuals – finding 60% of tax returns needed correction. Mostly due to incorrect deductions or amounts being claimed, omitting income, and the use of tax-minimisation schemes.

Superannuation and SMSFs

Schemes offering early access to superannuation and superannuation contribution caps are in sharp focus. Anything limiting the amount of contributions qualifying for concessional tax treatment is in focus. The ATO warns "firm action" for breaches related to self-managed super funds.

Small business benchmarks and cash economy

The ATO has identified 46,000 businesses under-reporting their cash incomes. The benchmarks are expected to expand

from 107 industries to 137 in the next 12 months. Officially, the benchmarks are to help businesses compare their performance versus the rest of the industry. In practice, the benchmarks set unrealistic expectations for many businesses to meet.

The Tax Office says plastering and coffee shop industries will be paid close attention this year to ensure they don't abuse tax laws through cash payments, with administrative penalties and prosecutions possible from business reviews.

GST evasion

The ATO says 300 audits and reviews will look at serious and significant non-compliance.

In Western Australia, the ATO recently successfully prosecuted a business woman for GST evasion in the District Court. Sentencing of that person is to take place later this month. That business woman is looking at a maximum 10 years imprisonment for each of the 3 offences.

Brett Davies, lawcentral.com.au



Business Succession Planning No. 1

Question: Hi Brett, I've been to one of your famous asset protection talks recently. You spoke about the importance of business succession planning. In particular, you said it was as important as having a Will.

One of my clients asked me last week about this very thing. He is concerned his business is at serious risk. His business partner is a risk taker. He races cars on the weekend and likes free-climbing cliffs and skydiving.

What happens to the business if he has a serious accident? Is my client stuck with his business partner's fire-breathing dragon of a wife as his new partner in the business? She knows nothing about the business and had a gambling problem a few years ago.

Answer: It sounds like your client is sitting on a ticking time bomb. He needs your help and he needs it now. You are right. The fire-breathing dragon would destroy your client's business.

Most people think about making a Will during their life. However, too many business people do not consider a business succession plan (BSP) for after they're gone. At Civic Legal we recommend a BSP – especially where you have a business partner.

What about the guidance given in the old 2000 BSP discussion paper?

In 2000 the ATO told us how they thought BSP should be structured. Self-owned or the Superannuation Fund owning the insurance looked ok. However, at the secret National Tax Liaison Group (NTLG) meeting in December 2010, the ATO said the 2000 BSP discussion paper is withdrawn. The ATO also said that

anyone relying on that discussion paper should cease to do so. That means any existing BSPs need reviewing. Consult your accountant or adviser to see if your Plan complies with the Tax Law.

What do you need to consider?

Business owners need to discuss their plans with their accountants and advisers. Important things to consider are:

1. Who is involved in the business other than family?
2. How is the business structured? (e.g. company, trust, partnership or a combination of one or more of these).
3. Do you get along with your business partner's spouse?
4. Does your business partner's spouse know anything about your business?
5. Who would you like to take over your legacy once you are gone?
6. How does the surviving business partner find the money to buy out the interest of the deceased partner?
7. Do you want to continue in the business once your partner dies?
8. Do you want to have the option to buy out the share of the deceased business partner?
9. Do you want the deceased estate to be able to force you to buy out their share?
10. How do you fund the buy-out of the deceased partners share?

Most people do not hide large quantities of cash under the mattress any more. It is not tax effective to do so. Most people in business prefer to have 'good debt' in place to reduce their taxable income.

So, given lots of business owners are geared up to fund investments – how do you find the money to buy-out your partner's share at such short notice?

The most common approach is to purchase insurance. Sounds like an easy solution. But there are issues to consider about how to hold the insurance and who gets the benefit from it. 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 insurance agent or financial planner to discuss your requirements.

What about using an Insurance Trust Deed to hold the life insurance policy?

The ATO released Product Ruling PR 2010/18, concerning a particular BSP arrangement. The Ruling applies to a beneficiary under the Insurance Trust Deed who is absolutely entitled to the rights under an insurance policy held on trust for the beneficiary. That ruling only applies to non-death benefit insurance pay-outs.

However, the secret meetings of the National Tax Liaison Group (NTLG) reveal that the ATO is yet to provide guidance on who is absolutely entitled under a Trust. The ATO did however, refer to the Decision Impact Statement of the Kafataris case in the meeting. Essentially, where there is any discretion bestowed on the Trustee of the Insurance Trust, you lose the CGT exemption described in the PR 2010/18.

Brett davies, lawcentral.com.au

Do Life insurance companies pay claims?

In 2010, 11 Australian Life companies paid \$3,567,649,826 (that's over 3.5 billion dollars) in one year in claims, It is also ½ billion dollars more than paid in 2008.

Breakdown of the 2010 figure:

- Life Insurance claims paid \$1,629,150,468
- Income Protection claims paid \$1,033,831,983
- Trauma claims paid \$443,736,522
- TPD claims paid \$460,930,853



That's an average of \$13.7 million per working day. Is it time to review your current cover?

Have you got a key person in your business?

If that Key person got run over by a bus or had to take 6 months or more off work due to sickness or accident, how would you cope?

The most valuable asset in any business, whether a newsagent or a multi-national Corporation is the key people who run the business, or produce a large part of the revenue.

While material assets such as plant and equipment can be replaced relatively easily, this is not the case with human assets, especially key people.

The loss of the managerial skills, sales expertise and leadership of a key person can have a substantial impact on revenue and profitability. Considerable

costs can be incurred in recruiting and training a suitable replacement and there may also be an adverse impact on the business's goodwill and its ability to repay debts or other expenses.

By taking out key person insurance, you can help fund the loss of a valuable employee (including a business owner in certain circumstances) by providing an injection of cash for a revenue or capital purpose.

How does the strategy work?

A key person is someone whose contribution is considered vital to the ongoing success of a business. The purpose of key person insurance is to protect the financial position of the business by providing a

lump sum payment to offset the estimated losses that would arise upon the death, total and permanent disablement (TPD) or critical illness of a key person.

Key person insurance may be used for a revenue purpose (to protect against loss of income and profits), or a capital purpose (eg to provide capital to repay business debt). Other options may be available to protect your business, such as drawing on savings, borrowing money or selling assets. However, all of these options are costly and some may not be feasible. Key person insurance can be a less expensive and more convenient alternative.

Talk to your adviser about key people in your business.

10 questions to make sure you have the right cover in place!

1. Does your income protection policy still reflect the income you are currently earning?
2. Will your house insurance pay you enough to rebuild your house?
3. Will your life insurance pay off all your debts and be able to support your dependants if you are no longer around?
4. Has your car been modified in any way?
5. Have you recently installed security devices or extra locking systems on your home that could reduce your premium?
6. Have you discussed the benefits of Trauma cover with your adviser? It generally pays out a tax free lump sum on diagnosis of 50 or more conditions depending on the type of policy
7. Have you changed jobs and not informed your insurance adviser that your new occupation is less risk or you no longer perform manual work. These changes could reduce your premiums?
8. Assignment of a personally owned insurance policy into a DIY super fund is not allowed, This 'in specie' transfer could render your fund 'non complying'
9. If you have given up smoking for more than 12 months you could change your policies to non smoking status and save substantial premiums.
10. Changing jobs, moving home, re-financing or birth of a child are some common Trigger events that should prompt you to review your insurance cover. There are many different choices of insurance and it pays to have a specialist analyse your needs and find the most cost-effective solution for your circumstances.

Call your adviser to discuss.

Buffett comes to the rescue...again.

Billionaire Warren Buffett has been busy again. He gave a welcomed lifeline to Bank of America, announcing that he would invest \$US5 billion (\$4.8 billion) in the troubled US banking giant, of course when Warren acts the stock market pays attention and it sent its stock price soaring.

"Bank of America is a strong, well-led company," Buffett said in a statement released by Bank of America. "I am impressed with the profit-generating abilities of this franchise, and that they are acting aggressively to put their challenges behind them.

The \$US5 billion provided by Buffet will help shore up Bank of America's capital base, after it has lagged other top US banks in moving towards the stricter Basel III capital requirements imposed by global regulators after the financial crisis (these are tighter financial asset to debt requirements for banks agreed sooner after the GFC).

Already in true Buffet form Berkshire Hathaway, his investment company, has already clocked up over \$200m in share value.

This is besides the preferred stock, under the terms of the deal Berkshire Hathaway will receive warrants to buy 700 million shares of Bank of Aermica's common stock at an exercise price of \$US7.14.

Bank of America's common shares closed at \$US6.99 the day before the Buffet announcement, but they soared to above \$US7.50 after the Buffett announcement, meaning that Berkshire could already exercise its warrants at a profit of over \$US200 million.

Buffett, 80, is renowned for buying stock in undervalued companies and reaping profits as their share prices rise.

His contrarian investing strategy has made him the third-richest man in the world, with a fortune of \$US50 billion, according to Forbes magazine's most recent list of the world's billionaires.

Based in the farm state of Nebraska rather than among the skyscrapers of New York, Buffett has been dubbed the "Sage of Omaha" for his uncanny stock-picking prowess.

In an interview with CNBC, he revealed that he had come up with the idea of investing in



Bank of America while taking a bath, in true Buffet style!

When asked why he had decided to invest in the bank now, Buffett told the television channel that its stock had "gone down a lot".

Bank of America is the United States's largest bank in terms of deposits.

Let's hope his faith is well placed with the American banks and in turn go some way to start a period of "calmness" across the financial markets, who knows?

Common Traps to Avoid When Looking for a Mortgage

No research and choosing opinion over expertise

It is very important to not be too influenced by what you hear from family and friends, who may be in a completely different financial or lifestyle situation to you.

Going direct to your current lender for your new property loan and not researching loans offered by other lending institutions may seriously disadvantage you. We are living in an increasingly competitive mortgage landscape that sees new products and new lenders becoming available every day.

Can you guarantee your current lender will provide the loan arrangement that best suits you? You had better be sure because you will be paying it off for quite a few years!

Making decisions based on honeymoon rates and giveaway offers

Don't make your decision based on a honeymoon (introductory) interest rate because you will be paying the 'normal' interest rate before you know it. A 0.5 percent discount on the interest rate for the first year or so will only benefit you in the short term and may end up making you much worse off over the long term.

It is a good idea to pay at the 'normal' rate from day 1. This way you will be prepared for the end of the honeymoon period and you will have paid off more off your loan! Also, when deciding between variable, fixed or split rate, remember that just because the rate is the cheapest in the market doesn't mean that loan will end up the cheapest in the long run. We all know a variable loan's interest rate changes over time and a fixed loan's rate has a limited timespan.

Not thoroughly considering the loan features you need

Upon deep consideration, you may be surprised to find that you need more loan features that you first realised. If the loan you choose does not have the facilities you need, e.g. allowing you to redraw on any money you have paid over and above your regular repayments, then you may be sorely disappointed.

Features to consider are:

- Variable, fixed or split interest rate
- If fixed, the loan period for which it is fixed

- Redraw facility
- Offset facility
- Internet/branch access
- Extra repayments availability
- Penalties
- Ongoing fees
- Overall flexibility

Ignoring associated fees and costs

Although it may be tempting to let your judgment be overshadowed by the standalone interest rate you should consider other fees such as application, deferred establishment, rate lock, monthly, break, switch and redraw.

Comparison rates are a guide when looking at different loans' overall 'true cost'. Each loan's comparison rate includes the interest rate plus fees and charges relating to it, reduced to a single percentage figure so you can easily compare.

Stretching yourself to the limit with repayments

Although a lender may have approved the loan amount and term you applied for, you really need to make sure you can make those monthly repayments fairly comfortably for at least the next few years (when you may think about refinancing).

If you haven't done so already, create a budget that lists every cost you incur over the year and break down those costs as per the timeframe of your expected loan repayments, which will usually be fortnightly or monthly. Include everything from vehicle maintenance to haircuts to magazines and morning coffees.

Not factoring in interest rate rises

Every savvy borrower factors in at least a 1 percent interest rate rise because mortgage interest rates increase and decrease at times over the lifetime of the loan. You don't want to get caught out by not budgeting for those rises! 'Factoring in' might mean you pay that little bit extra from the time you start repaying or you already have it in your budget for when a rise occurs.

If you can factor in even more that will really help in the long run. Any extra money you put into your mortgage will reduce the amount owing and should also reduce your eventual loan term.

Even if you are paying off a fixed rate loan, that fixed term will eventually end so why not

pay a little extra if you can afford to and the loan allows it. You will be grateful you have done so.

Thinking property investment is a short term strategy

Property investment is an exciting and life-changing decision that can set you in good stead financially, given the right choices and commitment to its long-term nature.

A reliable short-term investment strategy is difficult to achieve for the average person. Sensible borrowers should consider property investment as a long-term strategy especially now house price growth is at a much slower pace in most states. Over the long term, there are many regions of Australia where good gains can be made if the buyer researches the area well and identifies the strengths and weaknesses involved.

Not having adequate insurance cover

If the loss of your income would affect your ability to make your loan repayments, then you need to give serious consideration to income replacement cover. If you have dependents that are relying on your income to service the debts then you also need to consider adequate life & trauma cover to clear the debts and help replace some of that lost income to the family

Talk to a specialist mortgage broker & insurance adviser.

