

THE Wealth Brief

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To be or not to be: corporate or human trustee?

Question: My accountant suggested a corporate trustee for my Self Managed Super Fund. I already have a few companies - I know they are more expensive to operate than having individual trustees. Is he only trying to generate more fees from me? I'm not made of money you know.

Answer: It is a vexed question whether SMSFs should have corporate trustees. Everyone in the Superannuation game has a different opinion. I change my opinion daily. But no two SMSFs are the same. So a blanket 'yes' or 'no' won't cut it. Your adviser and accountant looks at the following things to formulate their opinion:

- What is the relationship between the members? Will they change often?
- What are the type and value of the SMSF assets?
- Where are the SMSF assets located? Other states or countries?
- How pedantic are you?
- Do you need extra asset protection? Is there risk that the SMSF can go insolvent?
- Are the members happy to pay higher maintenance costs for a company?
- Contemplating Limited Recourse Borrowing Arrangements (formerly known as instalment warrants)?
- Do you own more than one property in one state paying land tax?

Corporate Trustees add expense and complication. Your Accountant is best to do the cost/benefit analysis. If your accountant suggests a corporate trustee, they have already answered all of these questions.

Who can be trustee of a SMSF?

- Humans as Trustees. If you want a human Trustee, all members of the SMSF must also be Trustees. You can't pick and choose between members - it's all or nothing. (There are minor exemptions for children and members living overseas.)
- A company as Trustee (Corporate Trustee) . If you have a Corporate Trustee,

all members must be the Directors of the Company. All Directors must be members of the Fund. The Corporate Trustee carries out its role as a Trustee of your superannuation fund just the same as you as individuals do. If you are the only member of your SMSF, special rules apply. (See the Platinum member only section below.)

When should I have humans as trustees?

- You want less hassle and the lowest administrative cost
- It costs nothing (apart from food and shelter) to keep humans as trustees. There are no annual reports to ASIC or dates to lodge with ASIC.
- You are unlikely to change the SMSF membership

It can become a nightmare to change the members of your SMSF with human trustees. Firstly, you need to admit (or exit) that person as a member (you have to do this anyway). Then, title to the SMSF assets is transferred to or from the member. This is because SMSF assets are held in the name of the trustees, not in the SMSF itself. For example, the four of you as members hold the SMSF land in your names. That is the law. You die; the property must now be transferred into different names. If you had a company, no transfer is required.

When should I have a corporate trustee?

You change the members of your SMSF often. If your members change often, you simply remove (or appoint) them as members and as directors of the corporate trustee. Although the directors change, the actual corporate trustee does not. As the SMSF assets are owned in the name of the corporate trustee, there is no need to jig about with the land titles office.

You are secretive and own lots of assets.

Don't want anyone to know what assets you own? A Corporate Trustee holds the assets in the name of the company. If someone does a land titles search using your personal name, they won't find the real estate held in your

SMSF.

You want to borrow in your SMSF. If you want to take advantage of Limited Recourse Borrowing Arrangements to borrow to fund SMSF assets, beware. Many lenders only agree to lend you money if you have a corporate trustee.

You need to amp up your asset protection.

Assets in your SMSF are meant to be conservative - they are there for your retirement - not for speculation. Risky or not, I have had clients that have ended up with negative assets in their SMSF. Insolvency often leads to the SMSF Trustees going down with the sinking ship. Better to lose just a company.

You pay land tax. In most states, you pay a higher marginal rate of land tax the more land you have. Therefore, if you and your spouse already have a rental property then owning more land (as Trustee of the SMSF) increases the rate of land tax you pay. At Brett Davies Lawyers, we can usually transfer the land out of your name into the name of your new company - for no transfer (stamp) duty and no Capital Gains Tax.

Ok fine. I think I need a corporate trustee. Can I use one of my other companies as trustee?

Yes you can. But just because you can do something, doesn't mean you should. Using a company for multiple purposes is fraught with risk. People who are pedantic and never make mistakes should only do it. I am pedantic and never make mistakes; however, I still use one company solely for my SMSF. Why do you need a separate company? SMSFs are delicate. SMSF auditors are even more so. There can't be any overlap between SMSF funds and other company funds. Weekly, I get calls from accountants where their clients accidentally used the wrong cheque book (or clicked the wrong internet banking account). Sure it is an accident, but the SIS Acts say this is incredibly illegal. No one can guarantee that they never make mistakes. Best to bite the bullet and set up a separate corporate trustee.

Brett Davies, lawcentral.com.au

The Rise of the Australian Dollar

It was way back in 1966 that the Australian dollar replaced the pound and since that time it's seen plenty of ups and downs. Then in 1968 Australia decided to link its currency to the US dollar and was set at a rate of \$1.00 AUS to \$1.12 USD. During all this time, all 42 years of it, the Australian dollar has never been able to match or exceed its US counterpart. In fact in 2001 the Australian dollar was only worth 48 US cents!

Australian dollar rollercoaster

So we saw a major low in 2001, but as with all rollercoaster's we were back to a high. In July 2008 its value had increased almost 100% to 98.04 US cents, this was its highest rate in over 24 years. Since then we returned to not the huge highs and lows but still full of ups and downs and recently saw the Australian dollar almost hit parity. Have a look at the graph below, supplied by XE.com, from earlier in October to see some of these highs and lows over the last 9 years.



So what's the cause of this recent rise?

Basically this is down to two things, weakness and strength, with a mixture of opposing economic policies added. Firstly weakness. Weakness in the US economy has led many investors away from the US dollar and move into "safer" currencies. Secondly strength. Strength in the Australian economy. A lot of which has been provided by the mining sector, due to the continued demand from its trading partners for what comes out of the ground. This all helps keep the Australian dollar in demand and high. Finally into the mix goes the two countries economic policies. Australia and the US have employed opposite economic policies. Firstly the US.

The US is following a path of very low interest rates in the hope of providing stimulus to an ailing economy. Whereas Australia has focused on an inflationary path and keeping it under control with the use of interest rates being kept higher. Again this has the effect of providing interest in Australia's currency.

So how does this affect me?

Well with every good story there's two parts to this, one good, one bad. The good side of the stronger Australian dollar being high is that we should, in theory, be paying less for imported goods. In practice this isn't always the case due to importers not passing on the full currency savings. But sometimes, as with oil, prices have rose and we are in the fortunate position of not seeing huge price rises. Another positive to the high is we can holiday in the USA and other countries for much less, we get more for our money, accommodation and living expenses are much cheaper. The flip side is the direct opposite to the good that this provides us with. The cost of goods for others buying from Australia are higher, this may mean that they buy less or source from else where. Although we don't see too much of this when it comes to our minerals. Also people from other countries, like the US, may have the view that Australia has become too expensive to holiday in. it also means that more Australians holiday abroad in places like the US rather than at home, because they get more value for money. All these effects put pressure on our balance of trade figures, goods and services coming in and out of Australia, which directly affects our economy, basically less people buying Australian goods and services. Over the coming months it's going to be interesting to see how the Australian dollar goes against the US dollar, a lot of economists are predicting parity and some even far over parity, maybe as much as \$1.20 US dollars. Either way it's an interesting point in the Australian dollars rollercoaster ride.

What will you do on the death or disability of a keyperson in Your Business?

A keyperson is a business owner or employee who is critical to the ongoing revenue and profitability of the business. The keyperson's typically have a direct impact on company earnings or whose expertise and talents are crucial to the continuity or growth of the business.

What is keyperson insurance?

It is a simple, cost effective and flexible solution in the event of a potentially devastating event to a keyperson in your business. This cover can include Trauma, Total & Permanent Disability and Death.

There are two types of keyperson policies. One is to protect the business cash flow, while the other is to protect business capital.

Keyperson revenue

This policy can ensure that your business continues to operate by compensating your business for loss of revenue following the disability or death of the keyperson. A

typical example could be a successful sales person who contributes a major percentage of revenue and profit to the business.

The sum insured can also include the costs of finding and hiring a suitable successor in terms of experience, ability and education.

Keyperson capital

This policy can help to pay out any loans or debts of your business following the disability or death of the keyperson in the business.

Up to 6 people can usually be insured under the one policy.

Ownership structure

We can assist clients to construct a keyperson policy so as to ensure that the correct amounts and types of insurance are established for the business along with correct ownership structures.

Depending upon the purpose of the keyperson policy (ie. revenue or capital), then we will

discuss how the policy should be owned.

Taxation

Generally, for keyperson revenue policies, the premium may be tax deductible to the company (IT155). It may also be assessable at the time of benefit paid to the business (IT 155). You should refer to your accountant for tax clarification.

The benefits:

- Provides a lump sum to offset a drop in your business revenue
- Provide your business with the time and resources to find a suitable replacement
- Continue with your business plans without significant interruption
- Provide capital to repay loans
- Protect your business from a forced sale

Call Your Insurance Specialist to discuss this strategy for your business.

Is bankruptcy the end of the world?

Question: My client is in serious trouble. Once upon a time, he lived a financially charmed life. Recently, he's had bad luck: First, he got caught investing in a high level Nigerian internet scam. Then he got sued when the window cleaner fell off his home's third storey. Now he is broke. Last night my client called me after another panic attack. His creditors have been sniffing for a while - now they want blood. The only problem is that there is no blood left - except for a sizable insurance bond. The only option I see is to declare bankruptcy before things get any worse. Can the Bankruptcy Courts seize his insurance bond as well?

Answer: I'm glad to be the bearer of good news - it doesn't sound like your client has had much of this lately. Usually the Trustee in Bankruptcy comes in like a thief in the night. They pilfer and strip every asset you own and many of the assets you control. Eventually, you're left poor, homeless and hungry.

Section 116(1) of the Bankruptcy Act 1966 (Cth) defines 'owning' property widely. You 'own' property for the purposes of Bankruptcy when it:

- belongs to you;
- is vested in you;
- is gifted to you; or
- is controlled by you.

If you 'own' the property:

- at the start of the bankruptcy, or
- acquire it after the bankruptcy started (but before you are discharged as a bankrupt),

then it is divisible amongst your creditors

at Bankruptcy. Even death is no escape. The Trustee in Bankruptcy picks over your remains.

However, before you charge up the defibrillator, there is a silver lining. The Bankruptcy Act does give exemptions. Unless you acquired insurance bonds to defeat your creditors, then the Bankruptcy Act expressly exempts insurance bonds as 'property'. This is regardless of whether you hold the bonds in your SMSF or in your own name. Party time (Ed. But not too extravagant a party as it looks bad when you are crying poor.)!

How does the Bankruptcy Act exempt insurance policies?

A. Insurance Bond in Superannuation

Section 116(2) of the Bankruptcy Act excludes as 'property':

1. Your interest in:
 - a. regulated superannuation funds (regulated funds are any retail, industry or Self Managed superannuation fund covered by the SIS Act);
 - b. approved deposit funds; or
 - c. exempt public sector superannuation scheme.

This includes payment from any of these funds, even if the payment is not a pension within the meaning of the SIS Act.

2. Money you hold in a Retirement Savings Account (RSA).

3. Payments to you from an RSA received on or after the date of the bankruptcy, even if the payment is not a pension or annuity within the meaning of the Retirement Savings Accounts Act 1997.

B. Insurance Bond NOT in Superannuation

Section 116(2) of the Bankruptcy Act also exempts from section 116 (1) the following property:

1. Assorted property, being:

- a. property that you hold in trust for someone else's benefit;
- b. personal property with sentimental value (Ed. I am very attached to my room of gold);
- c. property you use to earn income; and
- d. property used for personal transport.

As always, there are strict restrictions and value limits on all of these property classes.

2. Policies of life assurance and endowment assurance - but only for the bankrupt's life or the life of their spouse and de-facto. It does not matter whether the bankrupt receives the proceeds on or after the date of bankruptcy. But, beware: if you receive the proceeds before the date you declare bankruptcy, then your creditors snap it up. If you're expecting to receive proceeds, better to declare bankruptcy earlier rather than later - that way the proceeds are 'exempt'.

What about my insurance bond?

An insurance bond is clearly a life policy under Section 116(2) of the Bankruptcy Act 1966. It is protected against division amongst creditors. This is provided you don't:

- Transfer money into the account to defeat creditors.
- Transfer the money outside the prescribed examinable period.

Brett Davies, lawcentral.com.au

What's the difference between Principle & Interest and Interest Only Loans?

Actually quite a bit and quite a few reasons why you may want to use one over the other.

Why take out an Interest Only over a Principal & Interest loan?

This is where you, as a borrower, just pay down the interest element of the loan, never paying off the original principle, until a pre determined date or time period.

So why would you want to just pay the interest on your loan and not pay of the principle? Well there's a few reasons why and they all depend on your personal situation, so it's best to always get the right advice.

Cashflow & being flexible

Cash equals flexibility. Having good Cashflow and the availability of cash can be essential if something where to go wrong, like illness, or other unexpected expenses.

This highlights one of the main difference between Principle & Interest Only Loans, the cost of servicing them monthly. Because, with Principle & Interest loan repayments, as the title suggests you are repaying part of the principle as well as interest ,making you monthly repayments greater than Interest Only repayments.

Some banks maybe flexible enough to allow you to change from one product to another, even temporally should the need arise.

Tax reasons for Interest Only Loans #1

When it comes to tax there are multiple reasons for wanting an Interest Only Loan. Firstly it comes back to flexibility and is the very foundation of tax law. The ATO are interested in what you do with your money that you claim as a deduction rather than where the money is from.

For example if you purchased an investment property the fact that the money was used to buy the property is more important that the fact that you may have used your home as a security to buy it. If you only have your home and no other borrowings, this will come into play if you decide to rent your property out in the future.

If you have a Principal & Interest investment loan that you are making repayments on, your debt is obviously going down. The great thing about this is that if you need

to get your hands on some money, you've been building up a buffer by paying down you debt. The downside is that if you use any of that buffer to buy something that is not income generating (such as a car, holiday or renovation on your own home) then the interest that you have to pay on the money that pulled out is no longer tax deductible. Why is that? You've just borrowed money to buy something that is not income producing.

Whereas had you been making payments on an Interest Only loans, you could direct all your spare money to an offset account. This is a normal bank account that a bank may give you that is then linked to your loan account, but is not part of your loan account. Every dollar that you put in the offset account is a dollar that the bank will take off your debt when calculating how much interest you have to pay.

As an example, if you owed \$600,000 and have \$200,000 in an offset account, the bank is only going to charge interest on \$400,000, even though the loan balance is still actually \$600,000. If you wanted to take out some of your savings and like before spend it on something that is not tax deductible (because it does not generate an income) then you're not actually borrowing any money – you're taking it out of your bank account. You'll be paying more interest since you'll have less in your offset account, but because you didn't actually borrow the money, the ATO will deem the nature of the debt to still be for investment and you'll be able to claim the lot of it as a deduction.

Interest Only Loan Tax Reason #2

The other main reason is a matter of efficiency and value. If you are claiming the loan as being deductible, then you can assume that the ATO is effectively subsidising the cost of you debt. Using some basic numbers:

\$100,000 loan @ 10% = \$10,000 interest

If the loan was for investment purposes, then the \$10,000 interest is tax deductible. If you're on a marginal tax rate of 40%, when you do your tax return you'll be entitled to get back \$4,000 from the ATO. Therefore, the net amount of interest is:

\$10,000 – \$4,000 (tax return) = \$6,000.

As a result of this, we can work out our after tax net rate of interest:

\$6,000 (net interest) on a \$100,000 debt = 6% after tax rate of interest.

Using this formula with today's interest rates, if you're paying your bank 6.5% interest on your loan, your after tax net rate of interest is actually 3.9%. That is pretty cheap money. Now ask yourself this – if someone lent you money at 3.9% – would you want to pay it back, or would you use what money you had to investment and aim for a higher net return?

Depending on the level of risk you feel comfortable with, the answer might be very clear now as to what is the best thing for you to be doing. A lot of people say you should pay Interest Only your loans because it keeps your tax deductions high. Tax deduction is another word for expense that the Tax Act allows you to claim as an offset to income. Keeping your expenses as high as possible does not sound like the right way forward, does it? It's similar to saying "I'll chop my arm off, that way I don't need to buy nail clippers" – well, that may be a little extreme.

You would want to pay Interest Only on your loan because – after tax – there may be more efficient things you could be doing with the money. However, it all comes down to what your long term priorities are and what type of risks you feel comfortable taking on.