Freedom Stage 7
Part B

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Wealth Creation

NOW® ACCOUNTING
Your financial potential. Realised.

Freedom Stages

1. Plan your financial freedom
2. Mini emergency fund
3. Protect your income (with insurance)
4. The debt snowball
5. Emergency fund
6. Healthy housing
7. Wealth Creation
8. Generosity

Disclaimer

The messages communicated in this online seminar will be a combination of the speakers personal views, financial education from a taxation and education perspective and general advice.

No action should be taken solely on the material contained in this presentation as the information is of a general nature and does not take into account your specific personal needs or circumstances.

You should consider whether what is discussed today is suitable for you and your personal circumstances.

Before you make any decision about whether to acquire a certain financial product, you should obtain and read the relevant product disclosure statement.

In Australia personal financial advice by a licensed financial adviser is ordinarily accompanied by an advice document called a statement of advice. If you have not received a statement of advice it is likely you have not received personal financial advice. Registered financial advisers are listed on a government website, along with the scope of their authorisation.

Wealth Creation

Choosing a tax structure:

Individual Ownership

Joint Ownership

Family Trust Ownership

Unit Trust Ownership

Company Ownership

Superannuation

Individual Ownership

Individual Ownership

When you buy an investment (like a share) in your own name, you are subject to marginal income tax rates.

Resident tax rates 2019–20

Resident tax rates 2019–20

Taxable income	Tax on this income
0 – $18,200	Nil
$18,201 – $37,000	19c for each $1 over $18,200
$37,001 – $90,000	$3,572 plus 32.5c for each $1 over $37,000
$90,001 – $180,000	$20,797 plus 37c for each $1 over $90,000
$180,001 and over	$54,097 plus 45c for each $1 over $180,000

The above rates **do not** include the Medicare levy of 2%.

Example: Salary income $100,000

Receive $1000 bank interest – marginal rate & medicare 34.5% - tax payable $345.

Receive $100,000 Capital Gain. Discount of 50%, so $50,000 taxable income at 34.5% or $17,250.

In the event of bankruptcy your assets go into your bankruptcy estate.

Joint Ownership

Joint Ownership

When you buy an investment (like a share) in joint names, your share of the investment (50%) is distributed to you and the remainder to the other owners.

The ownership is fixed and there are tax considerations to change it.

Each owner pays their own marginal rate of tax.

Family Trust Ownership

Family Trust Ownership

A trust is a unique instrument created under law. When correct established, the trustee of a discretionary trust with a family trust election is permitted to distribute the income to different family members. The family tree is usually very broad.

The distribution can change each year. This flexibility can allow tax minimisation across a family group as circumstances change.

Assets held by a trust are usually not part of the estate of a bankrupt.

In the event of death of a family member, trusts can permit continuity with a change to the trustee allowing the structure to continue.

Each individual beneficiary of a family trust pays their own marginal rate of tax.

The rate of tax that applies “as a penalty” for undistributed income is the top marginal rate of tax is 47%.

Unit Trust Ownership

Unit Trust Ownership

A unit trust is a structure where there is a trustee, and unit holders who own the trust.

A unit trust is like a company however the profit must be distributed equally to the unit holders. Unit trusts can not retain profits.

A fixed unit trust can be popular when a number of people want to pool capital to make an investment but want to clearly define ownership, and to ensure income is streamed to them.

A discretionary family trust can be the owner of a unit trust unit, giving a lot of flexibility.

The ultimate recipient of the income distribution pays the tax. The unit trust “streams” the income to that ultimate recipient.

Company Ownership

Company Ownership

A company is an unusual structure for non-business investments because it can not access the capital gains tax discount. But of course a company is a common structure to carry on a business!

For investments, a company can “lend” its retained profits to an investment entity (operating like your own bank) which may be able to access that discount.

A company can pay tax at the corporate rate. This would usually be 30% for an investment entity. This means that the income can be “shielded” from the individual shareholders if it is retained in this structure. This is a flat rate and clearly higher than the rate of $0 on the first $18,200 in income but lower than 47% on income over $180,000.

When a company pays tax in Australia, accountants track its “franking account” which is a record of the tax its paid. It can attach “franking credits” to dividends paid to shareholders.

An individual shareholder would receive a credit for the franking credit but would pay their own marginal rates. This means they could get a refund, break even or owe tax on the dividend.

Superannuation

Superannuation

Superannuation, or Super is the most tax effective structure in Australia.

The rate of tax paid by a superfund in accumulation mode is 15%. On capital gains (if the asset is held more than a year) there is a flat rate of 10%.

When a superfund account is eligible to move to an account based pension, no Australian tax is paid on its investments (foreign withholding tax may be paid). This means that investors can potentially defer tax, and never pay it.

A limit of $1.6m currently applies to an account based pension.

The contribution limits for Superannuation are changed every few years.

You should take professional advice before contributing to Super due to the complexity of those changing rates.

The purpose of Superannuation is to fund retirement. The deal is the government allows lower tax rates as an incentive to participate and they hope to not have to provide an age pension for you. They want you to be self funded.

Superannuation is a structure

Superannuation is a structure, not an investment.

When people say “my investment property is my Superannuation” and they refer to an investment property in their own name, what they really mean is “I have made this investment in a structure in which I will pay marginal rates of tax which go as high as 47% rather than in a structure that would allow me to potentially pay no tax on this investment”.

You can't understand tax, maths, and longevity and dismiss Superannuation.

However – its very difficult to get people interested in Superannuation.

A common objection is the perceived need to access the money earlier than retirement age.

From age 60 when retired, and age 65 either way, Superannuation pensions and lump sum withdrawals are usually tax free to their members.

Most people with a goal to maximise their overall financial position should be considering using Superannuation as part of their strategy.

Types of Superannuation funds:

- **Industry & Retail Funds (APRA regulated)**
- **Defined Benefit Funds**
- **Self Managed Funds (ATO Regulated)**

Retail Superannuation funds:

- Retail Superannuation funds are funds usually open to members of the public to join. They can be owned by a bank or financial institution. This means the fund could well have a “for profit” motive.
- These funds will have a default investment strategy for members based on some demographic information.
- Some retail funds have a history that might be considered by some shady. Before regulation was tightened, some paid commissions to financial advisers based on employee contributions. Some have selected products with very high fees.
- While there are similarities, every fund has its own set of fees, its own investment strategy, and own characteristics.
- Post the Royal commission, some retail funds have lowered their fees to be very competitive to try to attract more members.
- Some retail funds are aligned to banks or particular financial advisers.

Industry Superannuation funds:

- Industry funds are similar to retail funds in that they are usually open to the public although they can have specific “niche” clients where they are the default fund.
- Industry funds have marketed their brand very aggressively. This ranges from sponsoring the news, giving frequent flier points to new members and providing sporting tickets to employers and decision makers who nominate their fund.
- Industry funds market themselves as being not for profit but there are some considerations to ask whether they are really that different to retail funds. Industry funds might have a political motive, being controlled by a union. They might not pay a dividend to a shareholder but they might be making a profit running a fund that they expend on their own objectives rather than lowering fees to members.

Industry Superannuation funds:

- Industry funds are controlled by boards appointed under rules within their trust deeds.
- Industry funds often hold more unlisted assets than retail funds which can create valuation risks (if a member leaves, are they over paid, etc)
- Industry funds are not always transparent with their members.
- Industry funds may suffer from diseconomies of scale and inefficiency. Their pricing suggests so.
- Many industry funds outsource all of the actual investment decision making to private managers. Sometimes these are wholly owned entities. The fees charged to funds, when you consider the sheer size of the sector are staggering. They are a huge enterprise.
- Four large accounting firms undertake the majority of the audit work in Australia for Superfunds and the companies on the ASX.
- APRA is the regulator for Industry (and retail) superfunds.

Defined benefit funds:

- Defined benefit funds are less common due to the difficulty of guaranteeing retirement outcomes and the desire for people to have control over their retirement funds.
- The older (and according to their members best!) funds guaranteed a pension, usually referenced to your salary for life.
- They were then replaced by deferred benefit funds. These usually provided a lump sum amount, and often you would have a choice which fund you want to take it to.
- Some defined benefit funds required considerable contributions and one of the reasons they have provided good retirement outcomes is not that they are a magic investment vehicle – it is that the employees consistently invested over their working life and built a great retirement income stream.

Defined benefit funds:

- People in defined benefit schemes should take care not to leave the scheme early if there is a penalty to do so. Some unscrupulous advisers in the Royal commission were ignoring the “penalty” element for members leaving.
- People in defined benefit schemes that pay a lump sum should start getting advice many years before the benefit is due, to ensure they can make a well informed decision about investing the lump sum (choosing a fund etc).

Self Managed Super Funds (SMSF):

- SMSF is the superfund category thought to have the most Super within it in terms of dollars (not member numbers).
- SMSF is a controversial area. SMSF have been used by unscrupulous people to overcharge members, expose them to dangerous property investment gearing strategies, and generally operate in a way that is not in the members best interest.
- ASIC and the ATO have tried to address the unscrupulous conduct with considerable warnings about SMSF
- SMSF is a very good structure, it is not for everyone. It is a case of, the more you know, the more you understand the benefits. With an overly simplistic understanding of Superannuation, and naive acceptance of the marketing from other fund types, many wealthy Australians are overlooking this option.

Self Managed Super Funds (SMSF):

- A SMSF has a maximum of four fund members. Every member must be a trustee.
- It is common with a SMSF to have a company as a trustee so the underlying investment assets do not need a name change if members change, and also a one member fund must have a corporate trustee.
- SMSF trustees are responsible for the fund. If they do the wrong thing there can be considerable penalties. They do not have access to the same compensation methods as APRA regulated funds, if things go wrong they may need to use the courts.
- Anyone considering an SMSF should consider the information published on the ATO website and should read the trustee declaration that will be signed for the ATO.
- The ATO regulates SMSF. If a fund becomes non compliant, a significant penalty will be levied on the member balances.

ATO
SMSF

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Self-managed super funds

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- Self-managed super funds 20th anniversary
- Thinking about self-managed super
- Setting up
- Contributions and rollovers
- Investing

Self-managed super funds

Self-managed super funds (SMSFs) are a way of saving for your retirement.

The difference between an SMSF and other types of funds is that the members of an SMSF are usually also the trustees. This means the members of the SMSF run it for their benefit and are responsible for complying with the super and tax laws.

- News and alerts
- Thinking about self-managed super
- Setting up
- Contributions and rollovers
- Investing
- Paying benefits
- Winding up
- Administering and reporting
- SMSF auditors
- SMSF Resources

Instructions and form for SMSF trustees

Trustee declaration

To be completed by new trustees and directors of corporate trustees of self-managed super funds.

Self Managed Super Funds (SMSF):

- A SMSF enables fund members to know how their Super is invested.
- A SMSF can purchase an investment property directly.
- A SMSF can not allow a member to use a residential property it owns.
- A SMSF can however buy a commercial property for a members business if the terms are arms length.
- A SMSF has a regular bank account. Members can access their super directly through the bank account.
- A SMSF can access the government guarantee of $250k per bank.
- Some people use SMSF and run the fund themselves and some work with accountants and financial advisors.
- Every year a SMSF must prepare accounts and a tax return. The SMSF must be audited by an auditor independent of the accountant/tax agent.

Self Managed Super Funds (SMSF):

- A SMSF is not viable for low balances.
- A SMSF can be cheaper to run with larger balances, including the costs of financial advice, accounting etc (all costs) than other funds like industry funds because of difference in the way fees are calculated. Accountants have a conflict of interest to disclose regarding SMSF because of the accounting services they may provide to the fund.
- A SMSF member will have the opportunity to gain their own tax outcome. This is not necessarily the case in other fund types.
- A SMSF member may technically be able to allocate transactions after the year end, where as a contribution to a public fund might be difficult to reallocate after the fact.

Asset allocation

- A superfund trustee is responsible for the investment strategies of the fund.
- Public funds will offer a selection of strategies, with a default based on demographic factors.
- In order to manage risk, average returns and improve investment outcomes, successful investors usually diversify across multiple investment classes.
- The needs of the members to access cash should be carefully considered. If members need to access cash in retirement and the market falls, assets may need to be sold at a bad time.
- It is helpful to think of the number of years income you want guaranteed, and then hold this amount in defensive assets. Traditional asset allocation is generally referenced to percentages, but thinking about a cash buffer as an absolute number than then investing the rest would also be a logical approach.

You need an allocation to suit your needs and manage volatility

Asset Class	Hypothetical 80 G / 20 D	Hypothetical 70 G /30 D	Hypothetical 40 G 60 D
Cash & Term Deposits	2	20	20
Fixed Interest – Domestic	9	5	20
Fixed Interest – International	9	5	20
Australian Shares	35	20	15
Australian Listed Property	5	5	5
Australian Direct Property	0	0	0
International Shares	35	20	15
International Listed Property	5	5	5
International Direct Property	0	0	0
Infrastructure	0	10	0
Alternatives	0	0	0

These examples are to facilitate discussion about asset classes. They are not a recommended portfolio. These numbers are not based on any researched portfolio.

Asset allocation

- A financial planner should recommend an asset allocation for your investments/superfund.
- We like to work with funds that give transparent information about the underlying investment exposure of the fund and allow us to select the investments specifically.
- It would be difficult to recommend a fund that does not provide transparent information about its investments and that does not allow us access to select investments.

Its hard to interest people in the taxation of Superfunds. Let me try!

Segregated assets mean that the fund member pays the tax in relation to their assets which are held on a one for one basis because the fund actually transacts on those assets and realizes an actual tax event it can attribute to a member.

Unsegregated assets mean that the fund is taxed as a whole and all members pay a share of the tax, even if they do not do anything to create the tax bill.

Example: COVID Sell off

- During a pandemic the government allows early release of Super.
- You are in an industry specific fund with lots of impacted people.
- You have an emergency fund, don't need to access your super, and hold your investments. You don't withdraw money.
- Hundreds of thousands of members do not have an emergency fund, and they do withdraw from Super.
- To get the cash to pay out the members, the fund sells shares.
- Because the fund sells shares for a profit, it incurs a tax bill.
- The fund spreads the tax bill across all of the members. You receive a lower distribution due to tax payable because your colleague withdrew super.

Example: Member leaves fund

- Funds have generally grown, meaning they have had a river of cash coming in to their bank accounts.
- Therefore when members leave, they might not need to sell any physical assets, and don't have a tax event.
- It would appear that many members rollover to other superfunds with no deduction from their member balance for capital gains tax. However, they could have had considerable "unrealised gains" in their member balance. Ie, you invested $100k, it grew to $200k, they write you a cheque for $200k. But what about the $10k in capital gains tax that would be paid if the fund had sold the shares?

Segregated funds

- Public funds that allow members to select their own investments (not the category, the direct investments) would usually provide a member with their own tax outcomes. However, it might be difficult to verify this as the calculation may not be easily accessed.
- Wraps are a product used by advisers and investors where the assets are owned by the investor, but attached to the investment platform which manages reporting, taxation lodgement, and allows the adviser and the client to access.
- SMSF either works with all of the members sharing the investments in proportion to their member balance OR segregated assets can be maintained in the fund. SMSF investors are likely to get their own tax outcomes.

What the tax?

- The big deal about tax in Super, is that Super is the ultimate low tax environment.
- The idea is – keep buying good investments, and if you retire before you sell them, you pay no tax on the capital gains!
- But, its very very difficult to get tax information from large funds. While they are audited, think of the scale of the audit.
- The royal commission accused Hostplus of crediting an administration reserve with the proceeds of the insurance premium deduction tax savings (rather than charging a member a net premium).
- The reality is, a small investor is not going to really know what is going on with the tax in a large fund. With a small balance, this is a small issue. As your Super grows, you have more reason to worry about this issue.

Fees and your Super – How much should you pay?

The three main categories of fees to consider are:

1) Administration
2) Investment
3) Advice

Example 1: 1.5m in FSS Retirement Income Stream (according to Xplan, on 23/5/2020) Growth option

Selected Plans

	First State Super Retirement Income Stream
Account Balance	Proposed $1,500,000.00
Selected Investment Funds	First State Super - Pension - Growth

Product Costs

Ongoing costs		
Administration Fees		$1,500.00
Adviser Commission	0.00%	$0.00
Adviser Ongoing Service Fee	0.00%	$0.00
Contribution Fee		$0.00
Expense Recovery Fee	0.00%	$0.00
Insurance Premium		$0.00
Investment Fees and Costs	0.67%	$10,050.00
Membership Fee		$52.00
Other Fees (Ongoing)	0.00%	$0.00
Performance Fees	0.25%	$3,750.00
SMA Administration Access Fee		$0.00
Trustee Fees	0.00%	$0.00
Gross Ongoing Costs		**$15,352.00**
Total Existing / Proposed (p.a.)		

Admin: $1,552

Investment: $13,800

Advice: nil

Example 2: $250k in NGS Super High Growth Option

Selected Plans

	NGS Super
Account Balance	Proposed $250,000.00
Selected Investment Funds	NGS Super - High Growth

Product Costs

Ongoing costs		
Administration Fees		$250.00
Adviser Commission	0.00%	$0.00
Adviser Ongoing Service Fee	0.00%	$0.00
Contribution Fee		$0.00
Expense Recovery Fee	0.00%	$0.00
Insurance Premium		$0.00
Investment Fees and Costs	0.68%	$1,700.00
Membership Fee		$65.00
Other Fees (Ongoing)	0.00%	$0.00
Performance Fees	0.07%	$175.00
SMA Administration Access Fee		$0.00
Trustee Fees	0.00%	$0.00
Gross Ongoing Costs		**$2,190.00**
Total Existing / Proposed (p.a.)		**$2,190.00**

Admin: $315

Investment: $1875

Advice: nil

Example 3: SMSF

Accounting & Tax $2200
Audit $330
Software $300
Total $2830 per year or $235.84 per month

ATO Levy $259
ASIC Fee $53

Total admin $312 + 2830 = $3142

Advice fee $1650 per year

Investment Fee: (possible ICR for an ETF portfolio) .16%

Obviously fees are a matter between clients and advisers and specific to scope and needs. These are for comparison purposes. This is not a quote.

Example 3: SMSF

SMSF Fees get cheaper with larger balances due to fixed costs.

Balance	100,000	500,000	1,500,000
Admin Fee	$3,142	$3,142	$3,142
ICR .16%	$160	$800	$2400
Advice fee	$1650	$1650	$1650
Total	$4,952	$5,592	$7,192
% of balance	= 4.95%	= 1.11%	=.47%

For larger balances SMSF fees can be lower including financial advice than the fees charged by some funds with no advice provided.

If you compare the FSS Growth pension option to the option here, you will see that the FSS option is twice the price of the SMSF, and the fee difference (which excludes advice) would fund a modest annual holiday to Fiji each year.

Example 3: SMSF

What do you get for your fees?

This example was based on an accountant preparing the accounts and tax returns once a year, and meeting with the client to go through them. Looking at the minimum pensions and super contributions and budget changes at year end, and going through them with the client.

The financial adviser in this example would review once a year the investments in the fund, meet with the client to understand if anything has changed such as goals or circumstances, and recommend which investments the fund should hold.

SMSF is not for everyone. You have to be competent with administration and understand there are rules to follow including on time lodgment obligations and requirements to stay within Superannuation law.

If you are not good with money, haven't lodged a tax return for 10 years and couldn't care less about your retirement do not start a SMSF!

Warning : Fees are not everything.

If we compare two similar products, with different fees, of course we want the one with the best fees.

But if you follow fees as a race to the bottom, you might find that you give something up for the reduction in price. Some of the ultra low cost options have gotten there by stripping out diversification.

You also want to be mindful of 'loss leader' funds. The fee needs to be viable or it's a recipe for disaster!

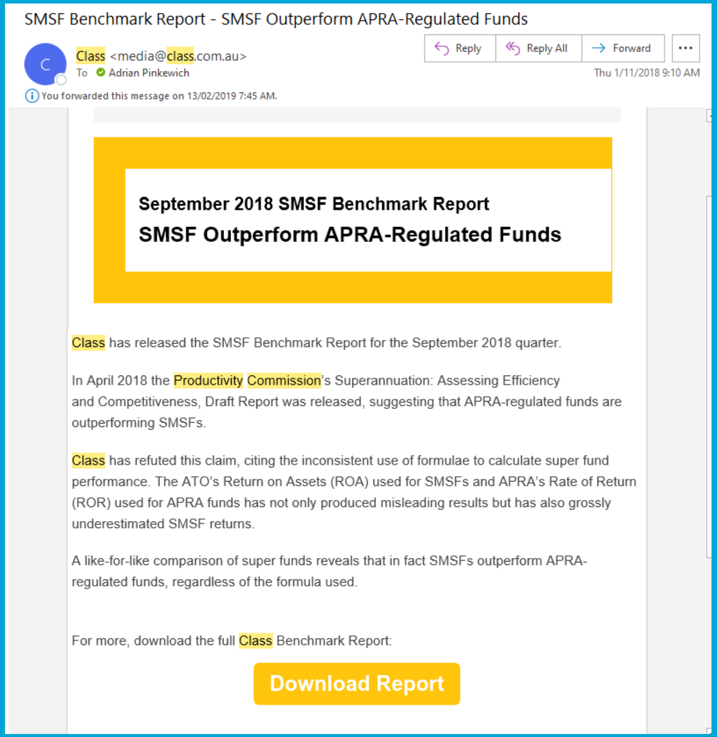
Value, means getting a good price for a good product.

In Super, value means you pay reasonable fees but they don't lose all of your money and your returns are good with risk appropriately managed.

Who gets the best returns?

The productivity commission released a report in 2018 stating that APRA regulated funds were out performing SMSF.

This didn’t sound right to me, based on the experience I have comparing various funds, their costs, and their investments. Our SMSF software provider class looked at the analysis and challenged the findings, based on the data it holds on SMSF using its software.



SMSF Benchmark Report - SMSF Outperform APRA-Regulated Funds

Class <media@class.com.au>
To Adrian Pinkewich
Reply | Reply All | Forward
Thu 1/11/2018 9:10 AM

You forwarded this message on 13/02/2019 7:45 AM.

September 2018 SMSF Benchmark Report

SMSF Outperform APRA-Regulated Funds

Class has released the SMSF Benchmark Report for the September 2018 quarter.

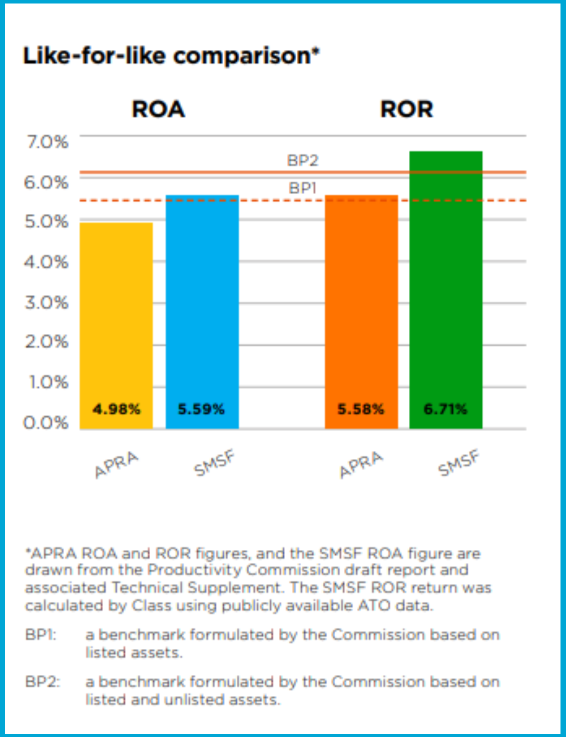
In April 2018 the Productivity Commission's Superannuation: Assessing Efficiency and Competitiveness, Draft Report was released, suggesting that APRA-regulated funds are outperforming SMSFs.

Class has refuted this claim, citing the inconsistent use of formulae to calculate super fund performance. The ATO's Return on Assets (ROA) used for SMSFs and APRA's Rate of Return (ROR) used for APRA funds has not only produced misleading results but has also grossly underestimated SMSF returns.

A like-for-like comparison of super funds reveals that in fact SMSFs outperform APRA-regulated funds, regardless of the formula used.

For more, download the full Class Benchmark Report:

Download Report



Wisdom and wealth creation

Whispers of wisdom, shouts of stupidity… just how broken is Australia's financial advice system?

Before we get into what to do, lets get what not to do out of the way.

Warning: You may need to stop and do an emotional reboot after all this negativity!

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