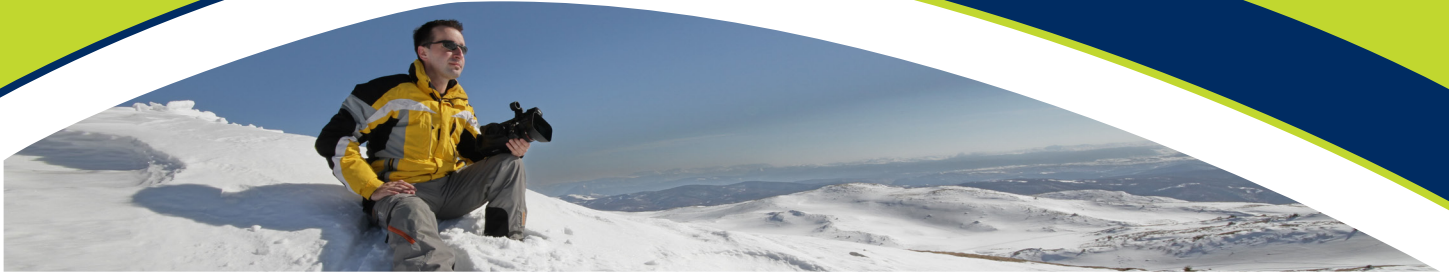


According to us

newsletter

Winter 2012



Best to focus on the horizon

by Geoff Greetham, Executive Director

The lack of confidence is palpable, with pessimists reigning supreme. 2012 to date, seems to be following the playbook of 2010 and 2011 – markets globally rising to May but falling away thereafter. However, Australia itself is another 12 months on from the GFC and still in relatively good shape, with a huge pipeline of resources-related investment spending and flexibility for policymakers to adjust settings to stimulate the economy.

The volatility and fragility of the market can't be discounted and has troubled many investors. Of the major economies, apart from China with its self-induced slowdown to suppress inflation which it is now reversing, durable growth of a magnitude to eat into unemployment is proving difficult to achieve. Austerity programmes being foisted on countries in Europe, which will be beneficial in the long term by reducing debt burdens, are having marked short term consequences.

Whilst markets continue to grapple with these issues, the argument for holding the course in 'risk' assets such as shares and property is well encapsulated in the recent 'Long Term Investing Report' we cover in this edition. With three of the last five financial years yielding negative returns, it is particularly timely for those who have benefited from holding large levels of cash to date. And who may now believe it to be a good investment long term. This report dispels that myth.

In difficult times such as we are experiencing, where investors' focus is on investment returns, it is paramount that opportunities to structure one's affairs are not overlooked. In our regular client calling programme, we continue to explore strategies which will provide tangible benefits either by trimming or streamlining costs and/or reducing future tax burdens. It is not all about nominal investment returns, particularly with tax often being an investor's greatest expense.

In this edition, Jackie Cook, our Financial Strategist, addresses a strategy which can reduce 'death duties'. Whilst not existing in the pure form, they do exist when you die and transfer assets to beneficiaries. Jackie outlines an approach to minimise or eliminate this potential impost.

In light of the latest raft of superannuation changes, with the government reducing further incentives to save, it has become even more imperative to consider such strategies and structures in and outside of superannuation to improve your financial position.

Finally, if you know of anyone not only disenchanted with the markets but also unsure of the way forward, we would certainly welcome the opportunity to talk to them to outline how our services and advice can be of benefit.

We trust with the market, on traditional measures, dramatically cheap, that we can provide a compelling proposition.

And the winner is...

By Geoff Greetham, Executive Director

With the investment world enveloped in gloom, investor caution is at all time highs. The recent June Westpac Institute of Melbourne consumer survey indicated close to 40% of respondents believed cash to be the wisest place to save. While the last ATO review of the Self Managed Superannuation Fund (SMSF) sector indicated cash holdings of some 30% across the sector. Cash and fixed interest are the 'destination of choice' with protection, rather than creation, of wealth the priority.

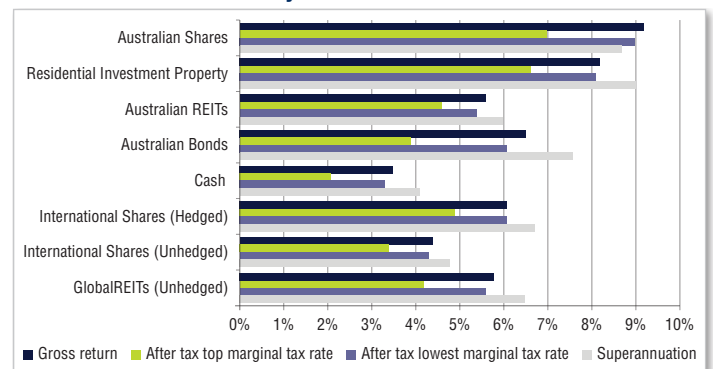
The recent publication of the ASX/Russell Investments (a globally recognised investment consulting firm) 'Long Term Investing Report' is therefore timely. This report has been produced for 14 years and investigates the performance of various investments over the past 10 and 20 years. It not only assesses performance at face value ie. gross returns for each asset class but also considers, what it describes, as the "real life impact of tax and costs on ultimate investment returns."

Not surprisingly, the results provide clear empirical evidence to the propositions that:

- tax "makes a significant difference to the final return outcome for various investments" and
- superannuation can "provide significant tax advantages which may increase net returns compared to investments outside of superannuation"

What would surprise people is that the best returning investment, over the past two decades, once tax is taken into account, has been Australian shares (refer chart). They returned 9.2% p.a. where held inside superannuation, 9.0% at the lowest marginal tax rate and 7.0% at the highest marginal tax rate. This is in spite of this period covering the precipitous fall in the market from October/November 2007 (some 6800) to today's seemingly trading-bound range of 4000 to 4300.

Investment Returns for 20 years to 31 December 2011



At the same time, cash had the lowest returns, after tax, of all asset classes over the 20 years to 31st December, 2011.

During the period covered, Australian shares, and residential property for that matter, significantly outperformed inflation, which averaged 2.6%.

It is notable though that, over the shorter 10 year timeframe, Australian bonds generated the second highest return, i.e. 6.4%, which is not altogether unexpected, given the flight to safety we have seen over the past three years. This appetite for bonds recently resulted in the yield on the Australian 10 year government bond hitting a post WW2 low of 2.8% early June. By comparison, in December 2001, the yield was 5.8% and in December 1991, 10.1%.

As Russell Investments succinctly puts it, “while there have been shorter periods of time in history when cash and bonds have outperformed shares, over the long run, history has shown equities have delivered superior returns”.

It is hard to envisage, given where yields are at now, Australian bonds generating a worthwhile return in the next 10 years, relative to other asset classes.

That said, whilst this report provides some comfort and solace for the long term investor, it above all also confirms the merits of diversification, given differing

performance over time periods as well as highlighting the importance of structuring and tax in the eventual outcome.

That is why we focus on analysing how assets should best be ‘owned’ and in our investment model include franking credits when we are assessing the intrinsic value of a company, given the enhancement it provides to eventual returns.

Another reason this report is quite timely is the introduction of the Stronger Super legislation recently into parliament, which has, as one of its elements, a requirement that superannuation fund trustees consider the expected after tax consequences of their investment decisions.

Clearly this is a recognition of its impact and, whilst not effecting SMSFs, has just as much, if not more relevance, given the clear entitlement to franking credits offered by this structure.

Avoiding death duties by another name

By Jackie Cook, Financial Strategist

Are your children over 18 and no longer considered tax dependents? Would you like for the eventual distribution of your superannuation assets to result in as little tax payable for your children as possible? If this is the case, a withdrawal/recontribution strategy may be appropriate for you!

If you are aged between 60 - 65, retired and receiving a pension from your superannuation benefits, this is an ideal time for you to consider this strategy, as you are in the fortunate position where there are no limits in relation to the amount that can be withdrawn from your superannuation savings, plus you are still able to make contributions back into your superannuation fund.

As the name suggests, a withdrawal/recontribution strategy involves firstly, a withdrawal from your superannuation benefits and secondly, a contribution back into your superannuation fund as a non-concessional contribution.

The specific benefits of this strategy will depend on the taxable and tax free components of your superannuation fund. Superannuation benefits are categorised into taxable and tax free components depending on how the original contributions were made into the fund as follows:

- The taxable component is made up of all ‘before tax’ contributions into the fund (i.e. SG or salary sacrifice contributions). These are known as concessional contributions.
- The tax free component is made up of all ‘after tax’ contributions (i.e. personal contributions made from ‘after tax’ funds). These are known as non-concessional contributions.

When superannuation death benefits are paid to a tax dependent (i.e. a spouse) as a lump sum, this will be paid to the beneficiary entirely tax free regardless of the tax components. However, when superannuation death benefits are paid to a non-tax dependent (i.e. adult children, siblings, etc.) as a lump sum, the tax free component will be received tax free, but the taxable component will be taxed at 16.5%.

Obviously, if you have a spouse, generally speaking, your superannuation benefits will be distributed to them upon your death, tax free. However, you must also remember that there will become a time when the combined total of your superannuation benefits must be distributed to other beneficiaries, and this is when this strategy can provide substantial savings in the future.

When withdrawals from superannuation are made, proportionate amounts are drawn from the taxable and tax free components of the member balance. Therefore, by withdrawing funds from superannuation and then contributing them back into superannuation as a non concessional contribution (assuming that you have a mix of taxable and tax free components), you will effectively be changing funds that were originally part taxable/part tax free to 100% tax free.

While this strategy can be implemented prior to age 60, it is generally more appropriate for those aged 60 and over, as at this time, withdrawals can be made from your superannuation 100% tax free (regardless of the tax components). When you are withdrawing funds prior to age 60, the withdrawal will be subject to tax at the member’s marginal tax rate (less a 15% pension rebate) on the taxable component of the withdrawal.

For a person under age 65, the maximum non concessional contribution a person can make in one year is \$150,000. However, there is also the option of ‘bringing forward’ three years and making a non-concessional contribution of \$450,000 in one financial year. You will then be precluded from making further non-concessional contributions for the following two financial years.

If you are over 65, you can still implement this strategy, however, the maximum non-concessional contribution a person can make in one year is \$150,000 (no ‘bring-forward’ provisions apply) and this is subject to meeting the ‘work test’ (i.e. working at least 40 hours in a period of not more than 30 consecutive days in the financial year).

I have provided an example below for a person who is 60 years old, retired, and has superannuation benefits of \$500,000 (30% tax free/70% taxable). This person’s spouse has passed away and they have one child (age 30), who is to receive 100% of their superannuation benefits upon their death.

Given the above tax components, prior to implementing the withdrawal/recontribution strategy, upon the member’s death, \$350,000 of these funds will be taxable to the member’s child at 16.5%, resulting in tax payable of around \$57,750.

After strategy	Superannuation Balance		
	Tax Free	Taxable	Total
Initial Super Balance	150,000	350,000	500,000
Withdrawal	135,000	315,000	450,000
Balance in Fund	15,000	35,000	50,000
Add Re-Contributed Amount	450,000	0	450,000
Balance after Re-Contribution	465,000	35,000	500,000

After the withdrawal/recontribution strategy, upon the member’s death, only \$35,000 of these funds will be taxable to the member’s child at 16.5%, resulting in tax payable of around \$5,775.

Therefore, by implementing the withdrawal/recontribution strategy, this member will save their adult child over \$50,000 in tax upon their death, with the option also for further tax savings by implementing this strategy again in three years time.

If you believe you are in a position to implement this strategy, please contact our office and we would be more than happy to provide you with an analysis of your specific circumstances.

Striking A-c-cord

Did you know....

The Euro is not the first attempt at a monetary union in Europe. The Latin Monetary Union (1866-1927) was a previous attempt, lead by France, with Belgium, Switzerland and Italy at its core, to create a single currency, based on fixing the gold and silver content of coins across member countries at a time when most national currencies contained these elements.

It nonetheless failed, for a variety of reasons - one particular country in this time was caught and expelled from the union for decreasing the amount of gold in its coins. Greece!



Please note that the information in this publication is for general use only. We would be pleased to talk with you in regard to your particular circumstances should you wish to explore any particular aspect further. Any tax planning matters should be discussed with your accountant before proceeding.

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Accordius Pty Ltd • ACN: 128 900 603 • AFS Licence No. 321955
Level 24, 333 Collins Street, Melbourne, VIC 3000 • GPO Box 2985, Melbourne, VIC 3001
Telephone: +61 3 8623 3378 • Fax: +61 3 8678 1235 • Email: information@accordius.com.au

