Personal Wealth Adviser

Managing your personal finances

ISSUE 2

HLB MANN JUDD
ADVISORY AND ACCOUNTING

Our Sydney personal wealth management team provides you with a simple solution for your personal wealth needs. We have specialists in wealth management, superannuation, self-managed superfunds, estate planning, debt advisory and insurance services.

One key article to highlight is Andrew Yee's latest superannuation update. The major changes to superannuation proposed in the May 2021 Federal Budget are now law. These changes apply from 1 July 2022.

THIS ISSUE ALSO INCLUDES ARTICLES ON:

- Bank of Mum and Dad - beware the risks
- Why 10 year forecasting is best
- What happens if I lose my capacity to make my own financial and lifestyle decisions?
- What is a family trust, and should I set one up?
- Why you should use a mortgage broker
- Key Personal Insurance matters at End of Financial Year

We encourage you to share this valuable content with your friends, family and colleagues.

MICHAEL HUTTON
Partner, Personal Wealth Management

BANK OF MUM AND DAD - BEWARE THE RISKS

The idea of people helping their children to buy a home, or buying it for them, was virtually unheard of 20 years ago – only the ultra-wealthy would consider such an approach.

Today, of course, things are different. Exorbitant property prices around Australia, particularly in cities, has made buying a home very challenging for young people without some form of assistance from their parents.

Most parents are happy to help their children take their first steps on the property ladder, but they need to be careful. It can be easy to get carried away and end up putting your own position at risk.

It's important to be sensible about what you promise, especially if there are other children who will expect the same support.

First and foremost, parents should look after themselves. This doesn't mean being entirely selfish but keep in mind there's no point in becoming a financial burden on your children later in life because you've made too many sacrifices now.

Next, look at the situation from the perspective of a bank, not a parent. The bank will want to know whether your child is a good credit risk and will be looking at aspects including the amount of the deposit, the borrower's income, their savings history and the security available.

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Each of these areas need to be considered. For example, banks like to see a deposit of at least 20 per cent of the value of the property. This will also avoid incurring the cost of lenders mortgage insurance, which can be thousands of dollars.

So, one way for parents to assist is by supplementing any savings to get them over the 20 per cent threshold. If this is the path chosen, parents must keep in mind that a gift is a gift, and there is no recourse and no asset protection.

Other assistance options could include providing free board to help children build their savings.

Another option is for parents to extend a loan to their children to minimise the amount required from the bank or cover the cost of stamp duty. This loan can be on relatively generous terms if desired – such as low or no interest, and extinguishable upon the parents' death. But the terms must be agreed and documented.

Next is the savings history. Borrowers must show a capacity to save based on income levels and costs of living, and parents can help by encouraging children to save and show they are a good credit risk.

This could include setting up a monthly savings regime (where money is automatically transferred into a dedicated savings account or an investment portfolio) as a way to show a disciplined and responsible approach to finances.

Security is another area where parents can assist, but it carries some risk. If children still can't get over the line with a deposit, parents can assist by offering their house as extra security.

They can also assist with the lack of regular income by becoming a part-owner on the contract and a party to the loan, thereby enabling their income to be taken into account.

These are both risky propositions and parents should carefully consider whether to get involved to this extent.

It can be messy, lead to equalisation issues with other children and have adverse tax consequences. In particular, being responsible for the debt of others tends to be perilous.

Parents shouldn't feel under obligation to help their children buy a property – and certainly not to the extent of putting their own financial future at risk.

There's a view that paying rent is 'dead money', but this isn't necessarily true. Paying rent while not being shackled to a mortgage and associated interest and property costs may be a sensible medium-term financial land lifestyle strategy.

People should also be careful of the approach of children buying where they can afford renting the property out, and then renting where they want to live. They are then earning taxable rent and are subject to capital gains tax while paying rent that is not tax-deductible. It's better to pay rent for a while, and save more, so they can buy somewhere they will live

Michael Hutton has a monthly opinion piece in the Australian Financial Review. This article first appeared as part of this series on 1 March 2021.

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JONATHAN PHILPOT
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WHY 10 YEAR FORECASTING IS BEST

I have been asked many times for my predictions on the share market over the next week/month/ six months and one year. Early in my career I would discuss whatever was in the investment headlines recently and then extrapolate that over the asked time period. I was frequently wrong and probably below the 50% strike rate. These days I learnt have not to provide an answer, with the honest reply of 'I don't know, and your guess will probably be better than mine'.

I do not recall over my 20 years of advising, anyone asking me for my investment prediction for the next two, three, five or ten years.

While I would still be very cautious with two and three year predictions, I feel much more comfortable providing a share market outlook for the next five and ten year periods.

This is because the volatility of share markets smooth over time, the range of likely outcomes narrows with each year. Investment returns will reflect the income you receive, the growth of that income and the purchase price today. Is the purchase price today cheap or expensive? If cheap your future returns will be greater, if expensive your future returns will be lower.

It is surprising to some just how accurate you can forecast share returns for the next 10 years, but when considered the process makes a lot of sense and it is not rocket science.

Perhaps the more important question is not the expected share market return for the next six or twelve months (I also don't recall anyone predicting after the initial COVID outbreak in March 2020 that the Australian share market would rise 37% over the next 12 months), but how long do I wish to invest for?

If the answer to this, is only a short period, say if you are saving for a home deposit over the next couple of years. Then the share market is not the place to be investing for this short a period. The uncertainty of the return, if X, Y, Z was to occur, is too risky, a negative return is a real possibility. Unfortunately investing in a secure, fixed interest type of investment that we know will only provide a small return is the only real option.

However, many investors are actually long term investors. Indeed most people will invest for the rest of their lifeand then wish to leave a legacy for children and grandchildren – this is a long time! Therefore not worrying about whether now is the right time to invest or not, but looking at the expected returns for the next 10 years for each different asset class makes far more sense when building an investment portfolio and making the very important asset allocation decisions.

This may sound like I am recommending you purchase shares, put them in your bottom drawer and never look at them again. While this is not the worst strategy, it does ignore that share markets will move between being cheap and expensive. You do need to make decisions at least every couple of years when deciding upon your asset allocation.

The good news is that when considering 10 year forecast returns, you are able to make gradual changes to your asset allocation, typically over a number of years. The share market will not become expensive overnight. This will stop the emotion charged decisions we tend to want to make after a crisis occurs and result in a better investment outcome.

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Information based on historical performance is often not a reliable indicator of future performance. You should not rely solely on this material to make investment decisions.

ROBERT MONAHAN
Director, Estate Services

WHAT HAPPENS IF I LOSE MY CAPACITY TO MAKE MY OWN FINANCIAL AND LIFESTYLE DECISIONS?

We all hope to live long and healthy lives, with the mental capacity to make our own financial and lifestyle decisions. However, not everyone is blessed with lifelong capacity. The purpose of this article is to explain the consequences which can arise if you lose your capacity.

In relation to financial matters, many people wrongly believe that if they lose their capacity to make financial decisions, then their husband, wife or partner can step in to make financial decisions and effectively manage the situation. That is not correct. The fact that you are in a relationship with a person, or own property jointly with a person, does not give them the automatic power to make financial decisions for you. If your spouse (or other family member) wants to make financial decisions for you, they need to apply for a Financial Management Order which involves an application to the Guardianship Division of the NSW Civil & Administrative Tribunal (NCAT). In many cases the financial management order then comes under the supervision of the NSW Trustee & Guardian (formerly known as the Public Trustee). Whilst the Trustee & Guardian provides a good service, many clients express their concerns about the involvement of the so-called ‘big brother’.

An application to NCAT for a Financial Management Order can be daunting for a family where a loved one has suddenly lost their capacity, such as due to a sudden stroke or other illness.

At HLB Mann Judd, we encourage our clients to put in place an Enduring Power of Attorney (EPOA) whereby the client appoints the substitute decision maker (called ‘an attorney’. Note that the EPOA attorney is different to an American Lawyer which is also called an Attorney). If a client has an EPOA in place, then in the event of incapacity there is no need to make any application to NCAT. The person or persons appointed by the client in the EPOA automatically has the power to make financial decisions and carry out financial transactions for the incapacitated person.

We find that many clients who are married or in relationships will appoint each other. However, it is also important to appoint one or more substitutes. An EPOA simply appointing each other is useless if both clients are in an accident together. The substitute(s) can be one or more trusted people such as adult children or other family members or friends.

An EPOA is essential for clients who have their own Self-Managed Super Fund (SMSF). The SMSF regulations require that members of the SMSF are either trustees of the fund, or directors of a company acting as the trustee. If a fund member is incapacitated, the member cannot be a trustee or a Director of a company. If that occurs, the SMSF becomes ‘non-complying’ which means it loses the tax concessions given by the super regulations. The Tax Office will allow the SMSF to retain its tax concessions if the incapacitated member has in place an EPOA and the attorney then takes the place of the incapacitated member.

A huge advantage of having in place an EPOA is that *you* decide who makes financial decisions in the event of your incapacity, instead of the decision being made by people unknown to you at NCAT or the NSW Trustee & Guardian.

It is important to understand that in NSW your financial attorney appointed via an EPOA cannot make health, medical or lifestyle decisions for you. That is done by a separate appointment called an ‘Appointment of Enduring Guardian’. The Enduring Guardian can be the same person or persons appointed as financial attorney or can be a different person or persons. We encourage clients to consider appointing both a financial attorney and an enduring guardian.

If you would like more information, feel free to speak with your HLB advisor who can then refer you to a HLB Estate Services (NSW) Lawyer.

PETER BEMBRICK
Partner, Tax Consulting

WHAT IS A FAMILY TRUST, AND SHOULD I SET ONE UP?

In Australia, trusts are routinely used as an investment or trading vehicle. There are several different types of trust structures available, but the most commonly used is a discretionary trust such as a family trust. What are the legal and tax considerations when setting up a family trust?

Who is a trustee?

A trustee is a person or company responsible for managing a trust's affairs. The trustee is also responsible for fulfilling the trust's tax obligations, such as lodging an annual tax return for it, because while a trust is not a legal entity like a person or company, it does need to be registered in the tax system.

When carrying out their responsibilities, a trustee is bound by the deed of the trust, as well as the relevant Australian tax legislation. These obligations can include distributing the net income or profit of the trust among the eligible beneficiaries at the end of each financial year.

What are some potential benefits of a family trust?

Trusts are a popular choice for families and their advisers because they inherently provide asset protection, allow income to be distributed flexibly in line with the family's wishes and enjoy a range of tax concessions.

Asset protection

Because the beneficiaries of a family trust don't own any of the assets sitting in the trust, these assets can potentially remain relatively safe even if, for example, a beneficiary becomes bankrupt or owes money to someone under a court order.

However, to achieve the maximum level of asset protection, the trustee must also consider any debts the trust owes to members of the family. For example, a common situation occurs when a mum and dad lend money to their family trust so the trustee can use it to make investments, with the money being recorded as a liability of the trust. In this case, creditors of the mum and dad may still be able to access the assets in the trust in a debt recovery procedure.

Income distribution flexibility

A trust usually has a broad class of beneficiaries which can be found in the trust deed. In any given income year, by making splitting the trust income amongst several eligible adult beneficiaries, the family group can potentially result in an overall tax savings as opposed to all income being distributed to a beneficiary with a high marginal tax rate.

Tax concessions

A family making an investment using a trust structure can access the 50% capital gains tax concession, as such, this remains a big incentive for family when choosing an investment structure to pass down wealth to the next generation.

Does a family trust or trustee need to pay tax on its income?

A trust is often seen as a flow-through entity, meaning trust income is usually taxed in the hands of beneficiaries who have a present entitlement to it.

There are several situations where a trustee may be liable to pay tax on trust income, however, including:

- Non-resident beneficiary: when a portion of the trust income is distributed to a beneficiary who is not an Australian resident for tax purposes, the trustee must pay tax on behalf of the non-resident beneficiary.
- Minor beneficiary: the trustee must pay tax on behalf of beneficiaries who are under 18 years old as at 30 June of the relevant financial year. Where the distribution to a minor is greater than $1,308 the top marginal tax rate of 45% is imposed on that portion of the trust income. The high tax rate is designed to deter families from making trust distributions to minors.

Undistributed trust income: if the trust income is not fully distributed to beneficiaries, either by choice or inadvertently, the trustee would have to pay tax on the income retained in the trust, also at the top marginal rate of 45%.

Key takeaways

Trust taxation is a complex area. Over the years, various governments have introduced more tax legislation to tighten the tax-effectiveness of the trust structure, and there will likely be further reform in the future.

While a trust structure still has many benefits, it's a complicated arrangement. Trustees should consult the trust deed and consider seeking professional legal and tax advice in order to properly discharge their responsibilities.

If you would like further information on setting up a family trust, feel free to speak with your HLB advisor.

(This article was co-authored by Helena Yuan – Manager Tax Consulting)

BETTY PRESHAW
Director, HLB Debt Advisory

WHY YOU SHOULD USE A MORTGAGE BROKER

Two in three home loans are originated by a mortgage broker in Australia.

What's causing this mortgage broker revolution? Is it a distrust in dealing directly with the lender? Or are Borrowers finding it increasingly difficult to navigate the thousands of loan options available?

Mortgage brokers do all the hard work for time poor borrowers. They will research the market and find the right home loan at the most competitive price to suit each Borrower's unique circumstance.

The entire application process is managed by the mortgage broker. A mortgage broker can also assist borrowers with the planning of a property purchase. Whether the borrower is a first home buyer or a property investor, a mortgage broker equips borrowers with the right tools, plan and product structure to meet the borrower's property purchasing goals.

A mortgage broker has direct access to all lender credit policies. Credit policies though governed by the National Consumer Credit Protection Act 2009 (NCCP) do differ across all lenders. With regulation and policies constantly changing, it is understandably why borrowers are increasingly turning to a mortgage broker for advice.

A good example of this is a self-employed borrower and how the lender treats their financial statements. Every lender has their own method of calculating income and therefore capacity to borrow. This has a tremendous impact on borrowing power, which could in turn impact the borrower's choice of property.

Sadly, many borrowers don't realise how much they could be saving if they reviewed their home loan regularly. In many cases savings are in the thousands and could pay for a holiday! A mortgage broker will continue to work for the borrower even after the loan has settled. Reviewing a borrower's home loan interest rate, after the first two years from settlement is fundamentally important to avoid any creep in interest rates, particularly variable rate loans.

Mortgage brokers work for their clients and are not aligned to any lender. Many mortgage brokers are industry professionals that have come out of front-line sales roles for the lender groups. They have the back-office lender knowledge but as a mortgage broker are aligned to maximising the borrower's household cash flow and not the lenders.

Unbelievably, most mortgage brokers run this service at no cost to the borrower. The lender will remunerate the mortgage broker on settlement of the loan.

All of this can be free to the borrower, it's no wonder two in three home loans are originated by mortgage brokers today, and this number is growing!

ANDREW YEE
Director, Superannuation

MAJOR CHANGES TO SUPERANNUATION ARE NOW LAW

The major changes to superannuation proposed in the May 2021 Federal Budget are now law. These changes to apply from 1 July 2022, are as follows:

1. Removal of the work test for those aged 67 to 74
2. Extending the access to the 3 year bring-forward non-concessional contribution rule
3. Reducing the downsizer contribution age from 65 to 60
4. Increasing the release amount under First Home Super Saver (FHSS) Scheme to $50,000
5. Abolishing the $450 monthly income threshold for Superannuation Guarantee (SG) purposes.

Removal of the contributions work test

Under the new rules, a person from age 67 to 74 no longer needs to meet a work test to make voluntary (non-concessional, or after tax and salary sacrifice) superannuation contributions.

However, if a person age 67 to 74 wishes to claim a tax deduction for a voluntary personal superannuation contribution after 1 July 2022, they would still need to meet a work test.

Extending access to the 3 year bring-forward non-concessional contribution forward rule

Those over age 67 and under age 75 will be able to access the 3 year bring forward non-concessional (after-tax) contribution rule, as long as a member is under age 75 on 1 July of the financial year the contribution is made, they are eligible to trigger the bring-forward rule, provided they do not breach their total superannuation balance cap which is currently $1.7 million.

Reducing the downsizer contribution age from 65 to 60

The age in which a person is eligible to make a downsizer contribution to superannuation will be reduced from 65 to 60. The other tests that currently apply to making a downsizer contribution will still apply.

Increasing the release amount under First Home Super Saver (FHSS) Scheme to $50,000

A person will be able to release up to $50,000 (plus a deemed earnings) of eligible contributions under the First Home Super Saver (FHSS) Scheme to purchase their first home. The current maximum release amount is $30,000 plus deemed earnings.

Abolishing the $450 monthly income threshold for Superannuation Guarantee (SG) purposes

The current minimum superannuation guarantee (SG) threshold of $450 per month will be abolished and employers will be required to pay SG to employees earning less than $450 a month.

Federal Budget of 2022-2023

Note in the Federal Budget of 29 March 2022, there were no major changes to superannuation announced, except the temporary 50% reduction in minimum pension payments introduced as a result of the economic effects of Covid-19 will be extended to apply for the 2022-2023 year.

ANDREW KENNEDY
Risk Adviser, HLB Insurance Services

KEY PERSONAL INSURANCE MATTERS AT END OF FINANCIAL YEAR

There are a range of important financial matters that arise at the end of financial year which are well covered in this publication, however, one area of your situation which is often neglected at this time of year is Personal Insurance – Life, TPD, Trauma & Income Protection. Here are some of the issues you should consider in the lead up to 30 June.

1. Tax Effective Income Protection Structuring

Income Protection is one of the more well known types of Personal Insurance, providing an ongoing monthly taxable benefit in the event of illness or injury to replace your income and ensure you can continue to meet your living expenses – food on the table, petrol in the car, debt repayments, school fees etc. while ideally avoiding the need to sell down assets to generate cash.

Structuring your Income Protection appropriately can sometimes be overlooked, as many people rely on cover held within their super fund to provide for some of their needs. However, if Income Protection is owned in your own name and the premiums paid from your after-tax cash flow, some or all of these premiums may be deductible in your personal Income Tax Return – potentially at a higher deduction rate than if owned solely through super.

That's because Income Protection premiums are tax deductible to the super fund owner at the super tax rate of 15%. Meanwhile, personally owned premiums can be deductible at your marginal tax rate, which depending on your tax bracket could be as much as 47.5% including Medicare levy.

2. Tax Effective structuring of Life & TPD cover

Life & TPD insurance can also be structured tax effectively depending on your situation. Life insurance provides a lump sum to your beneficiaries if you pass away, or to you if you are diagnosed with a terminal illness. Total & Permanent Disability provides you with a benefit if you suffer an illness or injury which prevents you from ever working again.

When owned within superannuation, both types of cover are generally tax deductible to the Fund – while personally owned and paid cover generally isn't. On an 'after-tax' basis this can result in a 15% net saving on premiums – however there are other issues to consider when making this decision, particularly who will be your beneficiary, and its important to seek financial advice on this matter before making any changes.

3. Timing of Insurance Premiums from Super and Claiming a deduction for Personal Super Contributions

An often misunderstood issue affecting insurance cover held within superannuation where a client is making personal super contributions they later intend to claim as a tax deduction is the timing of contributions, claiming the deduction, and completing a partial rollover of super to pay premiums.

It is important to get the timing right. When a partial rollover of super is made to pay Life, TPD or Income Protection premiums, a portion of the amount contributed during the financial year is included in that rollover. If the deduction for that contribution has not been notified to the sending super fund, then an "undeducted" amount is transferred, and this cannot later form part of the amount notified for the deduction.

Ensure you follow the rule of thumb;
1. Make the contribution;
2. Lodge the S290 notification;
3. Partial rollover for insurance premiums.

4. Industry Fund Cover Renewal

If you're like the majority of Australians, some or all of your insurance cover is held through an industry super fund. Most industry funds' insurance policies are due to renew on 1 July, and the majority of companies are adjusting their premiums again.

Once upon a time, the default cover in an industry fund was the 'cheap and cheerful' option for most people and provided useful automatic acceptance cover that allowed people to obtain cover where they may not be able to otherwise due to poor health. However, these policies have suffered from poor claims experiences and the insurers have been forced to pass these costs on in the form of higher premiums to members.

It can often pay to review your insurance ahead of the 1 July renewal to ensure you have cost-effective, appropriate cover in place to ensure your cover is right for you.

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