Personal Wealth Adviser

Managing your personal finances

ISSUE 9

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.

THIS ISSUE ALSO INCLUDES ARTICLES ON:

- The three biggest inheritance hiccups - and how to avoid them
- Part #1: $1.9M is the new $1.7M from 1 July 2023, the general transfer balance cap was indexed meaning many more retirees can again make non-concessional contributions this year
- CGT on residential properties - not as simple as you think part 2
- Why wealth should be liquid and accessible in retirement
- Why investors shouldn't give up on Australian shares

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

MICHAEL HUTTON
Partner, Personal Wealth Management

THE THREE BIGGEST INHERITANCE HICCUPS - AND HOW TO AVOID THEM

With huge intergenerational wealth transfers coming up, good estate planning will keep the family together and maximise what is passed on.

With Baby Boomers well into retirement phase, now is the time to consider preparing a good estate plan to ensure a seamless transfer of wealth to the next generation.

There has been extensive commentary on the level of wealth to be transferred in coming years, with the Productivity Commission estimating a transfer in Australia of $3.5 trillion in assets by 2050.

An appropriate level of estate planning is warranted to ensure the correct assets go to the intended beneficiaries seamlessly and tax effectively.

Notwithstanding complicated family circumstances such as blended families and the like, there are three key issues that often emerge when it comes to wealth transfer.

Equalisation between beneficiaries

Even with all the required estate documentation, arguments can still arise, particularly when it comes to the equalisation of wealth between beneficiaries

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If equalisation is the goal, keeping track of loans and gifts to family members can get messy and make equalisation upon death difficult. An example is when financial assistance has been provided. Is it to be treated as a gift or is it a loan? Is interest to be charged? Is it to be equalised upon death? It is worth having a method of keeping track of such loans and gifts. This can mitigate potential arguments in the future.

Wealthy parents often grapple with providing support as different family members require different levels of assistance at varying times, sometimes many years apart. What if some children do well financially and others don't? Should the wealth be left to the grandchildren, skipping the next generation partially or fully?

Sometimes a conscious decision is made to not assist the next generation financially as it "will all be yours in the future anyway". This makes equalisation simple, but with people living longer, the next generation may be old and have struggled financially by the time they inherit. On the other hand, parents passing wealth on early and being left short in their own retirement is also not a great strategy, so there needs to be a fine balance.

Managing family wealth as people get older

Another common issue with wealthy families is when the investment process that generated the wealth becomes compromised.

This happens when senior family members who have been investment savvy for many years and have generated much wealth through meticulous investment in property and shares, start to lose interest or even capacity.

If a family business is involved as a driver of family wealth, this usually complicates the situation further. If the senior family members are starting to run out of stamina and the next generation is not stepping up or has varying levels of interest, the business may flounder.

Having a plan for the succession of the family business or the maintenance of family investment portfolios is important. It can be beneficial to involve the next generation and engage advisers to liaise with the family. This is usually preferable to a death or loss of capacity occurring and an intervention being forced.

Record keeping

To run good investment portfolios, there is a need for good record-keeping. Keeping track of the value of assets owned, the structure of ownership, the cost of those assets and income generated including any tax credits is critical. This enables regular reviews and helps ensure compliance is up to date and correct tax is paid.

Problems will emerge if the administration starts to drift as people age. It is surprisingly difficult to create records retrospectively once people have let them slip.

Well-managed and administered wealth all the way through to when it is to be passed on can help maximise the amount that is available. It also helps ensure that the eventual wealth transfer is completed efficiently.

Michael Hutton has a monthly opinion piece in the Australian Financial Review. This article first appeared as part of this series on 20 November 2023.

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PRUE CHEESEMAN-GOODES
Director, Personal Wealth Management

PART #1: $1.9M IS THE NEW $1.7M: FROM 1 JULY 2023, THE GENERAL TRANSFER BALANCE CAP WAS INDEXED MEANING MANY MORE RETIREES CAN AGAIN MAKE NON-CONCESSIONAL CONTRIBUTIONS THIS YEAR

Contributing to superannuation is now much more accessible for older retirees with available cash and investments that they want to transfer into the tax effective superannuation environment.

The Changes

One change was the abolishment of the work test from 1 July 2022 which required an individual be working to make personal non-concessional (non-taxable) contributions until age 75. Note that for personal concessional (deductible) contributions, the work test rules still apply for those aged 67-75.

The introduction of the general Transfer Balance Cap (TBC) was one of the biggest changes in the July 2017 superannuation reform measures and it was initially set at $1.6 million. It is subject to indexation in line with inflation in $100,000 increments. The latest indexation occurred on 1 July 2023 when, due to the recent high levels of inflation in Australia, the TBC increased by $200,000 to $1.9 million.

- The general TBC determines the amount that an individual can transfer from their superannuation savings into a pension account. It also correlates to the individual's eligible Non-Concessional Contribution (NCC) cap based on the Total Superannuation Balance (TSB) at the previous 30 June. Put simply, you cannot make any further NCCs once your individual TSB is over the general TBC.

The non-concessional and concessional caps were not increased, as they are indexed against AWOTE instead, so in 2023/24 the concessional cap remains at $27,500 and the non-concessional cap is four times this, so remains at $110,000 (or potentially more as we explore in the next issue).

What are Non-Concessional Contributions?

NCCs are non-taxable contributions where no tax deduction is claimed. They include personal after-tax contributions, spouse contributions, the non-taxable amount of foreign super transfers & any excess concessional contributions that are not released. They are the large contributions that individuals usually make in the lead up to retirement as a final boost to their superannuation.

Individuals aged 74 on 1 July of the financial year can make a NCC on or before the day that is 28 days after the end of the month in which they turn 75.

Retirement Income Streams

It is important to distinguish that increasing the ability to make NCCs doesn't necessarily mean an individual will be able to then transfer these funds into a pension account if they had previously commenced a retirement income stream.

While those yet to transfer their funds to pension phase can have the full benefit of the $1.9 million TBC, those who had previously started a retirement income stream using the full $1.7 million TBC will not be able to transfer additional amounts to pension, as they have already 'used up' their personal TBC.

But, for those who started a pension previously for less than the TBC, a proportional indexation approach is used to calculate an individual's personal TBC. But that's another kettle of fish and it's best to seek advice on this matter.

To be continued ...

PETER BEMBRICK
Partner, Tax Consulting

CGT ON RESIDENTIAL PROPERTIES - NOT AS SIMPLE AS YOU THINK PART 2

When you think of capital gains tax (CGT) and residential properties the two most common situations are the family home (tax free) and an investment property (CGT applies on sale). What is not widely appreciated, however, is that this can be viewed as a spectrum on which lie various other scenarios where the tax treatment can be more complicated.

We have previously discussed some of the more common scenarios in Issue 6 of this newsletter and this article addresses two other situations where CGT can arise on the sale of the family home.

1. Carrying on a business v working from home

With advances in technology coupled with the onset of Covid, many more taxpayers may be carrying on a business from home. This results in a partial loss of main residence exemption on sale, usually calculated based on the period during which the home was used to carry on the business as well as the percentage of the floor area used for business purposes.

This can be contrasted with the more common situation of people working from home where they are not actually carrying on a business, which does not allow a deduction for property holding costs such as rates and interest (only specific working from home deductions such as a portion of heating, lighting and depreciation of furniture and equipment) but importantly has no effect on the taxpayer's main residence exemption.

The ATO will generally reduce a taxpayer's CGT exemption where it believes that the dwelling has the character of a place of business, considering factors such as whether a part of the dwelling is set aside exclusively as a place of business, is clearly identifiable as a place of business and is not readily adaptable for private or domestic purposes.

2. Implications for foreign residents

There have always been complexities associated with applying the main residence exemption to individuals were not, or ceased to be, tax residents of Australia. This relatively manageable landscape was, however, turned on its head by changes originally announced in the 2017 Federal Budget and subsequently legislated, subject to certain transitional arrangements that finished on 30 June 2020, to deny the main residence exemption to property disposals by non-resident individuals in quite a dramatic manner.

An exception to the changes was introduced for certain "life events" including the taxpayer, their spouse or child under 18 having a terminal medical condition or passing away during the period of foreign residency occurring within 6 years of their change in residency.

In the absence of such events, any disposal of the property while the taxpayer remains a non-resident will not be eligible for even a partial application of the main residence exemption.

Even worse, there are no rules allowing a "deemed market value cost base" along the lines of the special rule that applies when selling as a tax resident after the family home has become an investment property, which would seem to have been a simple, equitable measure to include in the amendments and the failure to do so makes the changes grossly unfair.

This leaves the entire capital gain where the property is sold while the taxpayer is a non-resident subject to CGT, taxed at non-resident rates and with a reduced CGT discount calculated with reference to the relative periods of residency and non-residency, which can be contrasted with the situation prior to the changes, when the absence rule allowed them to live outside Australia for a period of up to six years (or indefinitely if not rented out) and sell within this period with the full CGT exemption intact.

The only silver lining is that the changes apply only to sales by non-residents, so the situation has not changed for property sales made after returning to Australia, in which case the absence rule is still available and the sale could still be tax-free after all.

In summary, the CGT treatment of selling residential property can be more complicated than many people think, at times involving partial CGT according to the usage of the property for different purposes and is now even impacted by an individual's tax residency status.

LINDZI CAPUTO
Director, Personal Wealth Management

WHY WEALTH SHOULD BE LIQUID AND ACCESSIBLE IN RETIREMENT

Being asset rich and cash poor can cause enormous stress in retirement years when there is a need to draw a regular income from invested wealth to meet living costs. Significant wealth may have been built up in non-income producing assets such as the family home or assets that don't yield enough income to meet regular cash needs.

To avoid such stress in retirement it is important to take a diversified approach to building and structuring wealth in the pre-retirement years. Consider the balance between lifestyle assets (non-income producing) and investment assets, which do provide an income. The portion in investment wealth should be enough to sustain living costs throughout retirement. For instance, if $100,000 of income is required to meet annual living costs this would equate to investment wealth of $2,000,000, if that wealth produces an average annual return of five per cent after inflation.

For investment wealth to provide the required income on a regular basis it should be diversified and include liquid and accessible assets. Liquid and accessible assets can be sold down in portions.

Investment wealth can often be tied up in residential property. While residential property can provide attractive capital growth over the long-term, the rental yield is typically low and it's not possible to sell down portions to provide cashflow. When planning for retirement, consideration should be given to the overall wealth allocation to residential property across lifestyle and investment assets and how this would impact cashflow.

For instance, a $2,000,000 residential property may produce an average rental yield of $60,000 or 3% p.a. before costs. In contrast, a diversified investment portfolio of equities, listed property, fixed interest and cash assets invested with a balanced profile could provide an average annual return of $90,000 or 4.5% p.a. after costs.

The assets of a diversified investment portfolio tend to be more liquid and accessible than residential property as it is possible to sell down a parcel of shares or units in a managed fund. Care should be taken to include investments that are not locked away and can be sold on market at any point in time. Adding an exposure to equities, especially Australian equities, due to the franked dividend income can also be very useful in retirement years.

Finally, the structure of investment wealth in retirement is also important. In retirement, superannuation is the most tax effective place for wealth to be invested as it is a concessionally taxed environment. Once a pension is commenced, income earned on that pension account becomes tax free. Individuals can have up to $1,900,000 in a pension account which equates to an annual five percent draw down of $95,000. Building a strong superannuation balance should be a key part of retirement planning.

In pre-retirement years thought and planning should be given to the balance between lifestyle and investment assets. It is important to build investment wealth that can sustain a comfortable lifestyle in retirement by ensuring that wealth is well structured to make the most of tax-free pension limits and is then invested in a diversified, liquid and accessible manner so cashflow is available to meet lifestyle needs.

JONATHAN PHILPOT
Partner, Personal Wealth Management

WHY INVESTORS SHOULDN'T GIVE UP ON AUSTRALIAN SHARES

Investors' focus should always be towards the long-term, which is why it's worth persisting with Australian shares after a poor couple of years, especially now that a bounce back is a strong possibility in 2024.

The S&P ASX 200 Accumulation Index for the 2022 calendar year had returns of negative 2 per cent, and it was only the strong returns from energy, utilities and materials sectors which stopped the Australian market from getting to double digit negative returns.

For the current calendar year ending 30 November 2023, the Australian market has a total return of just under 5 per cent, and all of that was due to the bounce back in November. Interestingly, the two worst sectors in 2022 are now the two strongest sectors in 2023 – IT and consumer discretionary.

When Australian shares are compared to the MSCI World index over the last 10 years, the underperformance of the Australian market is considerable, about 5 per cent a year. This is nearly all due to one country and one sector – US technology.

The long-term driver of growth in share prices is growth in earnings. There can be very long periods of 10 to 15 years where companies or sectors can grow at rates well above 'normal' earnings growth, but ultimately a company or sector will revert to a normalised rate of growth.

Predicting when this will occur is difficult, but we have already experienced well over 10 years of above earnings growth for the US technology sector. This suggests the market has now entered 'overvalued' territory, hence our forecasts for US technology are well below half the returns experienced over the last 10 years.

Australian shares have not experienced the same level of abnormally high earnings growth. Looking forward, we estimate Australian shares will have earnings growth of about 3 per cent a year for the next 10 years.

It is the dividend return that pushes the outlook for Australian shares well above most global share markets for the next 10 years. In particular the additional franking credits, which can only be received from Australian shares, is a significant factor that contributes to the stronger outlook.

The dividend yield for the Australian share market is 4.3 per cent, however an additional 1.5 per cent is the franking credit return, that provides a total income return of 5.8 per cent a year. This is well above fixed interest rates, but more importantly when comparing Australian shares to global shares, the additional 1.5 per cent of franking credits is a significant advantage over the long term, particularly when total share returns are expected to be in the 7-to-8 per cent a year range.

It is surprising that the franking credits are often ignored when talking about investment returns. The S&P ASX 200 Accumulation Index only includes dividend income (excluding franking credits) and capital gains, and this is the most common index referred to when discussing the returns from Australian shares.

Our 10 year outlook for Australian shares is 5.8 per cent income return plus a further 3 per cent of earnings growth to provide a total return 8.8 per cent a year. After two relatively poor years from Australian shares, it would not surprise me to see a strong bounce back over the next 12 months, but the main focus should be on the longer-term returns.

Jonathan Philpot has a bi-monthly opinion piece in Money Magazine.

Disclaimer
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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.

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