WEALTHMATTERS

YOUR PERSONAL GUIDE TO WEALTH CREATION

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INSIDE

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A DIFFERENT PERSPECTIVE

Avoiding CGT on inherited property

There is often some confusion relating to the treatment and operation of capital gains taxes in the case of deceased estates.

Generally speaking, CGT events are considered to take place when an asset changes ownership. In the case of deceased estates, the CGT event is considered to have taken place on the day that the person passed away.

There are special regulations in place that allow capital losses and gains to be disregarded for tax purposes when assets are inherited. However, CGT may become payable when the beneficiary disposes of the inherited asset.

In some cases, the CGT bill associated with the sale of an inherited property can eat away a large part of the value. However, by being aware of some specific timing requirements, it may be possible to reduce, or even eliminate, the CGT bill on property inherited through deceased estates.

If the deceased person acquired the property prior to September 20 1985, then it may remain exempt from CGT, but only if it is sold within two years of the date the person passed away.

If the property is disposed of after this two-year period has passed, it may still be CGT free provided that it has been the main residence of the beneficiary and has not been used to generate any income.

Unfortunately, if the deceased acquired the property after the introduction of CGT in 1985, there are much stricter conditions that need to be met in order to avoid CGT when the beneficiary disposes of the property.

In addition to the conditions that apply to pre-CGT properties, the property must also have been the main residence of the deceased. It also must not have been used to generate any income at the time of the death.

It is useful to remember that the usual 50% CGT discount can be applied to the sale of inherited properties that have been held for over 12 months.

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Keeping an eye on your superannuation risk profile

When it comes to investing there is always a certain amount of risk involved.

The key to a great investment strategy lies in being able discern exactly how much risk you are willing to take on. The risk profile of your superannuation investment strategy should be determined by a combination of your financial goals and the time frame in which you want to achieve them.

As you get closer to retirement, you may care to reduce the risk profile of your investments. Younger people are better positioned to deal with market fluctuations because they have more time to make up for any losses.

The returns that you receive on investments are based on the income that those investments can generate and the capital growth that the investments will experience. Investments can be broadly categorised into defensive and growth assets.

Growth assets are typically considered to have a better potential for high returns but carry short term risks. Shares and property are examples of growth assets. Defensive assets, such as cash and term deposits, generally have a very low level of associated risk but will also yield lower returns.

By diversifying your superannuation investments between growth assets and defensive assets you can fine-tune your portfolio to suit your personal circumstances.

Individuals running a self-managed superannuation fund should already have a robust understanding of their risk profile. However, if you are a member of a public fund it can still be possible to retain a high degree of control over your risk profile.

Some public funds simply offer broad investment categories that you can select (usually between five and ten). Others offer members a much higher degree of control over their portfolios, even going so far as to allow you to select specific companies to buy shares from.

Individuals interested in gaining a higher degree of control over their superannuation risk profile may wish to look at joining one of these more precise funds. However, the downside is that these funds usually have much higher fees, which can potentially erode the benefits of more control.

Involved investors with an active interest in determining their risk profile may wish to investigate a self-managed superannuation.

Do you have enough to retire?

There are so many things that need to be taken into consideration when you are thinking about whether or not you have enough superannuation to retire.

You will need to think about what your expenses will be and the kind of lifestyle you would like to have.

Of course there are many factors that you cannot possibly predict. There is no way for you to know how long you might live, what your health care expenses will be, or how your investments will perform in your retirement.

However, despite all of this uncertainty, there are a lot of things you can do to get a much clearer idea about how far your superannuation will take you. A good place to start is by discussing your situation with a professional. The sooner you start talking about whether or not your superannuation is adequate, the better positioned you will be to improve your retirement savings.

Navigating term deposits

Term deposits are one of the safest places you can have your money invested.

As you approach retirement age, term deposits are a great option because you know exactly what your returns will be and there is no uncertainty relating to the time frame. Term deposits are a good option for your personal savings and your superannuation.

The biggest drawback of term deposits is that you are unable to access your funds without incurring a penalty fee. These penalty fees are usually pretty hefty, and can eat away any interest that you have earned. It is therefore advisable to be absolutely certain that you can afford to have the money out of reach for the agreed period.

Choosing a term deposit can be tricky. There are a lot of different options and you will earn different interest rates based on how much cash you deposit, how long you are prepared to leave it, and the financial institution you go with.

Most term deposits offer higher interest rates if you agree to put your money away for a longer time period. For this reason, a strategy known as 'laddering' can be a great way to maximise your interest whilst retaining flexibility.

Laddering involves splitting your money between a few term deposit accounts, thereby attracting high interest rates on longer deposits while still having liquid cash become available regularly. Using this strategy you may also be able to make the most of high interest rates when they come about.

Alternative investment properties

Choosing an investment property is an important decision, and you need to make sure that you are weighing up all of your options.

Most people will go for something that is familiar to them, usually a residential property that is in a suburb they are at least partially familiar with. There are definitely advantages to this approach: you know the market and you will have a relatively sound understanding of the kind of people who may become your tenants.

There can also be some advantages to exploring less conventional investment property options. However, if you are interested in a more unusual type of property, you need to do a lot of research to ensure that you are making the right choice.

This list details some of the things that need to be taken into consideration when exploring different types of investment properties:

Buying off the plan

There are a lot of financial advantages to buying a property off the plan. Your investment property will likely experience significant capital growth, as developers will often offer discounts for early investment in a project.

However, the main drawback to buying off the plan is that you can never be completely certain about what the final product will be.

For this reason, buying off the plan is something you should only do if you feel extremely confident in your decision, and preferably if you have a little experience in investment properties.

Issues to consider include median apartment prices in the area, any local developments that may impact your property (for example a nearby high rise that would block the view), vacancy rates and general demographic trends.

Empty land

Investing in an empty block of land is appealing because you have so much flexibility over what to do with it. The first thing you need to do is gain a thorough understanding of any regulations that may affect what you can and cannot do with the property.

For example, some local councils may have regulations on the number of storeys you can build or prohibit certain types of commercial activities. You should also seek out several quotes to give you an accurate idea about what your building costs will be, especially for utility connections.

Foreign real estate

Investing in an overseas property is an exciting prospect. Many people look at investing in foreign property with the dream of it one day becoming a holiday house, or even a dream retirement home. In many instances, foreign

real estate may be more affordable than the competitive Australian market.

The main drawback to investing overseas is that you will always be a distance from your investment, meaning that you will need a real estate agent that you can trust.

There are also likely to be some travel expenses that you incur in the course of purchasing and maintaining the property. The tax implications of owning a foreign investment property can also be complicated and will vary significantly from country to country.

Identifying investment scams

Fraudulent investments can be a serious problem in Australia, and individuals with a high net worth are often targeted in these scams.

Some investment scams in the past few years have been extremely sophisticated, and have managed to fool seasoned investors. Here are some things that should raise a red flag in a prospective investment opportunity:

Website only

If an investment opportunity is presented to you online, you should do a significant amount of research to determine that there is a legitimate organisation behind it. If a company is legitimate then they will have a valid Australian Financial Services Licence (AFSL).

Too good to be true

If the returns that you are being promised on an investment sound too good to be true then there is a good chance that they are.

Cold calls

Receiving a cold call with an investment offer should raise your suspicions instantly.

Organisations with legitimate investment opportunities usually do not need to resort to cold calling.

No risk

Any investment offer that claims to be risk free should be treated with caution. Even the most stable investment options carry a small amount of risk, and no respectable professional should claim an option is risk free.

Pressure to act

Sales people who pressure you to make an investment decision fast, for example by telling you that the opportunity will expire quickly, should be treated with caution. It is possible that they are trying to prevent you from conducting independent research.

You should never feel pressured to make a hasty decision regarding any kind of investment.

Don't work off your debts, they can work for you

Many people make the mistake of assuming that all debt is bad and that they should aim to reach a point where they are completely debt free.

In many cases, some debt can actually be an important part of the wealth creation process.

There are different kinds of debt: good debt and bad debt. The main difference between good debt and bad debt is how much income it is capable of generating.

For example, a credit card debt will almost always be bad because it will not generate any income (unless you have made a particularly clever purchase). A mortgage for an investment property, on the other hand, may be a good debt because it can eventually pay for itself and then continue to generate additional income.

Generally speaking, most people will accrue bad debts in times of financial hardship. Credit cards and personal loans are the most common and problematic forms of bad debt.

In many cases, bad debts such as these can continue to chase you for some time, even if your financial situation improves significantly.

Usually, as people's financial situation starts to improve, they begin investigating the possibility of taking on debt to use as leverage to secure wealth accumulating assets.

Unfortunately, if you have any remaining bad debts it may impact your borrowing capacity, and drawn out repayment periods can see your household cashflow being wasted on unnecessary interest payments.

You should also be careful about how much debt you are taking on, even if it is good debt. A slight rise in interest rates can push your repayments up significantly, and if you can't service a debt it might land you in a world of financial trouble.

There are two steps that you can take to try to make sure that your debts are good debts that are working towards wealth creation.

First, you should aim to reduce your existing bad debts. If it is possible, you should avoid accumulating any additional credit card or personal loan charges. If you struggle to control your credit card spending, you may consider replacing it with a debit card. Working out a detailed household budget each week will make it easier for you to see where your money may be slipping away.

Second, you should start looking into what kind of good debt might be beneficial for you. When you are considering taking on debt for the purposes of long term wealth creation there are three things you should look at:

1. The potential that the debt and associated asset will have to generate income, both currently and in the medium-to-long term future. You should ascertain if this is sufficient to justify the interest payments that you will need to make.
2. Whether or not the asset you are purchasing with the borrowed funds is likely to appreciate or depreciate in value. For example, borrowing to buy a new car would rarely qualify as a good debt because cars almost always depreciate in value.
3. What the tax arrangements surrounding the debt will be. In the case of investment properties, negative gearing can reduce your tax bill significantly. This may make the debt even more beneficial in the long term than it would have otherwise been.

How to account for superannuation in estate planning

It is not unusual for Australians to overlook their superannuation in general, let alone worrying about accounting for it in their estate planning.

For most people, superannuation is one of the most significant assets that they own, and it is important to make sure that it ends up where you want it after you pass away.

Unlike many of your other assets, superannuation is not what is known as an 'estate asset'. This means that your superannuation will not automatically be counted as part of your estate on your death.

Therefore, it is important that you very carefully document how you would like your superannuation to be accounted for if you pass away.

If you do not leave a death benefit nomination then the trustee of your superannuation fund is responsible for deciding how the super will be distributed.

There are two different types of death benefit nominations: binding and non-binding. A binding nomination means that the trustee will have no option but to comply with your directions. A non-binding nomination means that the trustee retains some discretion over the decision.

Binding death benefit nominations should be regularly updated to reflect any changes in your circumstances. For example, if you were to remarry, have another child or separate from your partner you may wish to change your plans for your superannuation accordingly.

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