



## Additional Information Flyers Non Superannuation Strategy

20th September 2021

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## Child savings plans

Investing on behalf of a child can help with the child's future. But before investing money for a child, it is important to understand who will be responsible for paying tax on the investment income and what tax rates might apply.

### Benefits

- Saving for a child can help to fund the cost of education or other life goals for the child to give them a good head start.
- Understanding the tax implications of children's investments can help you choose and structure an appropriate investment.

### How it works

Investing on behalf of a child can be complex because a child often can't hold an investment in their own name and penalty tax can apply to the investment income.

If money is invested for a child in a bank account, term deposit, managed fund or share, the owner of the investment will usually need to be a parent or guardian 'as trustee' for the child. The taxation of the investment income will largely depend on who is using the income from the investment.

If the trustee of the investment (i.e. the parent or guardian) is the source of the money and also uses the investment income, they will generally be deemed to be the owner and will be required to include the income in their tax return. Capital gains tax may apply if the trustee transfers the investment into the name of the child once they become an adult.

However, if the trustee reinvests the investment income for the future benefit of the child, then the child may be deemed to be the beneficial owner. In this situation, the child will pay tax on the income at penalty tax rates and capital gains tax may not apply when the investment is ultimately transferred into the name of the child.

### Child penalty tax rates

Penalty tax rates apply to income earned by a child except in limited circumstances:

- if the income is **excepted income** – which includes employment income or earnings on money inherited from a deceased person's estate or family breakdown
- if the child is an **excepted person** – which includes a child who is working full time or is married, permanently disabled or permanently blind.

If applied, penalty tax rates are as per the following table:

Child's taxable income	Penalty tax rates
\$0 - \$416	Nil
\$417 - \$1,307	66%* of each \$1 over \$416
\$1,308 and over	45%* on the entire income

\* Medicare and other levies may also apply.

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This means a child can only earn up to \$416 in a year before all income is effectively taxed at the top marginal tax rate. This is to stop parents diverting income into a child's name just for tax purposes.

### Other investment options

Some investment bonds and education savings plans have been specifically designed for children and may be simpler to use for investing from a tax point of view. Both of these products are 'tax paid' investments, which means there are generally no tax implications for the child or the trustee.

The earnings within an **Investment bond** are taxed within the bond at the rate of 30%. After 10 years, the bond is considered to be fully tax paid and can be withdrawn without any tax implications to the investor.

Additional contributions can be made to the bond each year but if a contribution is more than 125% of the previous year's contribution the 10 year period will recommence for the whole investment bond (the 125% rule).

An investment bond called a 'Child Advancement Policy' is held in the name of an adult on behalf of a child. The child must be under age 16 at the time of application and the adult can nominate the age that the investment converts to the child's name as owner. If no date is nominated, the bond will usually transfer to the child upon turning age 25.

**Education savings plan / scholarship plan** are also tax paid investments with earnings taxed within the plan at the rate of 30%. This tax may be refunded if the money is ultimately used for the child's education expenses, such as uniforms, travel costs, fees, books, living away from home allowance and residential boarding expenses. Withdrawals within the first 10 years may be taxable to the child, but tax offsets apply to reduce this tax.

### Consequences

- You should seek tax advice to confirm the tax treatment of child investments.
- If you are a Centrelink customer and you make an investment on behalf of a child, you are required to let Centrelink know as it may impact your entitlement under gifting rules.
- The decision on whose name to invest in also has implications for who has control over the money.
- If investments are held in your name on behalf of a child or grandchild you may wish to seek legal advice to ensure that child inherits the money upon your death, or that another person is nominated as trustee to manage the money on the child's behalf.

Date: 1 April 2018

## Investment risks

All investments carry some degree of risk. As a general rule, higher risk investments have a higher potential return, but higher risk also means an increased chance that the investment will not achieve that return, particularly over the short term.

This risk/return trade-off is important. You need to ensure that you are comfortable with the level of risk taken so that it can help you achieve your financial goals but still allow you to sleep at night without worrying about the impact of a financial downturn.

The key investment risks you should be aware of are listed below.

### **Diversification risk**

Diversification risk is the risk that if you put all of your assets into one asset class (one 'basket') then your portfolio is at risk of being adversely affected if that asset class falls in value.

The major asset classes include Australian and international shares, listed property, Australian and international fixed interest and cash. Every asset class has its bad years, but when one asset class is performing poorly, another asset class will usually be doing well.

Diversifying your portfolio across these major asset classes means that when one asset class falls in value, it can be offset by other asset classes that are performing well at that time. It also means that if one asset performs poorly it only affects a portion of your overall portfolio.

### **Inflation risk**

Inflation risk is the possibility that the return on your investments will not keep pace with inflation. If this happens, your 'real wealth' declines over time and you may not be able to meet your long-term income needs.

Including shares and property in your portfolio aims to produce positive real returns over the longer term. This is because shares and property are 'growth' assets which, historically, have outperformed inflation over time.

### **Fund manager risk**

There is a possibility that the fund manager you invest with will underperform over an extended period of time. This risk can be minimised by spreading your investments over several fund managers. If one fund manager underperforms it can be offset by other fund managers who may have strong performance at that time.

### **Currency risk**

There is a risk that international investments can be negatively impacted by exchange rate fluctuations. Specifically, as the Australian dollar rises, the value of international share holdings will fall. If the Australian dollar falls, the value of international share holdings will increase.

Investing in a variety of regions attempts to reduce currency risk as your international share exposure will be held in different currencies. You can also consider investment options that (for a fee) hedge against adverse currency movements.

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### **Liquidity risk**

Liquidity risk is the risk of not being able to access your funds when you need them (such as in an emergency). This risk can be reduced by using cash reserves that can be accessed immediately in the case of emergency. Alternatively you could invest in managed funds that can generally be accessed within 5 to 15 days, although you may incur a capital loss if the markets have performed poorly.

### **Regulatory risk**

There is always a risk that the government will change legislation in the future to the detriment of your investments. This risk is difficult to plan for and we find it more appropriate to develop strategies based on current legislation but including flexibility into your portfolio can minimise the worry of this risk.

### **Market risk**

Market risk is where an investor experiences losses because of factors that affect the overall performance of the financial markets.

Market risk generally cannot be eliminated through diversification because it occurs across all asset classes. Examples include negative investor sentiment, natural disaster, recessions, economic impacts and political changes that affect market performance. Different asset classes have different levels of market risk.

Market risk can be reduced by investing for an appropriate time-frame for each particular asset class as this gives you time to ride out any downturns.

Date: 1 April 2018

## Insurance/investment bonds

An insurance bond (also called an investment bond) is a managed fund investment provided by a life company. Earnings from the bond are taxed by the life company (or friendly society) at the rate of 30%. This may be lower than your marginal tax rate.

### Benefits

- Insurance bonds are a 'set and forget' type of investment, because earnings generally do not have to be included in your tax return.
- The tax paid on your investment earnings will be less than your marginal tax rate if your marginal tax rate is greater than 30%. This helps to increase your overall return on investment to boost your wealth accumulation.
- Insurance bonds can provide estate planning benefits because the bond can be paid directly to a nominated beneficiary instead of having it go through your estate.

### How it works

Insurance bonds are generally considered 'tax paid' investments. The life insurance company pays tax on earnings within the bond and, after 10 years, you are able to withdraw the value of the bond with no further tax payable. This makes an insurance bond a simple investment structure because there is no requirement to declare interest or capital gains in your tax return.

Withdrawals can be made from an insurance bond at any time, however you may be liable to pay some tax if a withdrawal is made within 10 years from commencement of the insurance bond.

Upon your death, the balance of your account is paid to the nominated beneficiary or your estate with no tax implications.

### Taxation

All earnings in an investment bond are taxed at the life insurance company rate of 30%. The life insurance company also receives the benefit of franking credits and tax deductions that may reduce this effective tax rate.

No amount is included in your assessable income unless a withdrawal is made within 10 years from the date of commencement, in which case you may be eligible for a tax offset on a portion of the assessable income.

### Tax offset

If you make a withdrawal within the 10 year period a portion of the investment growth is included in your assessable income as shown in the table below:

Withdrawal	Amount of growth included in tax return
Within 8 years	Full amount
Between 8 and 9 years	Two-thirds
Between 9 and 10 years	One-third

You are then entitled to a 30% tax offset on this assessable portion to allow for the tax already paid by the life insurance company. This offset helps to reduce your tax payable on taxable income, but cannot be used to pay the Medicare levy or be refunded as cash.

This means:

- If your marginal tax rate is higher than 30%, you will generally benefit from holding the bond for the full 10 years before making a withdrawal to maximise the lower tax rate.
- If your marginal tax rate is lower than 30%, you could benefit by withdrawing some or all of the bond before 10 years and receive a tax offset that can reduce tax on your other income.

### **Additional contributions and the 125% rule**

Insurance bonds provide flexibility for you to make additional contributions at any time, but it is important to note that if your contributions in any year are more than 125% of the previous year's contribution, this will restart the commencement date under the 10 year rule.

For example, if you make a contribution of \$1,000 in one year, the 10 year period will recommence if the next year's contribution is more than \$1,250.

### **Estate planning and insurance bonds**

An insurance bond is a life policy. The death of the life insured will trigger the payment of bond either to the nominated beneficiary or to the policy owner if no beneficiary is nominated. If the life insured is the policy owner the balance will be paid to their estate. Any amount received as a result of the death of the life insured is completely tax-free, irrespective of the 10 year rule.

### **Centrelink assessment**

Insurance bonds are considered financial assets for Centrelink purposes which means the full account value is asset tested and deemed under the income test.

### **Consequences**

- Investing into an insurance bond can reduce your cashflow because all earnings are captured in the bond as growth.
- If the life insurance tax rate of 30% is higher than your marginal tax rate, investing into an insurance bond may result in more tax being paid than if you invested into other investments.
- Withdrawals within the 10 year period that are assessable to you can impact your entitlement to certain tax offsets or other benefits or liabilities.
- Fees may be charged on investments. You should check the details in the fee section of your Statement of Advice and the Product Disclosure Statement (PDS) for your selected investment.
- The government may change tax legislation in the future.

Date: 1 April 2018

## Gearing

Borrowing for investment purposes is also known as 'gearing'. The aim of gearing is to increase your investment return by investing borrowed funds in addition to your own capital.

### Benefits

- The loan enables you to increase the size of your investment portfolio.
- A larger portfolio enables you to increase the diversity of investments or buy larger assets such as property.
- You may be eligible to claim a tax deduction for some or all of the cost of the loan to help offset the cost of the borrowing or to reduce tax on other income.

### How it works

Gearing involves taking out a loan to invest into growth investments such as shares or property. The aim of gearing is to increase the overall return of your investment whilst also reducing your income tax liability.

Borrowing gives you more money to invest which provides you with greater potential to diversify and build wealth. However it is important to remember that whilst investing more money gives you opportunity to increase capital gains, it also provides potential to increase losses if the investments do not perform well.

Interest and related borrowing costs are usually tax-deductible if the loan is used to acquire an income producing asset. If you are repaying the amount borrowed (the principal) as well as interest, only the interest amount is tax-deductible. Although the tax benefits of gearing can seem attractive, it is important that your primary aim for the loan is to maximise your wealth accumulation.

Gearing is often discussed as negative, positive or neutral, which refers to the cost of the loan (e.g. interest repayments and expenses) relative to the investment income generated (e.g. dividends, rent):

- Negative gearing – where the costs of the loan are greater than the income generated. Under current legislation, the shortfall is tax deductible against other income.
- Positive gearing – where the costs of the loan are less than the income generated. In this case the strategy is 'self-funded' because the costs of the loan are paid by the investment income and you are not required to meet these costs from your own cashflow. Tax is payable on the additional income.
- Neutral gearing – where the costs of the loan are approximately the same as the income generated.

Gearing is generally only appropriate for investors who have a growth oriented risk profile. For gearing to be effective, the overall return from investments should exceed the costs of the loan. This will typically only be achieved through investing in growth oriented assets such as shares and property. So you need to be comfortable not only with the risk of borrowing but also with the risk of investing in these asset types.

You should also meet all of the following criteria before considering gearing:

- have sufficient disposable income to comfortably meet loan repayments, even if interest rates increase
- have life insurance in place for a value equal to the outstanding loan, or have sufficient liquid assets to repay the loan or continue repayments in the event of illness or death, and
- have a strategy in place to repay the outstanding loan at some point in the future.

### **Gearing maximises returns but can also maximise losses**

Gearing can maximise investment returns, as shown in the following example:

Betty has funds of \$100,000 available for investment. She invests these into a growth oriented portfolio and obtains a total return in the first year of 8%, resulting in a return in the first year of \$8,000.

If Betty also borrowed \$100,000 secured against her home, the total amount for investment would be \$200,000. If the investments return 8%, this amounts to a total return of \$16,000. This represents a return of 16% on her original capital amount of \$100,000.

However, gearing can also maximise losses in the event of a capital loss, as shown in the following example.

Betty has funds of \$100,000 available for investment. She invests these into a growth oriented portfolio and obtains a capital loss in the first year of -8%, resulting in a loss in the first year of \$8,000 (that is, the value of her investment falls to \$92,000 after the first year).

If Betty also borrowed \$100,000 secured against her capital, the total amount for investment would be \$200,000. If the investments return -8%, this amounts to a loss of \$16,000 in total. This represents a loss of 16% on her original capital amount of \$100,000.

### **Gearing is a long-term strategy**

Because of its magnifying effects, gearing should only be considered as a long-term strategy. Investors should have an investment time horizon of at least 7 years. If you have to cancel a gearing strategy sooner than the recommended time frame you may find that the values of your assets are lower than when you established the facility.

### **Wealth protection insurance is a necessity**

Wealth protection insurance is important for everyone. However, wealth protection is particularly important when you implement a gearing strategy.

- Income protection insurance can help you meet interest repayments in the event that you suffer an illness or injury that prevents you from working for an extended period of time.
- Total and permanent disability (TPD) cover can help you repay the loan in the event that you are unable to work again.
- Term life cover can help your dependants repay any outstanding debt in the event of your untimely death.
- Critical illness cover can help you meet interest repayments in the event that you suffer a specified illness or injury.

## Consequences

- Tax advantages from negative gearing should never be the sole reason for establishing a gearing strategy.
- You should ensure your employment and cashflow are secure so that you aren't forced to sell some or all of your investment portfolio at a time when the markets are down.
- Although gearing provides the potential for increased capital gains when markets are rising, it also has potential for increased losses when markets are falling.
- A rise in interest rates will increase the cost of borrowing and a decline in dividends or distributions will reduce your income. You should ensure you have sufficient cashflow to absorb interest rate increases and investment income decreases.
- The value of your investment portfolio may fall in value to a point where the sale proceeds are not sufficient to repay the debt. So even though you have been entitled to tax deductions over time, it is possible that you could end up carrying a debt once the investment portfolio has been sold.
- Legislation may change in the future in relation to tax deductibility of interest payments.
- An unforeseen event, such as injury or illness that prevents you from working, may make it difficult to meet interest repayments. This risk can be minimised by incorporating wealth protection recommendations, including Income Protection, Critical Illness Cover and Total & Permanent Disability Cover.
- Fees may be charged on investments that you purchase with the borrowed money. You should check the details in the fee section of your Statement of Advice and the Product Disclosure Statement (PDS) for your selected investment.

Date: 1 April 2018

## Margin lending

Margin lending is a form of gearing, which involves borrowing money for investment purposes. The aim of gearing is to increase your investment return and wealth accumulation by investing borrowed funds in addition to your own capital.

### Benefits

- The loan enables you to increase the size of your investment portfolio.
- A larger portfolio enables you to increase the diversity of investments.
- You may be eligible to claim a tax deduction for some or all of the cost of the loan to help offset the cost of the borrowing or to reduce tax on other income.

### How it works

Borrowing money to invest is called gearing. Margin lending is a type of gearing facility where you use assets such as shares, managed funds or cash as equity to borrow additional funds.

The amount you borrow is limited to a percentage of your own investments that have been used as equity. This is known as the Loan to Value Ratio (LVR). Most margin lending providers allow an LVR of up to around 70%. This means that if you already had investments valued at \$30,000 (to use as security) you could borrow up to \$70,000 using a margin loan. The loan amount represents 70% of the total investment.

Gearing is generally only appropriate for investors who have a growth oriented risk profile. For gearing to be effective, the overall return from investments should exceed the costs of the loan. This will typically only be achieved through investing in growth oriented assets such as shares and property. So you need to be comfortable not only with the risk of borrowing but also with the risk of investing in these asset types.

You should also meet all of the following criteria before considering gearing:

- have a long-term investment timeframe of at least five to seven years
- have sufficient disposable income to comfortably meet interest costs as well as any margin calls (repayments) if the investment value falls, and
- have a strategy in place to repay the outstanding loan at some point in the future.

As with any debt, it is important for you to have appropriate insurance cover to repay the debt in the event of death, serious illness or total and permanent disablement.

### Features of a margin loan

Each margin lender has a list of approved investments where the borrowed money and the assets offered as security can be invested. These generally include managed funds and shares listed on the ASX.

The margin lender will set a 'lending ratio'. For example, if the lending ratio is 70% if you have \$30,000 of your own money to invest you will be able to borrow up to \$70,000 to invest.

The lending ratio may vary according to the type of investment. For example, blue-chip shares and many managed funds often have higher lending ratios of 65-75%, whilst higher risk assets such as small Australian companies have lending ratios of only 40-50%.

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## Instalment gearing

A margin loan can be drawn as a lump sum or in instalments. A lump sum margin loan provides you with a lump sum to invest. An instalment margin loan lends you a smaller amount on a regular basis, which you use to add to your own contributions to gradually buy investments. An instalment margin loan may reduce your risk and provide benefits from dollar cost averaging.

## Margin calls

A margin call can occur if your loan balance exceeds your maximum loan limit (i.e. when the LVR is exceeded). This may happen as a result of market downturn which causes your portfolio value to fall or if interest has accumulated on your loan to the point that the LVR is exceeded.

Hugh commences a margin loan with a total investment amount of \$100,000 and an LVR of 70%. This means Hugh could borrow up to \$70,000, but he only borrows \$65,000, which is below his maximum limit.

The market falls in value and Hugh's portfolio reduces to \$80,000. The LVR continues to be 70% but given that the total portfolio value has fallen, his loan cannot exceed \$56,000. Hugh will be asked to make a margin call to reduce the value of the debt back below the 70% limit.

A margin call is not a penalty, but you may be required to:

- repay part of the loan so that the lending ratio is restored
- lodge additional investments as security to increase the total portfolio value, or
- sell part of the portfolio and use the proceeds to repay part of the loan.

If the margin call is not met, the lender can sell some of the investments to meet the margin call.

Selling assets to make a margin call may result in a capital loss. Therefore to reduce the risk of a margin call occurring, it is generally recommended that you do not borrow more than half of the total investment portfolio (ie. do not exceed a lending ratio of 50%). At this level, if the maximum LVR is 70% your assets would need to fall by over 36% to trigger a margin call.

## Consequences

- Tax advantages from negative gearing should never be the sole reason for establishing a gearing strategy.
- Although margin lending provides the potential for increased capital gains when markets are rising, it also has potential for increased losses when markets are falling.
- A margin call could force you to sell some or all of your investment portfolio at a time when the markets are down, thereby creating a loss. It is important that you ensure your employment and cashflow are secure to avoid this situation and consider only borrowing below the allowed LVR.
- A rise in interest rates will increase the cost of borrowing and a decline in dividends or distributions will reduce your income. You should ensure you have sufficient cashflow to absorb interest rate increases and investment income decreases.
- The value of your investment portfolio may fall in value to a point where the sale proceeds are not sufficient to repay the debt. So even though you have been entitled to tax deductions over time, it is possible that you could end up carrying a debt once the investment portfolio has been sold.
- Legislation may change in the future in relation to tax deductibility of interest payments.

- An unforeseen event, such as injury or illness that prevents you from working, may make it difficult to meet interest repayments. This risk can be minimised by incorporating wealth protection recommendations, including Income Protection, Critical Illness Cover and Total & Permanent Disability Cover.
- Fees may be charged on investments. You should check the details in the fee section of your Statement of Advice and the Product Disclosure Statement (PDS) for your selected investment

Date: 1 April 2018

## Family trusts

The term family trust refers to a discretionary trust set up to hold a family's assets or to conduct a family business. The ability to arbitrage tax between family members, protect assets from creditors, and help with succession planning makes them as useful as ever in wealth creation. For tax purposes though, a trust is not considered a "family" trust until a "Family Trust Election" is made.

### How to establish a discretionary trust

There are four roles involved in the establishment of a discretionary trust:

- **The Settlor**  
The settlor is the person who creates the trust by "settling" a sum of money or item of property on trust for the beneficiaries.
- **The Trustee**  
The trustee is the legal owner of the trust property although not the beneficial owner. The trustee carries out all transactions of the trust in its own name and must sign all documents for and on behalf of the trust. The trustee's overriding duty is to obey the terms of the trust deed and to act in the best interests of the beneficiaries.
- **The Appointor**  
The Appointor is the person named in the Trust Deed who has the power to remove and appoint trustees. This would commonly occur when:
  - the trustee dies, becomes bankrupt or is incapacitated;
  - in the case of a company, the company is wound up.
- **The Beneficiaries**  
The beneficiaries are the people (including entities) for whose benefit the trustee holds the trust property. The beneficiaries of a discretionary trust do not have an interest in the assets of the trust. They merely have a right to be considered or a mere expectancy until such time as the trustee exercises its discretion to make a distribution.

The general beneficiaries are those beneficiaries named in the trust deed who are eligible to receive a distribution of income or capital at the discretion of the trustee (subject to the approval of the Appointor). The remainder beneficiaries are the beneficiaries automatically entitled to receive a proportionate distribution of income or capital to the extent that the trustee has not exercised its discretion otherwise.

### Benefits

- Asset protection. Assets held in a family trust cannot be attacked by creditors or lawsuits so they are ideal for protecting assets from business or personal disputes and they can also facilitate the transfer of assets from generation to generation tax free. Another area family trusts can be helpful is with "spendthrift children". If the assets were distributed immediately to children, there is always the risk that some of the children may spend the funds on "wasteful things". Furthermore, by housing assets in a discretionary trust, there is a much greater safeguard (virtually guaranteed) that the children will not realise the assets to switch to another investment or another asset class. For

example, it provides greater assurance for farming families that the farm will not be transferred outside the family.

- Cost effective. The cost of establishing a family trust is relatively low. A trust generally can cost between \$500 and \$2,000 in legal documentation with accounting fees varying between \$500 and \$2,000 each year.
- Tax minimization. Trust distributions can be directed to family members on lower tax rates, potentially saving you thousands of dollars in tax because the trustees of the trust have the “discretion” to distribute income and capital as they see fit – and no beneficiary has a fixed entitlement to receive anything – the trustees are able to “stream” income in a tax effective way on a year to year basis.
- Retirement planning. While the superannuation rules continue to change, a trust provides a flexible structure to accumulate long term wealth with tax benefits. Consider accumulating funds both in your super fund and also within your trust. Unlike your superannuation fund, your trust doesn't have any rules about when you can access the funds and can provide for an early retirement prior to gaining access to your super fund monies.
- Flexibility and estate planning. Most family trust deeds are flexible in their operation and can provide for good estate management, allowing for assets to benefit generations without the need for ownership to change from one individual to the next.

## How it works

While any kind of trust can elect to be a family trust, the need to pass the family control test restricts the choice to a trust that is not widely held and where a specific family effectively controls the trust.

An Australian family trust:

- is generally established by a family member for the benefit of members of the 'family group'
- can be the subject of a family trust election which provides it with certain tax advantages, provided that the trust passes the family control test and makes distributions of trust income only to beneficiaries of the trust who are within the 'family group'
- can assist in protecting the family group's assets from the liabilities of one or more of the family members (for instance, in the event of a family member's bankruptcy or insolvency)
- provides a mechanism to pass family assets to future generations, and
- can provide a means of accessing favourable taxation treatment by ensuring all family members use their income tax "tax-free thresholds".

The terms and conditions under which a family trust is established and maintained are set out in its deed.

The trust is established by the trust's settlor and trustee (or trustees) signing the trust deed, and the settlor giving the trust property (the "settled sum") to the trustee.

The settlor's function is to give the assets to the trustee to hold for the benefit of the trust's beneficiaries on the terms and conditions set out in the trust deed. The settlor executes the trust deed and then, generally, has no further involvement in the trust.

The trustee is responsible for the trust and its assets. The trustee has broad powers to conduct the trust, and manage its assets.

A trust does not have to pay income tax on income that is distributed to the beneficiaries, but does have to pay tax on undistributed income. The trustee is free to distribute trust income to as many beneficiaries as possible, and in proportions that take best advantage of those beneficiaries' personal marginal tax rates.

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The beneficiaries then pay the tax on distributions made to them. Undistributed income is taxed in the hands of the trustee at the top marginal tax rate, giving a strong incentive to family trusts to fully distribute the trust's income before the end of each financial year.

Distributions received from a trust are not a special form of income, but instead form part of a beneficiary's assessable income. If the beneficiary receives income from other sources in addition to distributions from the trust, all of the income will be taxed together.

Even if the beneficiary's income does exceed the tax-free threshold for a particular year, the rate of tax applied to the amount of the excess income over the tax-free threshold may be lower than for other beneficiaries because of the total income that these other beneficiaries already receive.

All distributions must be made only to people who qualify under the terms of the trust deed to be beneficiaries of the trust and who are within 'the family group'. If a family trust makes a family trust election and then pays out to someone not a member of the family group, they will be taxed at the maximum rate possible. The trustee should also take care in relation to which beneficiaries are chosen to receive distributions, as penalty tax rates can apply to distributions made to minors.

## Consequences

- When trust income is not distributed, the trustees themselves are liable to tax on the undistributed income – and a rate of tax usually higher than the beneficiaries themselves would have to pay.
- Disputes can arise where control of the trust is passed down to the next generation. The problem is the assets are all tied up together and when moving from the first generation to the next, the assets will need to be controlled by and distributed.
- It is always important distributions are made in accordance with the Trust Deed and the proper records are kept regarding distributions. Distributions of income which are decided upon but not paid to the beneficiary become a debt owing by the trust to that beneficiary and you need to obtain advice from an accountant to ensure you are complying with the taxation legislation in this regard.
- Buying a property in a family trust does not qualify you for the first homeowners grant or stamp duty concessions.

Date: 1 April 2018

## Dollar Cost Averaging

Dollar cost averaging is the process of making regular investments on an ongoing basis. It involves continuous investment of the same dollar amount into an investment at predetermined intervals usually monthly, quarterly, or annually, regardless of the investment's fluctuating price levels.

Because you're investing the same amount of money each time when you dollar cost average, you're automatically buying more units of an investment when its price is low and fewer units when its price is high. Over time, this strategy can provide an average cost per unit that's lower than the average market price.

**Example:** Every month you decide to invest \$100 in the XYZ Australian Share Fund.

Month	Unit price	Amount invested	Units purchased
<b>1<sup>st</sup> month:</b>	\$10.00	\$100	10
<b>2<sup>nd</sup> month:</b>	\$12.50	\$100	8
<b>3<sup>rd</sup> month:</b>	\$5.00	\$100	20
<b>4<sup>th</sup> month:</b>	\$10.00	\$100	10
<b>5<sup>th</sup> month:</b>	\$20.00	\$100	5
<b>6<sup>th</sup> month:</b>	\$10.00	\$100	10
<b>Total over 6 months:</b>		<b>\$600</b>	<b>63</b>

**Your Average Purchase Price** ( $\$600 \div 63$ ) = \$ 9.54

**The Average Price of the Fund** for 6 months = \$11.25

If you paid the \$600 in the first month, you would only have received 60 units vs. the 63 you would earn with dollar cost averaging.

### Benefits

- By investing gradually into the market, you will not expose your entire capital in the event of a severe market downturn. This can help limit capital loss.
- As can be seen above, by investing the same amount regularly, you automatically buy more units when the market is down and fewer when the market is up. This is exactly what successful investors do.
- While a dollar cost averaging investor might also suffer a loss in a declining market, the loss may be less severe than that of a lump-sum investor.
- A DCA strategy can take the emotion out of investing which can lead to the following psychological advantages:
  - it can reduce your propensity to “buy at the top” and “sell at the bottom” - thus makes you less tempted to “time” the market;
  - it gives you a concrete plan for moving out of cash. The move from “safe” to “higher risk/return” can be an uncomfortable one, and often people want to feel that they’re doing it in a controlled manner. Having a clear plan to do it over a period of time is better than not doing it at all.

### Consequences

- If you DCA during times when markets are increasing, you might forgo capital gains while you sit on excess cash. It holds true that while a DCA strategy can reduce risk, it can also mean lower returns in rising markets.

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- It can also be difficult to maintain the discipline necessary to buy your investments on a regular basis. Automation of the process helps.

Date: 1 April 2018

## Exchange Traded Funds (ETFs)

An ETF is a type of investment product that can be bought and sold on a listed exchange in the same way as you would buy shares. In Australia, most ETFs are generally 'passive' investments that track an asset or market index (for example, the ASX200 Australian share index). Note: An index measures the movement in value of the market or various sectors of the market. It is computed from the prices of selected stocks (typically a weighted average). Passive ETFs generally do not try to outperform the market index and will go up or down in value in line with the index they are tracking.

However, 'active' ETFs are also available where the investment manager is picking and choosing actual underlying investments rather than just tracking an index.

ETFs offer an alternative to more traditional investments known as managed funds, which are unlisted products where you buy and sell units from a fund manager.

There are some important differences to understand between ETFs and Managed funds:

	<b>ETF (Passive)</b>	<b>ETF (Active)</b>	<b>Managed Fund</b>
<b><i>Investment Approach</i></b>	Passively invested investment market indexes.	Actively invested in specific underlying investments which may or may be in the market index).	Actively invested in specific underlying investments which may or may be in the market index).
<b><i>Diversification</i></b>	Limited to the investments of the particular index it is investing in.	High – although limited by the range of products offered	High
<b><i>Transparency</i></b>	You can see the composition of the index that the ETF is investing in at any time.	Can be more difficult to determine where the ETF is actually investing.	Can be more difficult to determine where the managed fund is actually investing.
<b><i>Liquidity</i></b>	High	Generally high but not always.	Can vary.
<b><i>Cost</i></b>	Low cost	Higher cost	Generally highest cost
<b><i>Choice</i></b>	Reasonable	Relatively low but improving	High

Date: 1 April 2018

## Investing through a managed account

*Managed accounts are tax-efficient portfolios of assets directly owned by an investor that are managed by a professional investment manager.* Managed accounts combine the simplicity and scalability of traditional managed funds with the beneficial ownership, transparency and tax effectiveness of direct shares.

Like managed funds, the portfolio manager can make investment decisions without the need for client consent. Unlike managed funds, managed accounts are not unitised or pooled investments – all underlying assets are held in the beneficial name of the client.

Individual beneficial ownership means the client knows exactly what investments they hold. It also means clients receive all dividends, franking credits and distributions without inheriting existing capital gains. This allows clients to plan individual tax outcomes based on their transactions only.

### Types of Managed Accounts

A managed account can come in the form of a:

- separately managed account (SMA),
- individually managed account (IMA), or
- managed discretionary account (MDA).

#### Separately managed accounts (SMAs)

SMAs operate under a Registered Management Investment Scheme legal structure, with a portfolio managed by a professional investment manager. Each client receives the same underlying investments but of varying value, depending on the time of purchase. SMAs offer a more 'one size fits all' approach than MDAs or IMAs, with resulting cost savings and a lower minimum investment. SMAs are constructed on a 'model portfolio' basis by an investment professional and any changes in the model portfolios will result in corresponding changes to the client's portfolios.

#### Individually managed accounts (IMAs)

Typically operating as unregistered Managed Investment Scheme, IMAs offer greater customisation than SMAs and can be fully tailored to each client's needs. They offer the highest degree of individual tailoring, with the flexibility to include or exclude shares or other investments based on client preferences. This makes them especially suitable for high net worth clients who may already have significant holdings of particular shares or market sectors, and professionals who need to exclude shares of companies they work for or deal with. The minimum investment in an IMA is \$500,000.

#### Managed Discretionary Accounts (MDAs)

MDAs operate under a different legal structure to SMAs and IMAs, which requires the operator to hold an Australian Financial Services Licence. An MDA is a client portfolio of assets that are managed on an individual basis by another person (MDA provider) at the MDA provider's discretion, subject to any agreed limitation. Following initial agreement with the client, the MDA operator takes on responsibility of the investment selection and on-going portfolio implementation without requiring on-going client approvals.

### How do managed accounts differ from managed funds?

Managed funds are a very common form of investment vehicle that most people are invested in – either personally or through their superannuation fund. A managed fund is one type of 'managed investment scheme' where your money is pooled together with other investors. An investment manager then buys and sells shares or other assets on your behalf. You are usually paid income or 'distributions' periodically. The value of your investment will rise or fall with the value of the underlying assets. The investment manager may be called a 'fund manager' or 'responsible entity'.

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The best way to think of a managed account is that it is an alternative investment vehicle to a managed fund.

While a few similarities existing between managed accounts and managed funds, they differ in some fundamental ways:

- assets within a managed account are held directly (or beneficially) by the investor, they are not pooled;
- direct equity holdings can be transferred to a managed account; and
- investors are not subject to any embedded tax liability that may exist in pooled investment vehicles.

Feature	IMA	SMA	MDA	Managed Fund
Professional Fund Management	✓	✓	✓	✓
Customised portfolio construction	✓	✗	✗	✗
Client retains beneficial ownership	✓	✓	✓	✗
Minimise portfolio rebalancing	✓	✗	✗	✗
Offered via Product Disclosure Statement	✓	✓	✗	✓
Low minimum investment	✗	✓	✓	✓
Corporate actions administered	✓	✓	✓	✓
Tax reporting	✓	✓	✓	✓
Ability to see underlying investments	✓	✓	✓	✗
“In specie” transfers of investments	✓	✓	✓	✗
Avoid embedded capital gains tax	✓	✓	✓	✗
Exclude specific investments from portfolio	✓	✓	✓	✗
Tax efficiencies	✓	✓	✓	✗

## Benefits of managed accounts

A managed account can have a number of key benefits including:

- **Convenience** – You agree to an investment objective with your adviser and the portfolio can be rebalanced without having to provide additional advice.
- **Tax efficiency** – Managed accounts are not pooled investments; each investor is typically the underlying owner of their assets\*. This means investors do not inherit existing tax positions like other pooled structures (such as managed funds). Instead, the investor’s tax position is their own.
- **Transparency** – You and your adviser can view the underlying securities (which you can’t do in a managed fund). This ability to track the performance of the holdings can increase engagement with the client and give advisers more opportunities to discuss the portfolio.
- **Agility** – managed accounts offer the advantages of dynamic asset allocation, allowing managers to take advantage of emerging opportunities and manage risk.

## Consequences

- A Managed Account is an investment portfolio which is actively managed by investment professionals. There are fees associated with active management which can be higher than a passively managed portfolio.
- The investments in your Managed Account are based on the decisions of an Investment Manager. These decisions can be subjective and while Investment managers are required to exercise

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reasonable care and diligence, like most investments, there is a risk that a manager's investment decisions will result in the model not achieving its objectives.

- **Model mismatching:** the actual asset holdings in your Managed Account are unlikely to perfectly match the holdings of your chosen portfolio or "model". This can be caused by the implementation of the minimum trade sizes and minimum holding sizes, the required allocation to cash, differences in timing and prices achieved for trades and any personal investment preferences. As a result, the investment performance of your specific portfolio may differ from the reported outcomes of the managed account portfolio.
- **Trading costs:** the amount of trading associated with rebalances will have an impact on your trading costs and investment performance. Trading may be caused by investment decisions of the investment manager as well as by changes you make to your Managed Account such as additions, withdrawals and investment allocations. The application of minimum trade sizes, minimum holding sizes and your investment preferences may also cause more frequent trading to occur as part of the rebalance, particularly on smaller account balances.
- **Manager risk** - there may be changes to an investment manager that you have chosen, such as loss of significant staff, or that a manager may not apply their stated investment philosophy, or other changes may occur that affect the model and the way your money is invested.
- **Suspension of rebalances** - if rebalances are suspended then your managed account may not reflect the most recent investment decisions made by your chosen Investment Manager, which may not be implemented in your managed account. This means you may miss out on investment gains or you may incur losses on assets that have been sold down in your portfolio while your rebalance is suspended.
- **Trading delays** - during the rebalance process it is possible that the completion of a trade may be delayed by more than a day. This means that you may be 'out of the market' and you may not experience gains from a particular asset or market whilst trades are incomplete.
- **Operator and systems risk** - A Managed Account usually operates through an administration platform (such as a Wrap account) and operation of your Managed Account often relies on the administration platform provider's systems and processes to effectively and efficiently establish and rebalance the managed account model portfolios. If the administration platform provider experiences an interruption or fault in its systems this may cause the establishment of your managed account or a rebalance to be delayed or not occur, in which case trades may not be implemented in your managed account on a timely basis and your managed account may not reflect the most recent investment decisions made by your chosen Investment Manager/s.
- **Investment Manager information** - operation of your managed account relies on the Investment Manager providing the administration platform provider with updated information regarding investments on a regular basis. Any failure by the Investment Manager to provide accurate, complete or timely advice to the administration platform provider in receiving and acting on that information, may result in poor performance or capital loss.
- In respect of a Managed Discretionary Account (MDA), your Investment Manager has the discretion to make investment decisions without your consent. While there is an MDA Contract which does prescribe the investment rules (or mandate) that the investment manager will work within, they will not contact you when making specific investment decisions within that mandate. You need to be comfortable with this.

Date: 19 November 2018

## Managed Funds

A managed fund is a professionally managed investment portfolio, where your investment is pooled with funds from other investors and used to buy assets in line with the fund's investment objective.

### Benefits

Managed funds offer the following benefits:

- They provide an easy way to diversify your investments across different asset classes, companies, industries, sectors and countries.
- The funds are managed by qualified investment professionals who have access to information and research which is not easily available to individuals.
- Earnings can be reinvested, allowing an investor to take advantage of compounding.
- A regular investment plan can be set up, where the investor arranges for a small regular (e.g. monthly) amount to be invested, thereby benefiting from dollar cost averaging.
- Only a small amount is needed to start investing. Some funds will allow investment with just \$500.
- The fund manager can look after most of the administrative requirements associated with your investment.
- You don't have to sell the whole investment to access some capital (e.g. compared to direct property investments).

### How it works

In a managed fund, your money is pooled together with other investors. An investment manager then buys and sells shares or other assets on your behalf.

On purchase, you will be allocated a number of 'units'. The value of the units is calculated daily and will fluctuate as the market value of the assets in the fund rises or falls.

Fund managers calculate an 'issue' (buy) price and a 'withdrawal' (sell) price when valuing the fund's units. The issue price applies to an investor buying units in the fund, whereas the withdrawal price applies to those selling units. The difference between the two prices is known as the buy/sell spread, which represents an allowance for the cost to the fund manager of buying and selling actual assets within the fund. It is calculated so as not to disadvantage existing unit holders when others enter or leave the fund.

You are usually paid income or 'distributions' periodically. The value of your investment will rise or fall with the value of the underlying assets.

Traditionally, managed funds were unlisted investments, purchased by applying to a particular fund. Most funds still operate in this way, but you can now purchase some unlisted managed funds through the Australian Securities Exchange's (ASX) mFund service. You can also now buy listed managed funds (e.g. Listed Investment Companies (LICs) and Listed Investment Trusts (LITs)) on an exchange, such as the ASX.

The returns you get from a managed fund usually come in two forms:

- **Income** - which is paid to investors as a 'distribution'
- **Capital growth** - which only occurs when the unit price increases in value.

## Types of managed funds

There are many different types of managed funds and a number are listed below.

### Actively managed funds

Actively managed funds are those where the fund manager aims to outperform the market by frequently buying and selling securities that they think are going to provide greater returns than others.

Actively managed funds are generally more expensive as you are paying for the investment skills of the fund manager. It's important to be aware that many actively managed funds do not consistently outperform the market.

Actively managed funds are suitable for investors that want to concentrate on certain sections of the market or who want more control over the assets they invest in.

### Passive investing

Passive investment funds, also known as index funds, simply buy a portfolio of assets that mimic an index, such as the all ordinaries index or the S&P200 index. Index funds generate a return, before fees, that is almost the same as the index it is tracking (some funds may have timing delays).

Index funds are cheaper as you are not paying for investment expertise.

Investors wanting to invest directly in an index fund have a limited choice of fund managers in Australia, however some exchange traded funds are essentially index funds and they have the advantage of being traded on the ASX.

### Single asset managed funds

These are funds that invest in a single asset class, such as:

- **Cash funds** - Typically low-risk, short-term investments that can include cash or cash equivalents, such as the short-term money market deposits, short-term government bonds and bank bills.
- **Fixed interest and bonds** - Like cash, these are typically low-risk, short-term investments. They can include government bonds, bank bills, or mortgage-backed securities.
- **Mortgages** - Mortgage funds use pooled money to lend to many different borrowers who are buying properties of all types. The risks of these funds vary greatly depending on the borrower and the purpose of the loan. Returns from this investment typically come in the form of quarterly or half-yearly distributions.
- **Shares** - Shares or 'equity' in listed companies in Australia, overseas or both. These funds offer the potential for high returns but with higher risk.
- **Property** - Residential, industrial and commercial properties or property developments. You might not be able to withdraw from the fund at short notice; however, this is easier if the property trust is listed. You are not guaranteed a fixed rate of interest or return of your capital.

### Mixed asset managed funds

These are funds that invest in more than one asset class and can be called multi-sector funds. This group includes, for example, Capital Stable, Balanced and Growth funds, although different labels may be used by different managers.

## Managed fund fees

Funds charge a range of fees for managing your money. Small differences in fees can have a large impact on your returns in the long run. Below is a list of some common fees.

- **Entry fee** - Also known as an initial contribution or up-front fee. This is usually between 1% and 5% and will reduce the amount of your initial investment. If you deal directly through the fund or use a discount broker, you may not have to pay an entry fee or it may be rebated back to you. If you use an adviser, you may be able to negotiate this fee.
- **Contribution fee** - Similar to an entry fee and charged on each additional contribution you make to the fund. This fee may also be negotiable.
- **Indirect Cost Ratio (ICR)** - This is an ongoing fee and represents the fees paid to the investment manager for running the managed fund portfolios. The ICR may change over time as changes to underlying investments are made within your managed funds. It is typically between 0.5% and 2.5% per year, depending on the investment option you choose, and will be deducted from your account balance.
- **Performance fee** - This is an extra fee the fund manager may charge if the investment return is better than the benchmark or target return.
- **Adviser service fee** - An ongoing fee paid to your adviser for providing advice and arranging your investments. Typically, between 1 to 2% per year, your adviser may be prepared to negotiate on this fee.

## Consequences

- Investments in managed funds may incur fees and these fees may be higher than for other investment types. Fees vary between funds and you should understand the initial, ongoing and withdrawal fees associated with the particular investment.
- You can generally access your money within five to ten days after making a request. However, this does vary from fund to fund and some have greater restrictions on your ability to convert your investment to cash when you want to. Please read the Product Disclosure Statement carefully.
- Depending on the type of managed fund and ownership structure, an investment portfolio will usually produce income which must be added to the investor's assessable income. Capital gains tax may apply on the sale of the investments which also impacts assessable income. An increase in assessable income can also impact a person's entitlements to tax offsets and other concessions.
- You rely on the skills of other people and do not control investment decisions

Date: 1 September 2019