







# plumbing **new** depths

As Melbourne-based small business owners recently discovered, the chances of making money from an SMSF are severely diluted without a proper investment strategy, active management, and an understanding of how to maximise tax benefits. Mark Story explains.

**T**hrough passion and sheer hard work, 50-something empty nesters Joe and Carle Zahra had amassed a small fortune from the plumbing business they'd taken over from Joe's parents, Frank (79) and Grace (77), eight years earlier. But like a lot of small business owners who get caught up in their own entrepreneurial bubble, the Zahras had reached a point where errant disregard for money management was making a mockery of their success.

While they were sitting on a growing war chest of cash, the Zahras' singular dedication to the business had left them overly exposed to varying degrees of personal and business risk. In addition to lacking a coherent wealth creation strategy, their half-baked use of tax structures did little to protect their wealth or to minimise future tax liabilities.

Having had their fingers burnt with a bad investment in Timber Corp years earlier, their faith in financial advice was understandably low. Nevertheless, they had already started to seek out advice when they unexpectedly crossed paths with local financial adviser Robert Falconer.

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### Costly complacency

The Zahras got to know Falconer as a plumbing client early in 2011, and eventually succumbed to his offer of a complimentary review of their financial affairs.

"Joe and Carle weren't the sort of couple to be cocky about their success, as they'd worked hard for it," says Falconer.

"But the sheer volume of their cash flow, culminating in profit of \$175,000 annually, had simply made them overly complacent."

As Falconer was to discover, significant remedial work was required to get the Zahras' finances and investments in order.

Joe says a lot of the problems started with the family's self-managed superannuation fund (SMSF).

"The SMSF fund had been limping along without expert advice ever since being set up by the company's accountant in 1996," says Joe.

"In the last few years, following my parents' retirement, it had by default drifted into cash."

### Poor drafting

To make matters worse, a poorly drafted trust deed meant that Joe's parents each retained one share in the plumbing business that they'd started 38 years earlier. And since the company was the corporate trustee of the SMSF, Joe's parents – along with Joe and Carle – were also members of the SMSF, giving them a say in both changes to the business and the investment strategy of the SMSF.

Being naturally fearful of changes he didn't understand, Joe's father was reluctant to acquiesce to proposed plans, and even less interested in signing over power of attorney to Joe.

### Overdue restructuring

Faced with these issues, the Zahras' immediate goal was to get Falconer to correct anomalies within the existing structures.

He advised them of the need to appoint a new corporate trustee to the SMSF, with all members being directors and

## Robert Falconer

professional planner

Hillross Financial Services, Melbourne

An authorised representative of Hillross Financial Services, Falconer has more than 30 years' experience providing financial advice. He founded Falconer Financial Services Pty Ltd in 1975 with offices in both Melbourne and Hobart. A foundation member of the Financial Planning Association (FPA) and a past chairman of the Hobart chapter, Falconer is a Certified Financial Planner who specialises in wealth creation/protection, superannuation planning, plus SMSF structure and administration.

### Advice structure

Falconer Financial Services operates in a strictly fee-for-service environment. In addition to a set rate for an initial consultation, fees reflect a project-based estimate of the time required to provide the necessary level of strategic advice, care and management to meet client expectations.



trustees. That way, Frank and Grace could resign as directors of the trading company and sell their shares to Joe and Carle at market value.

To significantly streamline the SMSF administration and reduce the risk of non-compliance, the administration of the fund – including auditing and annual tax returns – was outsourced to a third party provider.

Meanwhile, Falconer quickly recognised that the pension being drawn from Frank's superannuation account was clearly unsustainable over the longer haul. Grace's account, which was still in the accumulation phase, was swiftly moved into pension phase.

### Maximising super

Falconer questioned Joe's tactic of withdrawing \$34,000 cash from the company each year as a fully franked dividend.

Instead, he recommended that Joe pay himself a salary of up to \$37,000 and increase employer super contributions for himself and Carle, to capitalise on the current \$50,000 concessional contribution cap.

With Joe and Carle having both reached the preservation age of 55 last year, Falconer also recommended commencing a transition-to-retirement (TTR) strategy as of January 1, 2012 to deliver further tax savings. Given that Joe and Carle's super funds were worth \$490,000 and \$265,000 respectively, Falconer says it made sense to transfer their super balances to TTR allocated pensions within their super fund.

Under the proposed allocated pension strat-



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## KEY OUTCOMES

- Parents both moved into pension phase.
- TTR strategy established for Joe and Carle.
- SMSF trust deed updated.
- Reduced exposure to cash.
- Outsourcing SMSF administration.
- Investments now actively managed.
- Parents de-coupled from business.
- \$14,100 in tax savings annually.
- Maximised concessional contribution cap of \$50,000.
- Margin loan account closed.
- Joe's loan to company repaid.
- Franking credits to reduce contributions tax.
- Moving majority of fund to tax-free pension phase.

egy, the Zahras will each draw the minimum pension from January to June 2012 from the wrap platform's cash account, plus salary of \$9000 each from their plumbing business.

"This will allow them to meet their [half-yearly] living expenses of \$35,000 and annual tax liability of around \$8000," says Falconer.

### Redeploying cash

Falconer's next challenge was to optimise returns from the Zahra family's growing mountain of cash, while minimising their tax exposure. In addition to \$220,000 sitting on term deposit, the Zahras also had \$520,000 in cash sitting in a company account, following the sale of an investment property in 2005.

The company also owed Joe an additional \$166,000 – an outstanding loan dating back several years.

The plan was to close an existing margin loan account – with a credit balance of \$123,600 – and use these funds, together with the repayment of the company loan, to each make a personal non-concessional super contribution of \$144,800. Within super, earnings will be taxed at a maximum rate of 15 per cent, compared to a maximum rate of 38.5 per cent outside super.

### Company restructuring

While Joe and Carle now have a coherent and more disciplined investment plan, Joe's parents' continuing involvement as directors casts an overhang on future business direction.

The plan, as mentioned earlier, is to resign Frank and Grace as directors and pay a fair market value for their two shares in the business, which has a net asset value (NAV) of around \$1.3 million.

Falconer says this will also help with any future claims for Centrelink entitlements, which they had never contemplated applying for before.



### Wrap account solution

While Joe and Carle were quick to embrace Falconer's proposed changes, they wanted a better understanding of how re-allocating surplus cash to a wrap platform – combining managed funds, cash and direct share investments – could improve returns, relative to the fees they would be paying.

Also, with all the changes in super regulations since the SMSF was established, Joe and Carle wanted to be sure that retaining an SMSF still made sense.

Falconer eventually convinced them that a wrap platform was a better option for the SMSF investments than having so much of their assets parked in cash at a notional 4.9 per cent return.

"Robert also reminded us that current market valuations made it an opportune time to buy in, even if there's further short-term weakness," adds Joe.

### Sense of direction

Both Joe and Carle always liked the idea of involving an independent third party financial adviser. They also liked the fact that Falconer's advice took into account the risk profiles of all four SMSF members.

Compared to a year ago, Falconer says the Zahras have much greater clarity as to how pension income payments and employment salary will deliver their stated goal of having \$70,000 income annually.

"Investing through super lets the Zahras access numerous tax-advantaged income streams on retirement – such as allocated pensions – that are unavailable using non-super money," Falconer says. ■

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