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Farming investments in the super environment

A farmer is expected to be able to do anything, but they don't teach investing at Agricultural College. So, at 55 years of age, Victorian sheep farmer Damien 'Smithy' Smith put out the feelers, had a few conversations, read a few articles, looked at a book …and finally, a decade later took the plunge to sort out his finances. A thoughtful man, he's not one to rush.

Having inherited the property on which he was born, he had kept up his father's accounting and banking practices, which were very successful in the 1950s (but at the time, not quite up to speed with 2012). When we first met, Smithy had four bank accounts, one small super account, two private loans to family, $230,000 in the bank, a handful of shares, and 3 parcels of land worth about $1.0 million.

Working too hard, Smithy was reaping very little financial reward, but then he did not live the high life. He was also paying no tax, due to the fact that his earnings were below the tax-free threshold of $20,542 inclusive of the Low-Income Tax Offset (LITO).

When I first provided him with advice aged 65, in October 2012, he had personal assets worth around $360,000 and investments, including the farm land, worth about $1.3m.

Smithy's superannuation balance was then only $61,000, still in accumulation phase, and being taxed by stealth within the fund. ***Many people believe super is tax free after age 60, and this is a common mistake. Withdrawals from super are tax free – but the earnings within the fund do NOT get tax free status until the accumulated super benefit is transferred to 'pension phase'.***

He was also paying 1.51% pa in super fund administration and investment fees (over and above the tax on his super balance) and this was way too high.

With careful planning, this farmer has been able to transfer a significant portion of his assets to the superannuation environment to meet his retirement income needs.

Over the last 5 years, cash and term deposits have gradually, been reinvested in cost-effective investment and account based pension platforms, with the added benefits of diversification to match his moderate 50% Growth / 50% Defensive asset allocation.

The family farm blocks have gradually been sold as reasonable offers were received from neighbouring farms. The sales have taken place in stages, to mitigate Capital Gains Tax. There are now two blocks retained, worth around $300,000.

As at October 2017, now aged 70 and a self-funded retiree, Smithy had $50,000 in his at-call account and term deposits, $90,000 in one remaining private loan to a family member, and $410,000 invested (since March 2016) in a non-super investment account using Index Funds invested 50/50. $541,000 (also invested in index funds) is held in an Account Based Pension which is now 100% tax free.

He currently has total investment assets of approximately $1.4 million net of all taxes (including CGT to date) and net of all investment fees. These assets do not include his personal assets.

Farming investments in the super environment

Smithy tells me he is living very comfortably, even more so than before – and in keeping with his moderate risk profile – generating a far more decent return on his investments than a miserly term deposit rate of 2.3% pa.

His non-super investment is also achieving good growth, as he does not draw any income from this investment. His Account Based Pension minimum income drawdown (approximately $27,000 pa) currently covers all his living costs.

The following earnings were achieved for the 12 months to October 2017:

Account based pension:	5.90% (net of investment and administration fees, tax free)
Investment account (non-super):	5.84% (net of investment and administration fees)

If measured from March 2016, when the ABP was reset with a further non-concessional super contribution (NCC) of $180,000, the ABP rate of return is 7.22% pa, with a similar longer term per annum rate of return on the non-super investment account (since reinvested from cash and TD's in March 2016).

Smithy can continue to add further NCCs to his Account Based Pension (possibly over the next five years) using proceeds from the sale of his remaining land, should he receive appropriate offers. *This provision is contingent on being able to satisfy the 'work test' which effectively allows people over age 65 and under age 75 to make super contributions, subject to being gainfully employed for at least 40 hours, in any one 30-day period per financial year*.

His investment returns are augmented by considerable savings on investment and administration fees. Remaining invested in the previous super fund with fees of 1.51% pa would have incurred an annual fee charge of $14,360. By changing to a lower cost provider, his combined ABP and non-super investment account fees are now less than half at 0.60% pa or $5,706, producing a saving of $8,654 pa.

Further, the tax exempt income from his Account Based Pension *(known technically as Non-Assessable Non-Exempt [NANE] ABP income)* does NOT need to be declared in a tax return, effectively removing another administrative hurdle.

Over the last five years, Smithy has effectively transferred a significant portion of his estate into the 100% tax free income and CGT exempt ABP environment.

The benefits:

- Combined tax free, net income $55,060 p.a. from ABP and non-super investments (in addition to modest casual wages and small amount of bank interest).
- $8,654 pa in administration and investment fee savings.
- A simplified, tax effective investment structure, appropriately diversified.
- One bank account, one term deposit, one private loan, one ABP and one non-super Investment account.
- No further requirement to lodge tax returns*
- Secure home ownership plus outright ownership of his personal effects and vehicle.

Farming investments in the super environment

- A simplified estate which allows tax free funds to be passed to his beneficiaries without a farm assets fire sale (particularly if over the next five years, he is able to sell his remaining farm land and add the proceeds to his ABP).

**based on Senior Australians and Pensioners Tax Offset (SAPTO) cutting in at $32,279 and Non-Assessable Non-Exempt (NANE) ABP income.*

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