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LEAVING A LEGACY
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A return to objective-based advice
Philippa Sheehan
My Adviser

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Case study
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LEAVING A LEGACY

Andrew Frith, chief executive officer, Leenane Templeton Wealth Management

A life threatening illness and building debt had left one family in a state of despair until they met an adviser who helped them fight financial stress and get them back on their feet.

Andrew Frith is a chartered accountant having been in the industry for 20 years and has been working with SMSFs since 1994. He established Leenane Templeton with his business partner Chris Laffey in 2001. Andrew was awarded the 2011 FPA Best Practice Award for the Newcastle Chapter, has been named one of Australia's top 50 financial planners in the Financial Review Smart Investor Masterclass for Financial Planners in 2006, 2007, 2008 and 2012.

He is a SPAA SMSF specialist advisor and an affiliate member of the Financial Planning Association.

This case study looks at one adviser who helped a family devastated by a medical scare and sinking under a sea of financial debt.

Michael and Jane Maguire* are in their early 40s. They have been married for 18 years and have two teenage children, Alex and Sophie.

Ten years ago Jane was diagnosed with breast cancer. With a loving husband and two children by her side she fought the cancer for seven years and won the battle.

However, the Maguire family was always concerned that one day it may return. Early last year, those fears were realised after doctors discovered an inoperable tumor in her brain. The new diagnose was brutal, as Jane was given only six months to live.

Michael went to see Andrew Frith, chief executive and financial adviser of Leenane Templeton Wealth Management for the first time at the beginning of 2006 when he needed help managing his business affairs.

Michael and his business partner John has been running a manufacturing firm together since 2000, which has been struggling severely in the ongoing volatile economic environment.

Frith said when Michael first approached him for advice, his business affairs where in a "big mess."

Five years down the track, it was brought to his attention that Jane had been given only six months to live due to cancer.

Frith said he was "stunned" when he first heard about the diagnosis. However, he said he knew straight away there were some beneficial strategies that could be implemented.

After carefully considering how to broach the sensitive situation, he approached Michael and had a quiet chat to him and outlined what solutions were available as a result of the unfortunate situation.

"It's not easy having the discussion with someone who knows that their wife is dying and that the strategy is predicated mostly on her dying," he added.

As it was a very raw subject for Michael and Jane it took a couple of months before they wanted to take action to solve their financial situation.

Strategy for change

From the outset it was clear that the situation was complicated. When Michael and Jane came onboard, their financial affairs were poorly structured. Over time the business had accumulated substantial debt and together with the home loan it was producing substantial challenges for the pair.

After reviewing the complexities of the case, Frith decided to focus on three key areas including the home, the preservation of the assets in super and leaving a legacy for the children.

"The aim with this strategy was to deliver reassurance and confidence to Jane that the family was well looked after," he said. "As she had never been financially sophisticated, her goals were simple - to leave a legacy to her kids and to ensure the home was protected."

As most married couples Michael and Jane bought their home as joint owners. This means that the spouse interest in the house automatically passes to the surviving spouse.

In addition, as Michael's business is high risk and needs a lot of capital, the business' finance facilities require the home to act as security.

In conjunction with their solicitor, Frith explained to the couple that the best option would be to change the title of the home from joint to tenants.

Frith advised that in order to execute this strategy, Jane also needed to give up her share of the house to a testamentary trust in which Michael was the sole trustee.

"This allowed at least half of the house to be protected going forward," he said. "The remaining half will always be owned by Michael and is always going to subject to risk."

Although a complete protection strategy was not possible, Michael would still control the ownership of the home and be exempt from capital gains and land tax.

The second area of focus was a two pronged strategy including retaining assets within super as well as the commencement of a disability pension for Jane with a 100% reversion to Michael.

The quote

As she had never been financially sophisticated, her goals were simple - to leave a legacy to her kids and to ensure the home was protected.

Frith explained that as half of Michael's business assets were owned by the Maguire Superannuation Fund and the fund's sole asset was 50% interest it had virtually no cash left as it had been used to reduce firm's debt.

"Even though Jane's interest in the fund only represented around a third of the total assets of the fund, it would not have the liquidity to pay lump death benefits," he added.

"Therefore the preservation of the assets within the fund was imperative to avoid a funding disaster."

Through a DBA Lawyer's advice, Frith recommended that a disability pension be commenced for Jane. The pension was about Jane having control over her money and enjoying the ownership and the freedom the regular income gave her.

However, secondary to this was that the intention was for the pension to be auto-reversionary to Michael. Frith explained that this meant that on Jane's passing the pension would automatically continue to Michael.

He said that this would give Michael the opportunity of drawing an income stream from super some 20 years before his preservation age or when his condition of release would ordinarily be satisfied.

Frith noted that these were the two main strategies in the advice but it was the flow of funds and the documentation that was the key for a successful outcome.

Achieving objectives

In order to achieve optimal results from the pension strategy, Frith suggested maximising Jane's capital account within her Maguire Superannuation Fund. This strategy was achieved through a reserving strategy, non-concessional contributions and contribution splitting.

Firstly, he recommended the implementation of a reserving strategy which is where the trustees make a conscious decision to retain some or all of the investment earnings of the fund for future purpose and not have these earnings allocated to members.

"As the fund's deed recently had been upgraded to the DBA Lawyers deed, it allowed for such strategy to be implemented," he added.

Frith explained that the intention was for the year ended (30 June 2011) the fund would allocate to reserve 100% of its investment earnings. In this case, the investment earnings are represented by the rent received from the 50% interest in the property, minus the operating costs of the fund.

Once the earnings had been allocated to the reserve, the trustees would then make an allocation from the reserve to Jane's members account.

Frith said because this allocation is not made equally to all fund members and would represent greater than 5% of the members capital balance, it is treated as a concessional contribution.

"Our review of Jane's circumstances indicated that she had only received minimal concessional contributions that year.

"Therefore as long as the allocation from the reserve together with the concessional contributions received from her employer during the year was less than her concessional contributions cap - she would not be subject to excess contributions tax," he explained.

To further maximise Jane's member account, Frith recommended that she make a non-concessional contribution of some of her life insurance proceeds into the Maguire Superannuation Fund.

"This had the immediate effect of boosting her capital account; but being a non-concessional contribution also boosted the tax free component of her member account.

"When drawing a disability pension, the pension payments are not tax free. The taxable component of the pension is treated as assessable income. This means this non-concessional contribution reduced the taxable amount of the pension," he explained.

The last part of Frith's recommended strategy involved contribution splitting which is where a member can split up to 85% of their concessional contributions with their spouse.

Up until this stage, Michael had only been able to afford to make minimal concessional contributions through his business.

However, in the lead up to 30 June 2011, Frith recommended that Michael salary sacrifice his remaining salary for the financial year to superannuation in order to maximise his concessional contribution caps.

Once he had maximised his cap, Firth proposed that he split his contributions with Jane, which would further inflate her member account balance.

Prior to the implementation of the three strategies, he also suggested that Jane enter into a re-contribution strategy to maximise the tax free component of her superannuation benefits.

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Volume 07 Issue 03 | 2012

Frith explained that the taxation implications are that lump sum withdrawals are tax free irrespective of the underlying member components. “However, pensions drawn under the same condition of release do not afford the same tax concessions.”

Therefore for both Jane and Michael, Frith wanted to maximise the tax free component.

“Utilising the cash that resulted from Jane’s non-concessional contributions, I further suggested that she make a lump sum withdrawal and then make a non-concessional contribution with these same proceeds to increase her tax free components.

“This then formed the basis of her disability pension,” he added. To round the strategy off, Frith completed a Binding Death Benefit Nominations for the couple.

Each nomination gave the surviving spouse the flexibility of taking either a lump sum, pension or part lump sum part pension.

“Even though it was built into the pension documentation for Jane’s disability pension that the pension would automatically pass (auto-reversion) through to Michael - the binding nomination would be the back up in the event the auto-reversion failed or there was an accumulation account,” he said.

Frith said that the culmination of these strategies was that it gave Jane the confidence that her affairs were in order.

The strategies were signed off and implemented on 27th June 2011. Jane passed away on 9 August 2011.

Financial situation after advice

Upon seeking advice, Jane and Michael were concerned about the pressures the family was about to face and the future well-being of their children. Before Jane passed, she had two financial goals in mind and that was to leave a legacy to her children and to ensure the home was protected.

After the implementation of the financial advice, however, half of Michael’s house is secured, his superannuation balance is significantly higher and his cash flow balance much steadier.

Frith noted that the benefit of a tax free income has certainly helped Michael reduce additional financial worries so that he could concentrate on being there for his children during this difficult time in their lives.

Fee structure

The first meeting Frith had with Jane and Michael was to allow them to understand the advice strategies that the unfortunate situation had brought on.

Frith spent approximately ten hours on the case which was mostly about discussing the matter with the couple, which he said was “incredibly difficult.”

For the advice and implementation, he charged the Maguire family a fee of $6,600.

The fee he charges are unique to each client and depends on a variety of factors, including the complexity of the case, strategy/advice provided and the time involved.

These fees are explained to client/s during the initial appointment before any cost being incurred. **FS**

** Names changed to protect identity*

Table 1. Summary of Jane and Michael’s financial position

Annual income details

Emplyoment Icome	Michael	Jane
PAYG salary (before tax)	90,000	40,000
SG contributions	9,000	4,000
Total	**99,000**	**44,000**
Assessable income for tax:	99,000	44,000

Table 2. Assets and liabilities - original

Lifestyle assets	Owner	Amount
Principal residence	Joint	500,000
Total		**$500,000**
Investment assets	**Owner**	**Amount**
Shares – Manufacturing Company Pty Limited	Michael	80,000
Cash	Jane	150,000
Total		**$230,000**
Superannuation assets	**Owner**	**Amount**
Maguire Superannuation Fund	Michael	183,295
Maguire Superannuation Fund	Jane	83,471
Total		**$266,766**
Total net worth		**$996,766**

Table 3. Assets and liabilities - now

Lifestyle assets	Owner	Amount
Principal residence	Joint	500,000
Total		**$500,000**
Investment assets	**Owner**	**Amount**
Shares – Manufacturing Company Pty Limited	Michael	80,000
Total		**$80,000**
Superannuation assets	**Owner**	**Amount**
Maguire Superannuation Fund	Michael	183,295
Maguire Superannuation Fund	Jane	418,715
Total		**$602,010**
Total net worth		**$1,182,010**

** This valuation is reflective of the revaluation of the business property*