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# Carpe Diem

Summer 2011

## Economic update

Summertime may have arrived in Australia but as the northern hemisphere moves into winter, lingering concerns about debt, banks and economic growth in Europe and the United States are starting to affect economies in other regions, including our own.

The good news is that China seems to be slowing growth, in order to reign in inflation, without bringing the economy to a halt. Of concern however, is that their important export markets include the US and Europe, both of which are struggling.

The danger for the stronger Asian and Australian economies is that as international credit flows tighten, it will affect funding costs for local banks.

Locally, the sharemarket roller coaster continued with October rises followed by falls in November. The Aussie dollar has dropped below parity, reflecting lower commodity prices, but its strength is biting into manufacturing, especially steel. As a result, the local labour market is softer.

Housing prices remain subdued but overall construction figures are strong. October brought a cut in interest rates and another may be in the offing. It remains to be seen how that flows into both housing and retail spending, but it has already lifted consumer confidence levels.

In the months ahead, there could be quite a bit of heat in the economic sun.

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# Protect yourself now *via* your super

## Cash flow concerns prevent many people taking up insurance

**I**t's amazing really, we always remember to insure our home and contents and cars, but many of us forget to insure the most valuable asset we have – ourselves. How long would your family be able to keep paying the mortgage if you died, or lost your income through illness or accident?

Proper estate planning is the process of identifying real threats to you and your family and managing them with proper planning. It involves arranging your financial affairs while you are alive so that when you die, your assets pass to the people you want to receive them, in the way you intend. As part of that process, insurance is often extremely important. What would you live on if your savings were eroded by huge medical bills? How would the school fees and the grocery bills be paid if you couldn't work for a period of months, or even years? It's easy to see why we need different types of personal insurance such as Death, Total and Permanent Disablement and Income Protection insurance but they are NOT simple products to buy. There are many different policies from many different insurance companies and the conditions and benefits vary substantially. It's critically important to choose the right policy for your needs as part of your overall plan.

Here are just three of the vital questions you need to ask:

### **1. How much money do I need to live on if I can't work because of accident or illness?**

Income Protection insurance allows you to insure 75% of your income in the event you can't work due to sickness or accident. It can be used to cover all your normal bills or anything else for that matter. In fact, the benefits can be paid to you each year until age 65 whilst you are unable to work. While Income Protection may be 100% tax deductible, cash flow concerns prevent many people taking up this vital insurance.

In most situations, it is appropriate for Income Protection insurance to be purchased directly. However, the Government has recently changed the legislation to allow Income Protection insurance to be acquired through a superannuation fund, and this may be appropriate in some circumstances.

### **2. What lump sum do I need to eliminate debt on death or disability?**

If you're like most people, you've used debt to finance a range of lifestyle purchases, including the family home. If you die or become disabled, loan repayments are still required and, consequently, most people want their lifestyle debts cleared as a bare minimum in the event of their death or disablement. Taking out insurance for death and/or total and permanent disablement will ensure you receive a lump sum to repay all your family's

debts. Death and Total and Permanent Disablement insurance is generally not tax deductible if the policy is purchased in individual names. However, if you purchase the insurance through your superannuation fund, it becomes tax deductible to the superannuation fund, and it doesn't affect your day to day cash flow. However, there may be tax implications to the lump sum payout.

### **3. How do I maintain the family's lifestyle?**

You need to ensure you have enough insurance to clear your debts, but your family will still need to meet ongoing expenses. That's why you should take out Death and Total and Permanent Disablement insurance for an amount higher than just your existing debt. With our help, you can determine what your ongoing expenses will be after a tragic event such as death or disablement, and how long you'd like your family to be financially supported.

Remember, superannuation is a tax effective vehicle to purchase personal insurance such as Death, Total and Permanent Disablement and Income Protection and it may not have any effect on your day to day cash flow. Because these are complex products with different features offering different premiums and benefits, it's important you find the right policy to fit your individual circumstances. Please don't hesitate to call us if you would like to discuss your insurance requirements.



# *winning* WINDFALLS

**I**magine winning the lottery or great Aunt Sally leaving you all her worldly goods. What would you do? It might all sound wonderful but, interestingly, windfalls like these can present as many problems as they solve.

Among a suite of possibilities, the classic choice of what you should do with a windfall is to either pay off your mortgage or put the money into super. But given that a lottery win or an inheritance is likely to be a post-tax sum, the mortgage route may often prove more effective, despite the appeal of superannuation's favourable tax treatment. In most cases, however, the decision will depend on your personal circumstances.

## **Can investments earn enough?**

A key factor in favour of paying off the home loan is that it is a non-deductible debt; there are no tax advantages or offsets to help service your borrowings. With mortgage rates around the 7 per cent mark you would need to earn at least that amount after tax from your investments to decide against paying off your mortgage.

Admittedly, earnings on your investments in super only attract a maximum 15 per cent tax in the accumulation phase and are tax-free in the pension phase, but you would still need to earn at least an 8.25 per cent return to make it a better option than paying off your mortgage.

## **A taxing question**

Mind you, if Aunt Sally has left you her holiday home or some other asset with a capital gains tax (CGT) liability, when you sell it, then contributions to super might be a way to offset that liability. For this to be the case, you first must be eligible to claim a deduction. This requires you to have no more than 10 per cent of your income derived from employment in the financial year you wish to claim the tax deduction.

For example, if your capital gain was \$200,000 and your CGT liability was on 50 per cent of that (i.e. \$100,000)<sup>1</sup>, you could further reduce this liability by making a \$50,000 contribution to super (if you are aged 50 or more; otherwise \$25,000). This could bring the sum on which CGT is payable down to \$50,000. These are all issues you need to discuss with us (and your tax accountant) to ensure your needs and personal circumstances are fully considered. For example, exceeding contribution limits may incur a large tax penalty.

If you are someone who is used to having a mortgage and building an effective family budget around that, consider taking two steps: pay off the mortgage first, and then redraw funds to purchase an investment. If you use that approach, the interest on your loan becomes tax deductible.

Of course, if you don't have a mortgage, consider putting the money into super as a non-concessional contribution. That way you would benefit from the

15 per cent tax on investment earnings rather than paying your full marginal tax rate which could be as high as 46.5 per cent.

## **Calculating your options**

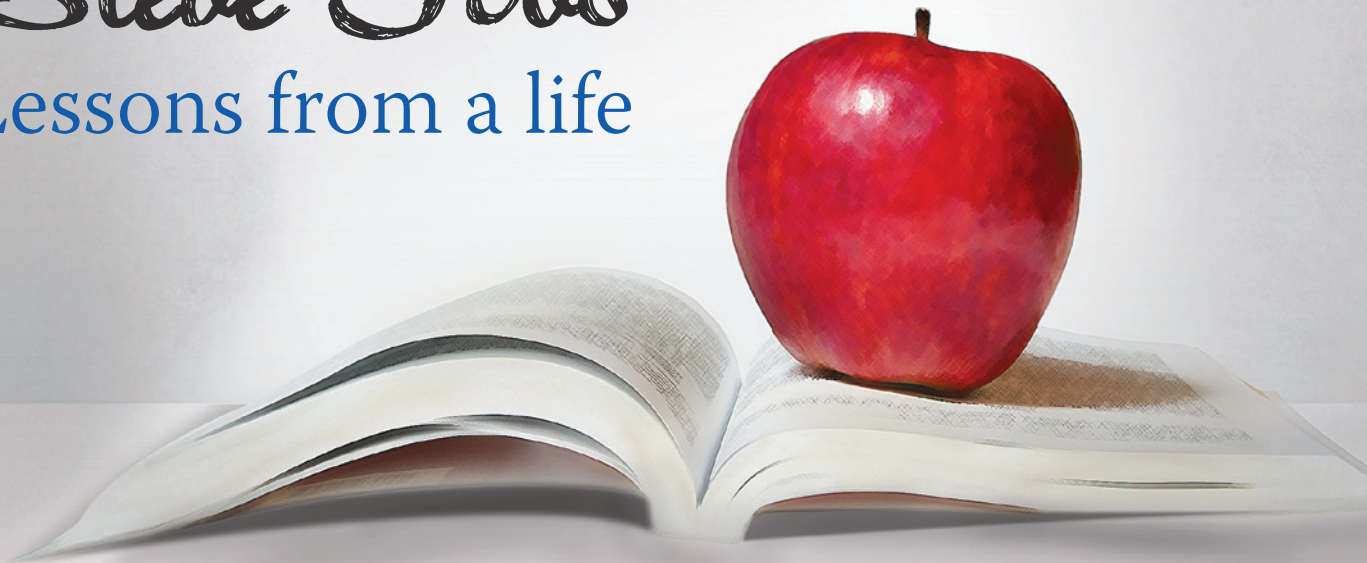
According to the Government website [Moneysmart.gov.au](http://Moneysmart.gov.au), somebody aged 50, earning \$100,000 a year, would be better off paying down their mortgage if they received a \$300,000 windfall, in comparison to making super contributions. The assumptions behind this are the person has a \$300,000 mortgage with 15 years to run at 7 per cent. It also assumes a 3.5 per cent inflation rate and a 7 per cent return on super investments. According to the website, the difference once the person turns age 65 would be \$449,778. And if you had been 40 at the time of the windfall, you would have been \$629,392 better off. It is important to remember however, if superannuation returns were more than 7 per cent, this would reduce the benefit of paying off the mortgage first.

There are so many variables to consider, it is important that you do your homework well and seek professional advice to match your decision with your personal circumstances. A windfall might be money received without effort on your part, but effort and planning are what you need to get the best from your gift of good fortune.

1. Assumes the property was held for more than 12 months.

# Steve Jobs

## Lessons from a life



Steve Jobs always lived life on his own terms, doing what he loved, which was to explore the creative possibilities which computers offered.

Financially, he began with nothing, starting Apple Corp in his parents' garage with a friend, and inventing a new kind of computer which gave birth to a multibillion dollar company. He was then thrown out of his own successful company, humiliated. Despite this, he believed in himself enough to start again and built not one, but two more companies before returning to Apple.

Money was never the driving force in Jobs' life, but he made three fortunes by sticking to the basic values that energised him. So what lessons can we learn from the life of this man?

### Lesson 1: Trust your instincts.

Jobs, an adopted child, dropped out of his college course after only six months because he thought it was a waste of his working-class parents' hard earned savings. But although he quit his course, he did not walk away from learning.

He said later that he didn't really know why he hung around college but, aged 17, he spent the next 18 months sleeping on friends' floors while learning things he found interesting.

The reality is that much of what he learned by following his curiosity and intuition turned out to be really useful in later life, subjects like calligraphy and typography. Ten years later, the typographic functions built into the first Apple Macs sparked a revolution in publishing and printing. Jobs said, "If I had never dropped out of college, I would have never dropped in on this calligraphy class, and personal computers might not have the wonderful typography that they do."

### Lesson 2: Never give up on yourself.

Apple had grown into a \$2 billion corporation when the board of directors turned on Jobs and shut him out of his own company.

Jobs was devastated, but he slowly realised that he still loved the creativity of computers and he still had his expertise and experience. During the next five years he created an IT company called NeXT. He then bought and developed Pixar which became the world's leading computer animation studio before it was swallowed by the Disney corporation, making Jobs into Disney's largest shareholder. Finally, Apple realised they had lost their way without Jobs, and bought NeXT to get him back on board.

"I didn't see it then," Jobs recalls, "but it turned out that getting fired from Apple was the best thing that could have ever happened to me."

### Lesson 3: Do what you love. Love what you do.

Jobs' life reflects his belief that if you love what you do every day, you will achieve happiness and success. "Your time is limited, so don't waste it living someone else's life," Jobs told Stamford University graduates. "Don't be trapped by dogma — which is living with the results of other people's thinking. Don't let the noise of others' opinions drown out your own inner voice. And most important, have the courage to follow your heart and intuition."

We don't have to have the creativity and talent of Steve Jobs, but his story can still inspire each one of us to keep going when things are not working out, to treat setbacks as an opportunity, and to pursue our dreams with hard work and confidence.

When you look at it more closely, Jobs' success was built on a basic principle of successful investing. He always had a goal, even if he wasn't always sure of how things would work out.

Once you know where you want to go, you have a much better chance of getting there.