Post-divorce is stressful so take time and consult

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THE MENTOR
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I've just received my divorce settlement that includes 60 per cent of the house we shared, half our combined super and about $150,000 in cash and other investments. I have a good job paying $150,000 a year and no debt. What sorts of things do I need to prepare when starting again on my own?

Starting over can be difficult, and it's great to see that you are thinking about how you will do this.

No matter what your stage of life, or your circumstances, it is important not to rush. The first step is to sit back and think about what it is that you want to achieve, what assets or income you have, and then the steps necessary to get you on track and monitor your progress into the future.

I see you have received 60 per cent of the house you previously shared with your ex-partner. While assuming you currently have somewhere to live, I don't know whether that is a permanent or temporary measure. So clearly thinking about where you want to live into the future is important, and whether you want to purchase a property, or would prefer to rent (whether short-term or long-term).

Owning your own home may give you a sense of security, though it is also a big commitment to make, especially if you will need to borrow to fund the purchase. Without knowing all of your circumstances, it's not possible to outline the relevant considerations for you, but some of the key considerations would normally include how much you need to borrow, what the regular repayments would look like (which will be impacted by the amount you borrow and interest rates), and how easily (or not) you can afford these items. Ideally, when you look to borrow, it's great if your finances allow you to have a buffer (or surplus of income) that can accommodate interest rate rises in the future. It could also allow you to try and pay ahead on your loan.

You mentioned that you have ended up with about half of your combined super. Assuming this to mean you have received some super from your ex-partner, it's important to be aware of how the reallocation of super savings upon a divorce works. Unlike settlements outside super, where you may end up with some monies in your bank account, the splitting of super upon divorce stays in the super system. If you have received an allocation from your ex-spouse, that will remain in the super system. However, if your spouse was able to access their own super then you would also be able to access the amount allocated to you. But if they were not able (for example as they have not yet retired), then you also cannot access it, and you will not be able to access it until such time as you are able to access your super. This is the case even if your ex-spouse can access their super at an earlier time than you in the future.

Additionally, you need to determine if an amount has been notionally allocated to you within the super fund of which your ex-partner is a member. This could result in you now having multiple superannuation arrangements, and you should consider if there is a benefit to consolidating your savings to one account. There could be some initial costs when consolidating, and you should be careful that you don't accidentally lose any insurance cover through super.

Speaking of insurance, as your circumstances have now changed, you should also review your existing insurance arrangements (if any). You may need more or less insurance, and

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if your ex-partner was a nominated beneficiary, you may wish to consider changing that. In making any changes, you should take care to ensure you do not accidentally end up in a position where you are not appropriately covered at any point in time.

Another significant area to be considered upon divorce is estate planning. When a divorce is finalised, it will generally render invalid any will made during your marriage. While this could have a desired effect of preventing your ex-spouse inheriting anything from you in the future, you do need to reconsider to whom you would want your estate to now be distributed. For some people, this could still include an ex-spouse, so taking the time to put in place a new will is important.

You also need to remember that your superannuation savings are not automatically part of your estate, and therefore may not be dealt with under your will. You should review and, if necessary, update any nominations you have made about who your super should be paid to in the future if there are amounts remaining in super when you pass.

Although there are a number of important considerations upon divorce, make sure you don't forget some of the basics. How much are you earning, how much do you spend, and how much can you save? Do a budget, think about your goals, and put in pace a plan to help you achieve them.

Divorce can be a stressful and difficult time, but you don't have to go through it alone. In addition to family and friends that may support you, don't forget to consider the help of professional advisers to navigate you through the many complex financial issues that will arise at this time.

Bryan Ashenden is BT Financial Group's head of financial literacy and advocacy.

Bigger SMSF member limits

There is one way to offset Labor's change to franking credits

MEG HEFFRON

As the bank inquiry dominated news headlines in recent days the government announced a change that will certainly be very welcome for some families with self-managed super funds.

Until now the most people allowed in an SMSF fund was four, but Financial Services Minister Kelly O'Dwyer has announced the government intends to allow six people. The timing is especially useful since some families are reviewing their SMSF arrangements in the light of the ALP plan to scrap cash refunds for franked dividends.

One way to mitigate the impact of the ALP proposal is to include adult children in the SMSF so the franking credits generated by the parents' share portfolio can at least be used to pay the tax generated by the children's super, rather than being wasted

To put some real figures around this issue, let's assume an SMSF has two members and $1.5 million in assets (combined). Both members have retired, stopped making contributions and are receiving pensions from their fund. The fund earns about 4 per cent in investment income a year (a combination of dividends, rent, and interest) in addition to any growth in the value of their assets. About 50 per cent of the investment income is franked dividends. This means that in addition to receiving the cash dividends of $30,000 (4 per cent x 50 per cent x $1.5m), the fund will receive franking credits — these will be about $12,857. Under current law, the fund would pay no tax and would receive a tax refund of $12,857.

Under the ALP proposal the fund would still pay no tax but would not receive the $12,857 refund. In other words, if the ALP measure is introduced as planned, the fund (and therefore the members) will be $12,857 poorer every year.

What if the couple included their adult children in the fund?

If the children are working, their employer could contribute to the fund, creating more taxable income (which in turn will use up the franking credits rather than wasting them). Or the children could make personal contributions for which they claim a tax deduction.

Let's say the employer contributions made for the children were as high as possible ($25,000 each). At the moment, only two children can be included in the SMSF before the four-member limit is reached, so this would help but not entirely solve the problem. Adding the children's contributions would now mean the fund would use $7500 of the franking credits (the amount of tax that would normally be due on the contributions). But the family would still waste the rest of the franking credits ($5357).

Note that it would also be possible — and reasonable — to make sure the benefit of being able to use some of the franking credits passed to the parents rather than being a windfall for the children, given that it would be the parents' investments that created the opportunity in the first place. This would be worked out by the fund's accountant.

Make the most of rules

Is there any way of making sure the fund uses up all of the franking credits? In fact, it is difficult. Even if the children transferred their own superannuation balances into the fund (and so the fund paid income tax on some of its investment income), this would also mean the fund would have more investments and probably more franking credits.

Really, what the fund needs is more taxable contributions. This is why large funds (such as industry funds and retail funds) are not affected quite so much by the ALP proposal. Even though these funds might have many more pensioners than an SMSF, they also have many more members receiving employer contributions.

It is also why the latest announcement about increasing the limit on SMSF members to six will be particularly interesting to those with larger families. Parents in this position with four children (or two children and their spouses) with the maximum rate of taxable contributions could use all the fund's franking credits.

Of course, this relies on couples conveniently having family or others who can direct large contributions to the fund and want to do so. Nonetheless, where feasible, it is likely that including children and possibly even extended family in an SMSF will be a common response if Labor's proposal is introduced. As the figures, left, show, it will certainly help make better use of the franking credits that might otherwise be wasted, particularly in a pension fund.

But be careful here — there are issues you need to consider.

First, new members are generally also required to be trustees of the fund. This means the children become decision-makers when it comes to the running of the fund. There are some protections that can be put in place but, at the very least, the fund's trustees must make decisions with the interests of all members, including the children, in mind. Even now, when funds are limited to four members, if one parent dies there is a risk that the children (combined) have more control over the fund than the surviving parent. In a six-member fund, with for example four children, this problem exists from day one.

If a couple has more children than can fit in the fund — more than two now or more than four in future — some must miss out. This may not be a problem — who really wants to belong to their parents' superannuation fund anyway? But it does create the potential for the children who are not in the fund to feel excluded.

Finally, adding the children to the parents' fund may disrupt the children's own superannuation planning — at the very least it may delay their ability to set up their own SMSF with their spouse. It is also an arrangement that will need to be unwound at some point — for example, once the parents die, will the children want to continue combining their superannuation arrangements? Even this has some solutions — the children could routinely roll out most of their superannuation contributions to their own fund, the contributions just need to be made to (and taxable in) their parents' fund. But then life starts to become more complicated.

So while adding children to an SMSF may provide a better tax result by making sure more of the franking credits are used, the solution won't necessarily be right for every family.

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Super rule change affects tax exemption on pension assets

MONICA RULE

There is some perfectly understandable confusion about which method to use when calculating the tax exemption on income from assets supporting superannuation retirement pensions.

The sources of the confusion are the changes to the superannuation law that took effect from July 1 last year and the Australian Taxation Office's interpretation of the tax law as to which method must be used when calculating the tax exemption. Let's see if we can clear this up.

If a self-managed superannuation fund has a member with a total superannuation balance of $1.6 million (as at prior June 30), across all their superannuation funds, and the person is in receipt of a retirement pension, then the SMSF can only calculate the tax exemption using the unsegregated or proportionate method. This is regardless of whether the SMSF's pension assets were segregated at any time during the current financial year.

If an SMSF has members in receipt of retirement pensions and each of these member's total superannuation balance is less than $1.6m across all their superannuation funds at June 30 of the previous financial year, then the SMSF can claim the tax exemption using the relevant segregated and/or unsegregated method.

For fund members with a total superannuation balance of less than $1.6m, the ATO's interpretation of the tax law is based on whether the SMSF had pension assets that were segregated at any time throughout the financial year. If an SMSF had segregated pension assets at any time throughout the financial year, then it must calculate the tax exemption using the segregated method for that time period.

What this means is that if, during a financial year, an SMSF did have pension assets that were segregated but at a later time it no longer had segregated pension assets, then it must use the segregated method to calculate the tax exemption for the time period where the pension assets were segregated; and use the unsegregated method to calculate the tax exemption for the period the SMSF's assets were no longer segregated.

Prior to July 1 last year SMSF trustees and professionals were simply using the unsegregated method to calculate the tax exemption when SMSFs had segregated pension assets at some time during the financial year, and unsegregated assets at other times during the same financial year. They did this to simplify the tax exemption calculation. Unfortunately, the ATO has stated that using the unsegregated method for those situations is no longer an option from July 1, 2017.

Let's look at an example. Assume an SMSF has two members in the accumulation phase on July 1, 2017. On October 1, 2017, both members started retirement pensions with their total superannuation balance of $1m each. Then on December 1, 2017, one of the members makes non-concessional contributions into the SMSF and on February 1, 2018, starts a second retirement pension account. This means the SMSF was completely in the retirement pension phase during the periods October 1, 2017, to November 30, 2017, and February 1, 2018, to June 30, 2018. However, the SMSF was not entirely in the pension phase during July 1, 2017, to September 30, 2017, and December 1, 2017, to January 31, 2018.

The SMSF trustee will need to take into account four accounting periods and apply the segregated method of a 100 per cent tax exemption on investment earnings of pension assets during the period the SMSF was completely in pension phase and apply the unsegregated method to the other periods when the SMSF was not totally in pension phase.

The calculation of the tax exemption is certainly more complex now and it is most important that SMSF trustees and professionals are aware of this.

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DIVIDEND DETECTIVE

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Pro-Pac Packaging (PPG)

ASX CODE: PPG
SECURITY PRICE: $0.39
INDUSTRY: Packaging
FORECAST FY19 DISTRIBUTION: 2.3c a year

DAMEN KLOECKNER

Small companies with low margins and unremarkable products or services are not typically attention-grabbing. Pro-Pac Packaging (PPG), a diversified distribution company providing flexible and rigid plastic packaging solutions, historically fell into such a category. PPG acted as a middleman, offering logistics and storage services for packaging, as well as limited manufacturing capability, sourcing product from third-party manufacturers to fill its supply shortfall.

Last September, PPG announced its intention to merge with IPG, Australia's largest specialist manufacturer of flexible plastic packaging. IPG has a much larger manufacturing capability but lacks an extensive distribution capability, making it a strong strategic fit. The combined group structure is more vertically integrated, better using existing capacity in manufacturing and distribution to service larger and more complex projects. This should help PPG win market share, while also improving asset utilisation and operating leverage, which should drive margin improvement over time.

The opportunity for improvement in margins is not widely understood in the market. Management have already raised estimates of merger benefits from $2 million to $6m by FY18. We believe the entire long-term cost saving opportunity could ultimately be significantly higher given the quantum of synergies (relative to sales) realised in similar mergers. Management will need to integrate multiple systems, optimise the asset base and logistics, and create a cohesive culture and vision. FY19 is likely to be the first year where the combined group can be assessed in full, with stronger growth driven by synergies and a cyclical upturn in volumes.

PPG will also benefit from structural growth in flexible packaging driven by a shift towards convenience packaging, unitisation and cost savings. Fresh produce that previously sat in large piles in boxes in the supermarket are now being pre-packaged. This standardises the number/weight of the item, reduces losses from perished product and saves the customer time.

PPG recently revised its EBITDA guidance down 4 per cent. The share price fell as a result, and once again presents compelling value on a one to three-year view.