prp keeping you informed

December2018

The NEW 'downsizer contribution' on the sale of a dwelling from 1 July 2018

Traditionally, the concessional and non-concessional contribution caps have restricted the total amount that an individual can contribute into a concessionally taxed superannuation environment. The contribution caps have also prevented many older Australians from investing (or contributing) the proceeds of selling a dwelling that was used as their family home into superannuation.

Therefore, to provide greater flexibility for older Australians selling their home to invest some or all of the sale proceeds into superannuation, the Government recently introduced the **downsizer contributions** measure. Broadly, this measure allows individuals **aged 65 years or more** to make **contributions of up to $300,000** (or up to $600,000 per couple) from the **sale of a dwelling that was previously used as their main residence**, if the individual or their spouse owned the dwelling **for at least 10 years**.

The downsizer contributions measure will apply to the disposal of an ownership interest in an eligible dwelling **where the contract for the disposal is entered into on or after 1 July 2018.**

Refer to the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No.1) Bill 2017 ('the Bill'), which received Royal Assent on 13 December 2017 (as the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No.1) Act 2017).

The **ATO has** also recently **issued additional guidelines** on applying certain aspects of the downsizer contributions measure, by way of **Draft Law Companion Ruling ('LCR') 2018/D4.**

TAX TIP – No need to downsize and acquire another residence

Despite the above measure being referred to as the downsizer contributions measure, there is no requirement for an individual to actually 'downsize' by purchasing another (smaller) dwelling to be used as their home (or main residence). Rather, an individual selling their home can move into any living situation that is suitable for them, including, for example, moving into a retirement community, an aged care facility, or a smaller property, renting (i.e., where the individual lives as a tenant) or living with family.

Courtesy J Deliyannis & M Gilmore NTAA

Did you know?

We have accounting and taxation services in both Adelaide and Renmark? We would be happy for you to refer friends and family to have their tax returns completed by us!

Do you know someone who would benefit from PRP Group Services? Why not pass along this newsletter to introduce us!

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The power and benefits of compounding over time

Albert Einstein famously stated: "Compound interest is the eighth wonder of the world. He who understands it, earns it... he who doesn't...pays it."

Most people are familiar with the concept of compound interest when it comes to term deposits. By continually rolling over the term deposit and interest you can earn interest on interest on interest.

Compounding can also be used in the share market by using the dividends that are paid out to buy more shares and most companies on the ASX have dividend reinvestment plans (DRP) that encourage investors to do just that.

What is less well known is that there is another layer of compounding at work in the share market.

To understand how the second layer of compounding works, you need to think about the underlying company that the shares represent and not the pieces of paper or words on a screen that represent your "share" of the company.

While every stock's share price tends to jump around on a day to day basis as the sharemarket oscillates, the reality is that whenever you buy a share of a good quality industrial company you are purchasing and investing in a slice of that company's future earnings and dividends into the future.

All good quality industrial companies generally pay a dividend from their annual profits – but what many investors often don't appreciate is that most companies also retain a significant portion of their annual earnings. Management of these companies must then decide how to best utilise these retained earnings to grow the future earnings of the company. For example, they could use the retained earnings to pay down debt, or to purchase new assets for the business, or management may decide that the best option to grow is to acquire other companies or alternatively buy back shares.

The best way to demonstrate how compounding works within a company is to use a simple example.

ABC Co. Ltd is a profitable Australian company that generates a sound recurring earnings stream.

Looking at the table below, imagine that ABC Co. Ltd starts year 1 with $100 of assets and makes a profit after tax of $10 on these assets i.e. a rate of return of 10%. The company's management adopts a 50% dividend payout ratio meaning that the company pays its shareholders $5 in dividends in year 1, while holding onto the other $5 as retained earnings.

As can be seen above, in year 2 the company's assets have now grown to $105 in assets and if one assumes another 10% return on this higher asset base the earnings of this company

Year	Business assets	Profit (R.O.E)	Dividend	Retained earnings
1	100.00	10.0	5.00	5.00
2	105.00	10.5	5.25	5.25
3	110.25	11.0	5.50	5.50
4	115.75	11.6	5.80	5.80
5	121.55	12.2	6.10	6.10
6	127.65	12.8	6.40	6.40
7	134.05			

Source: IML and Peter Thornhill

grow to $10.50 in Year 2. Assuming the same 50% dividend payout ratio again, then and the dividend declared in Year 2 has grown to $5.25.

By this simple method of compounding one can see from the table how by year 6 the earnings of the company have grown to $ 12.80 while the dividend has grown to $6.40 and the asset base ends at the end of year 6 (and starts year 7) at $134.05.

You can see from the table above that by investing its retained earnings wisely every year, ABC Co. Ltd has effectively been compounding its own earnings and by so doing it has managed to achieve growth in its earnings and dividends while growing the assets of the company over time.

To give you some real world examples:

- The global pallet operator Brambles (BXB) has made a profit from operations over the last 20 years with a dividend payout ratio in the 50% to 70% range. So on top of the dividend paid to investors every year it has grown the number of pallets in its global pallet pool from 96 million in 1998 to 316 million today (Source: Brambles; July 1998 – June 2018) .
- Woolworths is one of the key supermarket operators in Australia. On top of the dividends it has paid out over the last 20 years it has also grown its supermarket base from 500 supermarkets in 1998 to over 1,000 today (Source: Woolworths; July 1998 – June 2018).
- Pathology company Sonic Healthcare (SHL) has grown its pathology revenues from $146 million in 1998 to $4,625 million for the year ended 30 June 2018. Over the same timeframe the dividend has grown from under 10 cents per share to around 80 cents per share. (Source: Factset and IML; July 1998 – June 2018)

If, as an investor in ABC Co. Ltd, you also elect to reinvest your dividend in the DRP rather than taking the money, you receive more shares in the company and you add to the assets of the company enabling management generate more profits resulting in larger dividends and larger retained earnings. Having more shares also means that the actual dividend you receive (and can elect to reinvest) is even larger as well.

The best way to demonstrate this is by way of example of what would have happened to $100,000 invested in the Australian sharemarket on July 1, 1998.

In the chart below, the blue line shows what happened to $100,000 invested on 1 July 1998 into an ASX 300 index fund and where the investor has used the dividends received from this portfolio to live on. As can be seen above, 20 years later the initial $100,000 would have been worth $237,460 as at 30 June 2018 and in addition, the investor would have received $148,546 in dividends over that period. Simplistically this means that the original $100,000 invested returned $386,006 in total capital growth and dividends received over the 20-year period.

If, however when investing the $100,000 on 30 June 1998 in this index fund the same investor decided not to spend his dividends but to reinvest all dividends received over that 20-year period back into the ASX 300, then as shown by the orange line above, the initial $100,000 would have been worth $530,876 at 30 June 2018.

This is $159,710 more than if the investor had spent all his dividends instead of reinvesting them. The difference comes from the impact of the dividends received having been reinvested and compounded over the last 20-years – clearly demonstrating the benefits of compounding to the investor as the sharemarket rose over this 20-year period.

Whilst the next 20 years will clearly not be the same as the last 20 years, it's worth remembering that the last 20 years' return from the sharemarket were not always easy given the impact of three severe corrections, including the tech crash of 2001, the GFC slump of 2008-09 as well as the Euro crisis of 2012.

Conclusions: It pays for investors to take a long-term view with their equity investments and to embrace the benefits of compounding, rather than try to precisely time the sharemarket or the cycle. Albert Einstein was a pretty smart cookie.

This article is an abridged version of an article released on 21 November 2018 by Anton Tagliaferro and Michel O'Neill from Australian fund manager Investors Mutual.l.

Source: IRESS; July 1998 – June 2018 Past performance is not indicative of future performance. Returns can be volatile, reflecting rises and falls in the value of underlying investments

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Cranberry glazed turkey with pumpkin and pecan stuffin

Always wanted to cook a turkey for Christmas but never quite had the confidence? Well, your prayers have been answered. Anyone with an oven can cook this super-easy turkey.

Ingredients

- 1/2 cup (40g) salt flakes
- 2 tbs raw sugar
- 4kg whole turkey, giblets and neck discarded
- 2 bunches rosemary
- 2 tbs olive oil
- 100g unsalted butter, melted, cooled
- 1L (4 cups) chicken stock

Cranberry sauce

- 200g dried cranberries
- 600g frozen cranberries
- 1 tbs finely chopped rosemary leaves
- 2 cups (440g) raw sugar
- Finely grated zest and juice of 2 oranges

Pumpkin and pecan stuffing

- 150g unsalted butter, melted
- 1 onion, coarsely grated
- 2 garlic cloves, crushed
- 200g speck, finely chopped
- 300g coarsely grated butternut pumpkin
- 200g fresh sourdough breadcrumbs
- 150g pecans, finely chopped
- 1 tbs finely chopped rosemary

Method

1. The day before cooking, to brine the turkey, combine salt and sugar in a bowl. Rub salt mixture over turkey and inside cavity. Place turkey, breast-side down, in a deep-sided roasting pan. Cover with plastic wrap and chill overnight.
2. For the cranberry sauce, combine all ingredients in a bowl and leave at room temperature overnight to macerate.
3. The next day, rinse turkey well under cold running water and pat dry with paper towel. Spread rosemary across pan and place turkey, breast-side up, on rosemary in the middle of the pan. Set aside for 1 hour to come to room temperature.
4. Preheat oven to 200°C (fan-forced).
5. Meanwhile, for the stuffing, place all ingredients in a bowl and combine well with clean hands. Fill cavity with stuffing and tie legs together with kitchen string.
6. Combine oil and butter in a bowl and brush over turkey. Add 2 cups (500ml) chicken stock to pan. Transfer cranberry sauce to a separate deep-sided roasting pan and add remaining 2 cups (500ml) stock. Place turkey on the middle shelf of the oven and cranberry sauce on a lower shelf, and roast for 30 minutes or until turkey is slightly golden and sugar in cranberry sauce is dissolved. Remove sauce from oven and set aside.
7. Reduce oven to 150°C. Rotate turkey 180° and roast for 1 hour 20 minutes, then rotate 180° again and pour over cranberry sauce. Roast, brushing with sauce from pan every 10 minutes, for 40 minutes or until a meat thermometer inserted in the thickest part of the thigh reaches 75°C. Remove from oven and rest, loosely covered with foil, for at least 20 minutes. Serve turkey drizzled with sauce from pan.

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Behind the Scenes at PRP

Farewell Alby

Our smiling receptionist Albina has split her time in recent years between her work at PRP and a Community Carer in Aged Care. With the offer now to take on more hours in her caring role, Alby is leaving PRP after 17 years. Many of you will have been greeted by Alby over that time and we are sure that you, like us, wish her the very best for the future. Good luck but not Goodbye.

Welcome Jade

Jade is a mother two very active boys aged 4 & 7. Growing up in Renmark Jade loves spending time on the river and enjoying our Riverland lifestyle.

Jade comes to us with substantial accounting experience and qualifications. She looks forward to providing accounting services and support to our clients for many years to come.

Welcome Kathy

It is a pleasure to introduce Kathy Polst as our Self Managed Super Administrator. Kathy has worked with PRP for 7 years and during 2018, assumed responsibility for all client SMSF needs. Kathy loves spending time with her teenage son Zac and assisting her brother Mark with his catering business from time to time.

Christmas Wishes

The management and staff of PRP wish you and your family our warmest wishes for a wonderful Christmas and a Prosperous New Year.

PRP Christmas Trading Times

Adelaide & Renmark Wealth
Closing from 12pm on the 21st December 2018 and re-opening 7th January 2019

Renmark Accounting
Closing from 12pm on the 21st December 2018 and re-opening 7th January 2019

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