

10

STEPS TO MANAGING  
INHERITANCE  
AND NEW

*Wealth*

wealthtoday



## Before you get started

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## Letter from Wealth Today

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Dear [Reader](#)

### WELCOME TO WEALTH TODAY

Wealth Today was built specifically to facilitate the integration of financial planning into existing appropriate businesses and to provide sound individual financial advice to everyday Australians.

Our mission is to build an accessible, comprehensively supported team of Members who share our vision and commitment to providing tailored financial advice and building a new foundation of financial understanding and security for everyone.

With a national network of like-minded experts, we have the potential to provide the financial building blocks for future generations.

### KNOWLEDGE GIVES YOU A HUGE ADVANTAGE

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals; and in being prepared for whatever unexpected twists and turns life may present.

That's why our team of experts has created this series of eBooks that seek to inform you of not only the benefits but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this eBook and find it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

### TAKE THE NEXT STEP

We invite you to meet with one of our authorised representative to discuss what it was you were hoping to achieve when you downloaded this eBook and to establish if they can help you achieve your goals and objectives.

At the rear of this book you will find the details on how to book an appointment with one of our experts.

We look forward to meeting you soon.

[Wealth Today](#)

## Contents

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Before you get started .....	1
This eBook contains general and factual information only.	1
Information in this eBook is no substitute for professional financial advice.	1
Introduction .....	4
Step One: Get Help .....	5
Step Two: Determine Your Tax Situation .....	5
Step Three: Be Aware of Capital Gains Tax .....	6
Step Four: Treat Yourself – But Do It Conservatively	6
Step Five: Invest Your Money (Short-Term) .....	7
Step Six: Sit Tight.....	7
Step Seven: Determine What Will Change – and What <i>Needs</i> to Change	8
Step Eight: Pay Off Debt – Wisely .....	9
Step Nine: Create an Intermediate-Term Plan... ..	10
Step 10: That Fits into Your Long-Term Plan.....	11
Conclusion.....	12
Readers Notes.....	13
Take the next step.....	15
Appointment Booking Request form .....	17

## Introduction

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*'If we command our wealth, we shall be rich and free; if our wealth commands us, we are poor indeed.'* Edmund Burke

Every day our financial advisers help clients create plans to follow a sure, steady path to building wealth. But what happens if you are the recipient of unexpected new wealth?

Receiving an inheritance or other form of significant new wealth can cause mixed emotions, to say the least.

Why? Recipients of instant fortunes must deal with a wide variety of new and complex issues like asset management, tax strategies, estate planning, and philanthropy.

As a result, often the money is quickly squandered. Statistics show that over half of windfalls are lost in a relatively short period of time; for example, an American news agency recently reported that more than 70 percent of lottery winners spend their fortunes within three years.

Here's the key: whether or not your money was "easy come", never let it be "easy go." Your sudden wealth is now *your* wealth. Protect it, make it go as far as possible, and make plans that help you truly change your life... now and for the rest of your life.

## Step One: Get Help

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Accountants, financial advisers, and lawyers can all offer invaluable assistance to help you properly manage your new wealth. Select a team of financial and legal consultants, or a firm with a broad-based approach you can trust.

But even as you assemble your team, never forget that you're still in charge. Surrounding yourself with a team of knowledgeable consultants does not mean letting them take control of your financial future. *Always* be involved in every aspect of decision making.

## Step Two: Determine Your Tax Situation

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While this is Step Two, calculating your tax burden should be done in conjunction with Step Nine, when you decide how to invest your new wealth. Certain investments that reduce your tax burden might be a good choice, but only if they fit your overall investment and lifestyle goals. So first get help determining the short-term tax effects of your new wealth. Later you will create broader strategies to minimise the long-term tax effects.

Keep in mind a variety of factors can influence taxes. An inheritance might not change your tax situation, but if you sell a business or property, your taxes are likely to be significantly higher than what you are accustomed to, especially in that fiscal year. A major key to managing your new wealth properly is to fully understand your new tax situation, make plans to minimise your tax burden, and most importantly to know exactly how much money you'll have left to work with once taxes are paid.

## Step Three: Be Aware of Capital Gains Tax

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Your tax status is such an important part of managing your new wealth we thought we'd mention it again. In the case of inheritance, while there are no direct taxes, assets acquired from an estate can be subject to capital gains tax. A capital gain is any profit that results from the sale or transfer of an asset. To calculate a gain, simply subtract the original purchase price plus any other costs from the sales price, or in certain instances when the property is inherited its current market value.

For example, say your father purchased his home for \$200,000. He spent \$20,000 improving the property. When he died, the home's appraised value was \$250,000. When you sell the home, unless you use this home as your main residence, the taxable capital gain is calculated as the difference between the proceeds you receive and the market value at time of death i.e. \$250,000. Keep in mind this is a very simple example and you should seek professional advice before entering into any contract for sale of an asset, so you understand the tax ramifications beforehand.

## Step Four: Treat Yourself – But Do It Conservatively

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The fun part of acquiring new wealth is splurging. Most people have, over drinks, played the 'What would you do if you won the lottery?' game at least once. But instead of deciding which trip you'd like to take or which car you'd like to buy, start by deciding what percentage of your windfall you're willing to spend to do something special. *Then* decide how to treat yourself within the limit you set.

Say you receive a \$200,000 bonus for winning an Olympic gold medal. Instead of reaching for the phone to book a holiday to Bali, reach for a pen and determine the limit of your "fun" spending. The percentage you pick isn't terribly important. What is important is that you pick a percentage – *and stick to it*. Effectively managing new wealth is all about planning.

What is your number? One per cent? That's \$2,000. Doesn't sound like enough? How about five per cent? That's \$10,000 you'll have to spend.

But wait – why not spend 10 per cent? While that is still a relatively small percentage, it yields \$20,000 in "fun money." Treating yourself on that sum could be fantastic!

But – and isn't there always a "but"? – think about that 10 per cent in real terms. If your \$200,000 is from a taxable source it probably puts you in the 45 per cent tax bracket; assuming you don't take any financial steps to minimise your tax burden, your original \$200,000 could be cut to \$110,000. If you then spend \$20,000, you're left with \$90,000 – and your original lump sum is cut by more than half.

Have some fun with it, but do so within the limits you set *before* you start to spend.



## Step Five: Invest Your Money (Short-Term)

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In a later step you'll create long-term investment plans. For now, park your money in a safe, liquid account while you sort through your investment and lifestyle options.

Common choices for short-term investment include term deposits, commercial bills, bank bills, at call bank savings accounts and cash investment trusts.

While the returns may be relatively small, your money will still be working for you. Say you receive \$500,000 as a lump-sum. If you place your money for six months in an account yielding five per cent per annum, you'll earn approximately \$12,500 in interest.

Just be sure to choose a liquid investment i.e. one you can access fairly quickly. (A bank account is liquid; a holiday house... not so much.) Once you develop long-term financial plans, you'll start shifting money into investments with higher returns, so ready access to your funds is important.

## Step Six: Sit Tight

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Face it: the bigger your inheritance or new wealth, the more your life has changed... and you've had no chance to prepare for those changes.

So what should you do? Sit tight. Let the impact soak in while you take the time to decide what you want to do and what role your new wealth will play in your life. In all likelihood, the only decisions you'll regret when you acquire new wealth are ones you made too quickly.

## Step Seven: Determine What Will Change – and What Needs to Change

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New wealth doesn't just change the number of commas on your bank statement. It creates a ripple effect that will change – and possibly complicate – your entire financial picture. While it is a good problem to have, sudden wealth can change the entire framework of your financial and legal situation. Each decision (or purchase) you make could cause you to consider changing your plans for:

- Personal finance – income, expenses, investments, budgets
- Insurance – home and car loans, life insurance
- Housing – new home, holiday house, financing, insurance, taxes
- Legal – will, estate plan, creating a trust
- Gifts – donations, sharing with family and friends

Let's use an example to illustrate the point. Say you've dreamed of owning a holiday house on the coast. You and your financial adviser decide the purchase is well within your means and fits nicely within your overall financial goals. You find and buy the perfect house. Great!

But it's not that simple... or at least, handled properly, it *shouldn't* be that simple.

Your new home creates new tax implications – have you determined the best way to structure the purchase to take advantage? Or say you decide to pay cash for the house – should you own the house as an individual or should it be placed in a trust? And who will inherit the property when you pass away? If the house is part of a collection of assets you'll leave equally to your four children, it may need to be sold so the proceeds can be distributed according to the terms of your will.

First determine what changes need to be made to your current financial situation. Then, as you make purchases, investments, and long-term plans for your new lifestyle, you can easily adapt your financial framework to accommodate those changes.

## Step Eight: Pay Off Debt – Wisely

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It may not seem exciting, but using newly acquired wealth to pay off debt is almost always the best course of action. If you have existing debt, especially high interest-rate debt, use your newly acquired capital to eliminate it. You'll increase your cash flow by reducing monthly payments, save the money you're paying in interest, and improve your credit rating.

Each situation, however, is different and there is no one size fits all answer. Let's look at a couple of examples: one with a clear-cut decision, while the other is a more complicated.

Say you have a \$3,000 balance on your credit card. Your interest rate is 18 per cent and you make the minimum payment of \$75 per month. If you never make another purchase using the card, and you continue making your minimum payment only, it will take 62 months to pay off the card – and you will have paid over \$1,600 in interest. Clearly paying off the card – immediately – is the best choice you can make.

Now let's look at a different example: paying off your home loan. You could choose to pay off the entire balance, or you could choose to pay extra each month to pay off the loan more quickly. Say you have a 30-year, \$300,000 mortgage at 8% interest. By paying an extra \$100 a month, you save nearly \$89,000 in future interest and pay the loan off four and a half years early. Sounds great, right?

Yes, but here are some potential problems. Mortgages, because they are secured by a tangible asset, tend to have low interest rates. That interest can be deductible, if borrowed for income producing purposes and reduces the amount of overall tax you pay.

Plus, much of your savings will occur in the future where inflation could erode their value. For example, \$100,000 in 25 years is worth less than \$48,000 in today's dollars, assuming a moderate three per cent inflation rate.

And you won't have the advantage of using someone else's money to invest, losing the power of leverage.

Or you could choose to pay off your entire mortgage... but that can create financial inflexibility. If most of your new wealth goes into paying off your mortgage, you will reduce the amount of emergency funds you have on hand. If you have liquid savings equal to three to six months of expenses, it could be the difference between surviving a rough patch and facing financial disaster. In short, pay off debt wisely – and within the parameters of your *overall* financial plan.

## Step Nine: Create an Intermediate-Term Plan...

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You've come a long way. You've gotten help, parked your cash in a safe, short-term investment vehicle, taken a long, deep breath to settle your emotions, and put your financial house in order by assessing your current situation and paying off debt sensibly.

Now it's time for the fun part – making intermediate – and then long-term plans for your new life.

A major factor in what you will do is, naturally, the size of the windfall. Depending on the amount of your new wealth, you could consider some or most of these options:

- Purchase a new home (or second home)
- Go back to school
- Embark on a new career
- Create trusts for your children
- Retire early (or immediately)

Note we didn't include "Buy a new BMW" on the list. You could certainly choose to, but we've stuck to higher-level goals for a reason. Driving a new BMW, while certainly fun, won't change your life. Leaving a higher-paying position you hate for a lower-paying career you love, for example, *will*.

Say you currently earn \$60,000 per year managing a call centre, but what you'd really like to do is teach. A NSW teacher's starting pay is just over \$50,000\*. You would love to change careers but you just can't afford the \$10,000 cut in salary.

If you invest a \$200,000 windfall at a five per cent (pre-tax) return, you can make up the difference in salary *and* change careers.

First determine your near-term goals, then get help to ensure your windfall helps you reach your goals.

## Step 10: That Fits into Your Long-Term Plan

Whatever short-and intermediate-term plans you make should fit seamlessly into your long-term goals. Let's look at one example of a long-term plan: say you'd like to retire early.

'How much money do I need to retire?' is one of the most common questions we are asked. Of course our first answer is, 'That depends.' Since everyone has unique circumstances and goals – we take the time to learn about your financial situation and your dreams before we answer specifically. But for the sake of this example we can make some assumptions.

First, how much you want to spend in retirement? Start by defining what lifestyle you wish to lead. Where will you live? What will you do (activities, hobbies, travel, part-time work, etc)? What things will you wish to have, especially big-ticket items (cars, boats, etc.)? When you have defined the lifestyle you wish to lead, then determine how much those items or experiences cost in today's dollars.

If that exercise sounds too difficult, take another approach. Simply decide if your retirement lifestyle will cost more, less, or the same as your current lifestyle.

Research of current retirees suggests to live a "comfortable" retirement lifestyle a couple needs at least \$48,648 and a single needs at least \$36,319 per year.

(Source: Westpac ASFA Retirement Standard, September 2007)

Once you know how much you need per year, use the chart below as a guide to how large your nest egg should be. We'll assume you're 35 years old, so the Age Pension does not apply.

To keep the maths simple, we'll also assume you'll live forever and will live off the proceeds of your investments and not the principal. (While you could plan to live off a portion of the principal each year as well, which increases the amount of money you can spend each year, you also run the risk of outliving your nest egg as it slowly dwindles... so for the sake of simplicity we have assumed you will leave your nest egg to your heirs.) We have also ignored the effects of taxes; money available to spend per year is shown as pre-tax dollars.

To Receive This Income per Year:	Your Nest Egg Should Be: (assuming a 7% return)
\$150,000	\$2,143,000
\$120,000	\$1,714,000
\$90,000	\$1,286,000
\$70,000	\$1,000,000
\$50,000	\$714,000
\$48,648	\$695,000
\$36,319	\$519,000

Keep in mind the higher your return on investment the more you will have available to spend each year (or, if you choose not to spend the difference between what you need and what you earn, your

principal balance will increase instead.) Just make sure your short- and intermediate-term plans support your long-term goals.

## Conclusion

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There is only one person to decide precisely which changes you'd like to make to your life. *You*.

Take your time, get help, and plan so you preserve, grow, and use your new wealth wisely. Make sure, as it does for so many, that 'easy come' never turns into 'easy go'.



**Readers Notes**

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## Take the next step

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## Appointment Booking Request form

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### About the Adviser

Please complete the Appointment Booking Request below and scan and email to:

Appointments are available Monday-to-Friday from 8am and until the normal final starting time of 6pm. After-hours appointments are available by request most weekday evenings and on most Saturdays if preferred. Please nominate your preferred day, date and time to meet with us. One of our client services representatives will call you to confirm your appointment.

Preferred appointment day and time

Day

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Date

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Time

Am/pm

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### Our services

Your email address

If you would like us to contact you via email to confirm your appointment or to answer any questions you have please provide a valid email address for our records.

Email

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### Contact details

Email:

Phone:

Your Details

Title

---

First name

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Last name

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Mobile

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