2017 ISSUE TWO

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Financial advisers for your lifetime goals

## Boxing up your money

Until credit cards and ATM machines existed, both handy things admittedly, banking used to consist of a basic set of different accounts. Everyone had a savings account, which was for savings, and a separate cheque account for major expenses. Often, households would withdraw a week's worth of cash and allocate it into different jars. This jar for the groceries, that jar for the power bill.

Banks even offered separate bank accounts for different purposes. Christmas Club accounts took regular deposits and were untouchable until December. In exchange for that lock-in, the banks offered greater interest than they offered savings accounts. That was Christmas sorted.

Different accounts had different operating rules. The upshot was that households could have a keener, more visible, sense of purpose with their spending. Goals were adhered to.

But with plastic cards came the bundling of all kinds of purposes onto one. Plastic could be used in ATMs, or as credit cards or – more recently as swipe-and-pay cards too. Of course, you can now use your phone to do the same thing. No wonder so many people don't use cash any more.

But at the same time, they have no tangible idea whether they are in debt or in credit. Many people have no idea of their net financial position on any given day. Some banks to their credit have implemented on-line tools to help you keep track of your money.

Rather than using jars, we suggest apportioning your money into "boxes" for their specific purposes. The boxes you choose to park your money will vary according to how readily accessible your money needs to be, the timeframe and the amount you have on hand.

- When a client has money to invest, we first make sure that they set aside funds for their emergency fund, and their goals (e.g. travel). These should be parked in an accessible savings account.
- We then create an investment portfolio for the balance of the money.
- For retired clients, the simplest arrangement is to have an account for living expenses, which are funded by the drawings from the portfolio and any other income streams e.g. NZ Super or rental income.
- Savers can invest surplus savings over and above Kiwisaver into their portfolio.
- Within the portfolio, discrete portions of the portfolio have their purpose.

**The table below gives a general picture of how we might 'box up' a simple financial arrangement:**

**ALLOCATION OF YOUR MONEY**

| | | Investment Portfolio | |
|---|---|---|---|
| | **Cash Flow Box** | **Security Box** | **Long-term Box** |
| **Purpose** | Meet day-to-day living expenses and emergency fund | • To derive certainty of income<br>• To rebalance portfolio in event of downturn | • Maximise returns<br>• To derive dividend income |
| **Where** | Bank account | Term deposit/ bonds various matturities | Shares/Property stocks |
| **Investment characteristics** | • Security<br>• Liquidity,<br>• No volatility | • Security<br>• Liquidity<br>• Not correlated to shares<br>• Risk reduction | • Long-term security<br>• Not so liquid<br>• Growth oriented<br>• Riskier – more volatile |
| **Amount allocated** | 2 years of cash flow | Up to 20% to 70% depending on risk profile | Remainder of the portfolio money |

No two savings and investment portfolios will be identical, but the table above demonstrates the roles that different silos play. For the long term, it is far easier to keep different facets of your money separated. They have different purposes and different operating rules.

## Our core beliefs

We recently attended a Masterclass run by the Portfolio Construction Forum. The first session focused on what we as advisers believe to be our investment philosophy and core beliefs. Sitting with competitor colleagues we certainly heard a range of investment philosophies and some focus, as we do, on the life goals of our clients.

Our philosophy is to help clients reach their goals and then to maintain their income requirements throughout retirement without diminishing their wealth prematurely.

The session was useful because it made us reflect on what we believe are the essential ingredients of a good investment strategy. One essential ingredient that our long-term clients will recognise is our emphasis on peace of mind.

The second ingredient is consistency. Even though the markets may go up and down, and the economy goes through different cycles, and the investment industry comes up with hot fads, our core beliefs remain the same.

We don't jump around or chase the latest get-rich-quick opportunities. Rather we create investment portfolios that are tailored to the client's needs and objectives. We do this through:

- Setting in place a structured asset mix
- Taking risks only within each client's tolerance and financial capacity
- Ensuring those risks carry a reliable reward
- Staying diversified – never putting all the eggs in one basket
- Seeking cashflow assets
- Keeping costs and taxes as low as possible

Our approach asks clients to acknowledge some basic investment principles, and to understand their own comfort level with risk. We also encourage clients to focus on the things they can control.

Diversity is the key to reduce the volatility of an investment portfolio. Those asset classes that rate best or worst will vary from year to year, so in the long run it is better to hold a wide mix and to stay disciplined and to capture gains (by rebalancing) when these occur.

The workshop was a good opportunity to re-assess our framework of beliefs: we remain very comfortable with our approach.

## Investments are global – well, now the taxation regime is too.

Hands up if you know anyone who has moved country recently. You do? Us too. Yet in an age when people (and their investments,) become complicatedly global, isn't it comforting to know that the Inland Revenue is tracking your every move? Warms the cockles doesn't it?

We recently attended an Auckland District Law Society conference entitled "Cradle to Grave" where lawyer Henry Brandts-Giesen of Kensington Swan summed up the impact of growing global tax compliance. This stems from the advent of FATCA – the Foreign Account Tax Compliance Act, initiated by the USA, and now the CRS -the Common Reporting Standard - now adhered to by most OECD nations including New Zealand.

Said Brandts-Giesen: "FATCA and CRS are amongst the most audacious legislative developments in modern history. The two regimes will result in arguably the biggest transfer of data in human history. They represent a significant generational shift from privacy to transparency and both regimes are now part of New Zealand law."

- Our clients will be familiar with our need to ask them if they are US citizens and then if they invest via their family Trust, whether any controlling persons (trustees) are US citizens, and whether the Trust is deemed a financial institution – that's FATCA.
- IRD in New Zealand must collect the US Tax File number and information is thus exchanged.
- But why stop there? The rest of the OECD quickly decided that identifying errant taxpayers who may be sheltering money offshore is an excellent way to boost the tax coffers – everyone paying their fair share.
- The birth of CRS became effective 1 July 2017.
- The big change is a shift from information upon request to mandatory and automatic sharing.

**What does this mean in practical terms?** Well for a start there will be a whole lot more compliance and accompanying paperwork. We are now obliged to ask our clients whether they are citizens and tax residents of other countries. Next time we meet, expect a form to sign and to "self-certify" those details.

- If your portfolio is owned by your Trust, the settlors, trustees and appointors must self-certify as they are controlling persons.
- An unfortunate side effect is that CRS also deems Trust beneficiaries as controlling persons but only if they receive a payment from the Trust in a tax year. Yes, that goes against conventional trust law because the Trustees, not the beneficiaries, have control, but now we have to abide by it.

### The bad news:

- If your son or daughter or grandchild is living overseas, and you pay them money from your Trust, you will need to collect their foreign tax number and they may be taxed on the payment in their jurisdiction. If they are US citizens or living in the US, the rules for Trust beneficiaries are even tougher.

### What to do?

- The good news: Trustees can self-certify other trustees and beneficiaries, so the paperwork is containable.
- If you want to make gifts to family overseas, it will be easier to do so from personal monies.
- As always with trusts, keep your paperwork in order. For example if you make a loan from your Trust to a beneficiary, make sure this transaction is recorded.
- Review all your financial arrangements; for example, is the purpose of the Trust still relevant to your stage of life?
- Above all, be guided by your accountant and lawyer with the aim of simplifying your affairs and therefore reduce the amount of compliance required.