

The Divorced Mum

...a Financial Survival Guide



Post Divorce Recovery Strategies

Dr Steven J Enticott

CIA Wealth

www.CIAWealth.com.au

Legal Disclaimer

This article is not financial advice. You need to consider the risks and benefits of any investment strategy either on your own or, as we strongly recommend, with the assistance of a licensed financial planner.

This article is not taxation advice. You need to consider the risks and benefits of any taxation strategy either on your own or, as we strongly recommend, with the assistance of a registered tax agent.

Copyright © Steven Enticott 2009. The right of Steven Enticott to be identified as the author of this work is hereby asserted. All rights reserved. Without limiting the rights under copyright above, no part of this publication may be reproduced, stored in or introduced into a retrieval system, or transmitted in any form or by any means (electronic, mechanical, photocopying, recording or otherwise), without the prior written permission of the copyright owner.

Introduction

Why read this article?

...because divorce is the time when decisions are often made under duress, financial mistakes are rife and the stakes high.

This is the second and complementary article in a series dedicated to supporting those enduring the complex burdens of divorce and separation. The first article focussed on fathers, “The Divorced Dad ...a Financial Basket Case”, whilst a further article assisting divorcees without kids is to soon follow.

I was compelled to write these articles to address both the enormous lack of awareness of the forward options available, as well as the psychological despair arising from a general lack of plan or inaction.

Divorce in its own right has a huge level of despondency associated with it, which when combined with the exasperation of perceived financial doom can often be too much for parents to bear.

There aren't any basket cases, but having a plan helps divorcees accept their situation, work with the pieces and move forward again; to be the best parents possible.

There are always ways forward and I am passionate about getting you the best outcome.



This article is written specifically for divorced Mums and the many challenges they face in their post divorce recovery. The Dads have very different but equally significant challenges which are covered in my other article. There is no bias, simply different issues to be addressed. So if you are a divorced Dad, take heart that the intent of this article is to promote the Mum's financial recovery, which will assist both parents in their recovery.

Please email me for a copy of the "Divorced Dad" strategies!

Regrettably, I can't patch up the differences underpinning the demise of a marriage, but what I can do is make sure that the loving Mum is afforded every opportunity to recover to the best possible outcome financially. There are a significant number of strategies you can use which will marginalise the downside, make your recovery as fast as possible and ensure that you can continue to provide for your children in the best possible way.

How do I know this? I run a successful accountancy practice, am a tax specialist, a financial planner and have a Doctorate dedicated to the power of tax-effective investment and self-managed superannuation. Moreover, I am also a divorced Dad and loving father of two beautiful children who regularly sees both sides of the challenge...

The strategies I cover in the following pages are widely applicable, but ideally target divorced Mums who:

- Are aged 30-55.
- Are left with 50-65% of the combined asset base, dominated by the family home (for ex. \$500,000 value).
- Have main custody of their children and receives tax-free maintenance.

- Usually receive Family Benefits and other Centrelink payments.
- Usually forgo the superannuation in the asset split.
- Are encumbered with new, additional expenses, including:
 - High costs of living independently.
 - Rent or another big mortgage. (for ex \$200,000)
 - Credit cards and other easy credit debts.

So, how can I help? Let me give you a typical '*before*' and '*after*' picture:

Before:

- Financially, you're feeling alone, lost, vulnerable and very exposed.
- You lose your home in a poorly conceived scheme to reduce your overhead and to save money.
- You're now paying 'dead' rent money at high market rates.
- You have no other assets working towards your future well-being.
- Your credit position continues to swell unabated.
- You have a complete reliance on the government, your friends and family.
- You don't see anyway forward.

After:

- The family home remains yours, is protected and growing in value.
- You are free of the need to pay 'dead' rent money.
- The equity of the family home is being put to work in additional investment opportunities, growing the wealth position of the Mum at an accelerated rate.
- Debt issues are contained and being managed.

- Superannuation is consolidated, advanced and leveraged.
- All tax obligations have been minimised.
- All entitlements, allowances, pensions, concessions and other all benefits have maintained or increased.
- You are on top of your position, know where you're at, where you're going and enjoying the comfort of being in control.

Which picture would you rather be in?

Let's look at a common scenario and the mistakes that a 'typical Mum' makes:

Sadly, a marriage ends. The Mum receives 65% of the asset base which normally includes the family home and the mortgage. (The father typically receives a cash settlement).

Most importantly, the Mum keeps the family home which continues to increase in value without tax or maintenance implications, receives tax-free child maintenance from the Dad and mostly tax-free Centrelink benefits.

But the Mum looks at the \$200,000 mortgage she has inherited and fears the risk (without understanding the risk) and decides to sell and buy a cheaper home for \$350,000 - in the process she has just lost \$50,000 in stamp duties, agents selling fees, advertising, moving costs, connection costs, etc, so she has decreased the mortgage by only \$100,000 and now has a lower value asset that increases at a proportionally slower rate.

She has also forgone the superannuation or has a token amount of \$10,000 (for example) in an account that is being rapidly eroded by fees. Invariably this amount is 'out of sight, out of mind'.

Some divorce lawyers aren't able to act in the best interest of their clients if they aren't advising you prior and at the point of settlement to get financial advice; as it's not their area of expertise. (This obviously doesn't include your lawyer if they have been prudent enough to give you a copy of this article!)

Any divorce lawyer who doesn't instruct his client to seek separate financial advice before accepting a settlement and to have a plan for post-settlement is guilty of a significant omission in service. Mums' security or sense of security is heightened considerably if they have a plan for going forward. This makes the arduous settlement process much smoother for everyone.

Regrettably, by the time most divorced Mums make it into our office a great deal of damage has already happened. Houses are sold and superannuation has been slaughtered with no plan for recovery in place. This frustrates the living daylight out of me. The Mum feels financially devastated, bereft of faith and directionless; all of which are major contributors to alcohol abuse, depression and other scourges.

But, there are ways forward.

Having been through a difficult divorce myself, I now have the ambition of guiding every recently divorced or separated parent into a new sense of purpose, empowering them with the tools of financial recovery and re-instilling the confidence to once again set forth on the road to a fulfilling and rewarding life.

So here's the plan...

Getting Over It

Invariably you feel insecure and very exposed. You may have the majority of the assets but you certainly have the minority of the income. You now have a mortgage on your own, possibly the burden of part-time work, and hardly any superannuation. Your new world seems decidedly unfair, but fair or otherwise, it's just how it is.

Invariably at this point you have so much to process emotionally, spiritually and practically. Singularly, the most productive and empowering approach you can take at this point is to 'get over it' and start the process of recovering.

'Getting over it' is as important for your financial recovery as it is for your mental health. No-one wants to be or know a victim, and being that victim only erodes your own finite life, not to mention the lousy attitude you reflect upon your kids as a role model.

The best way to move on financially is to latch on to a strategy that you believe in and can commit to; to get going again, picking up the pieces that remain and making a new start. You're not alone and there are many avenues for support and guidance. Make an appointment to see someone like myself, get some direction and get going. There are always ways forward.

Let me keep it simple. The 'suggested' road to recovery in this article (there are many others) is as follows.

1. Keep the family home or look to buying a home.
2. Look at tax effective investing (buying a rental property, etc), particularly if and when you return to full time work.
3. Review your superannuation position and take it seriously. But do not add to it beyond the 9% compulsory until you reach the age of fifty in most cases.

Irrespective of the above, we would also consider a raft of other tax-effective investing strategies regardless of your age or circumstances, but these are covered in greater details in my other books (which are available from our website).

What is the primary objective from here?

1. To build equity in property (your family home).
2. To accelerate the funding of the recovery program by leveraging (when able/appropriate) all permissible tax allowances, concessions and deductions.
3. To structure a protected wealth recovery strategy by using all available tax allowances, concessions and deductions (super superannuation!).

The following extracts are from two chapters of my book “**Tax Effective Investing**” (available for free at www.ciawealth.com.au). These chapters alone are particularly useful in getting my points across.

Hold Onto the House

Stage One:

When marriages break down for whatever reason and there are children involved, it is usually, but not always, the case that the Dad moves out and the Mum retains the family home.

Consider the example from the introduction:

The Mum looks at the \$200,000 mortgage she has inherited and fears the risk (without understanding the risk) and decides to sell and buy a cheaper home for \$350,000 - in the process she has just lost \$50,000 in stamp duties, agents selling fees, advertising, moving costs, connection costs, etc, so she has decreased the mortgage by only \$100,000 and now has a lower value asset that increases at a proportionally slower rate.

Even worse examples include instances of Mum selling the family home and placing the sale proceeds in the bank. Here's what wrong here:

- Mum loses an asset that would have grown in value, importantly in untaxed dollars.
- The money received from the sale sits in a bank earning lowly interest which then is taxed.
- The sale proceeds reduce pensions, child maintenance and other benefit entitlements which, again, are untaxed.
- The sale proceeds now count against you in the Social Security Assets Test.
- And to top it all off, you are now paying rent in after-tax dollars.

Mostly it's all very, very bad.

I am not saying in all cases the right strategy is to hold the home but in the most it is the best way forward. Either way you *will* need a tax/financial advisor who understands all of the above - use this article as the basis for getting specific advice.

Tax isn't usually a problem for the Mum. Most of their 'income', including untaxed child maintenance (and, in some cases, spouse maintenance), part-time employment, (mostly) untaxed government benefits and other concessional rebates free the Mum of any significant tax obligation - let's keep it that way.

If you can't afford to hold onto the family home (or acquire one - equally as important) then there are two strategies we can look at to assist. One is moving from capital and interest mortgage repayments to paying interest only.

Why would you do that? Simple - rent is dead money and you don't have any claim on the appreciating value of someone else's property. Why not pay a similar or lesser amount to enjoy both the comfort of owning your own home as well as the capital appreciation over time?

For example: If you have a \$200,000 mortgage at 5.00%, you need only pay less than \$200 per week in interest, which is *much* cheaper than rent!

If, for example, interest rates rise to 8% you will need to pay only approximately \$300 per week in interest; again, still cheaper than most rental options.

The second strategy is based on the notion that it is better in the short term to watch the loan go up and win in the long term on tax free capital growth.

If, for example, when we have a \$400,000 mortgage (on a \$600,000 home) at 8% requiring approximately \$600 per week in payments and we can only afford \$450...

Remember from earlier that it costs upwards of \$50,000 to sell and buy again at these levels. Let's assume a 5% growth rate (very conservative) of \$30,000 per annum

compounding and equivalent rent of \$350 (too conservative). It's not hard to do the numbers, is it? To save \$100 per week you are losing \$30,000 in tax-free, compounding asset appreciation!

At this point you also need to review your other credit facilities and consolidate expensive debt (credit cards, leases, etc) which are all paid off in *post-tax* money and refuse to extend it. Draw the line in the sand, make the change.

If there is no home, then look to buying one as soon as possible with the proceeds of the settlement. If you don't have the equity to start, look at the many government grants available, and/or turn to family or friends to get you started. At the moment it is cheaper to buy than rent in most locations.

Why is this all so important?

Two reasons; firstly, owning a home is important as it builds wealth no matter how small and wealth gives you choices, no matter how bad you perceive your situation to be there is always something that can be done to begin.

Having wealth choices are important. For example, if one of your children falls sick and you need to stop working, having an asset to fall back on allows you to do this more comfortably than having nothing at all.

And secondly, banks love equity and will readily lend against it, affording you wealth-building opportunities along the way which leads us into stage two.

Invest Tax-Effectively

Stage Two:

You're ready to consider a raft of options if you are now back in full time work, the kids are less of a burden (for example at secondary school) and you are still under the age of fifty.

In most cases, and where income and equity allows, you should consider investing tax-effectively into another property or shares or any one of a number of other asset classes. There are plenty to choose from and most are cost-neutral at the moment (meaning no out-of-pocket expense).

Let's look at a few examples to illustrate the points.

Example:

Buy another home using the equity that has built up in your family home and rent it out.

By doing this you avail yourself of the consistent and strong capital growth of the property market over time. Please note though, that any capital gain here will, unfortunately, be taxed upon sale, so... don't sell! This is perfectly fine, because you will use that (unrealised) capital gain to leverage off into your next opportunity, whatever that may be.

Alternatively, consider this approach via one of the superannuation investment strategies (described next) and *avoid all tax* on the sale in retirement. Very powerful stuff!

Here's how it works:

\$400,000	House/Unit loan
\$20,000	Interest payable at 5%
\$3,000	Rates, repairs, body corporate, etc
<u>(\$18,000)</u>	Rent received
\$5,000	Cash flow loss
\$1,000	Non cash - Chattel depreciation
<u>\$7,500</u>	Non cash - Building depreciation at 2.5%
\$13,500	Tax loss
\$4,250	Tax refund at 31.5%
\$750	After Tax cash flow loss

** in this example we have used a tax rate of 31.5%. (The tax saving rises to \$6,275 for a tax payer on the 2009 top tax bracket).*

Not a bad scenario is it? A minor cash flow loss at worst, or even cash flow positive if you earn in a higher tax bracket. Not a lot to bear and a great platform to operate from.

Where to from here?

Buy another property, buy two, buy one through your super. It is all very achievable. The main outtake is 'Do something, don't do nothing'.

If you consider a conservative capital growth rate of 5%, this equates to \$20,000 per annum compounding on your \$400,000 property. History shows that, in the long term, this has been easily achieved in most parts of Australia.

A couple of words of warning - Always allow for affordability in your strategy. For example, if interest rates move to higher levels, so too will your loan repayments.

Fortunately, if interest rates rise, so too does inflation and rents (usually) with it, unless things get really ugly of course, then we're all in trouble. As a rule of thumb, allow for 2-3% above current rates *and* for periods of vacancy, major repairs, etc.

Always remember that the passage of time will inflate the property's value. At the age of forty you have a probable twenty-five years left in the work force - plenty of time to reap the rewards of this approach.

Superannuation

Stage 3.

Post the age of fifty!

Tax-effective investment doesn't get any better than making pre-tax contributions to superannuation. Super contributions are taxed at a lowly 15%. Compare this to the 31.5% tax rate most taxpayers face, meaning that for every \$100 you 'salary sacrifice' into superannuation, you have an immediate saving of \$16.50* in tax.

** in this example we have used a tax rate of 31.5%. The tax saving rises to \$31.50 for a tax payer on the 2009 top tax bracket.*

Example:

Assume you pay tax at the 31.5% tax rate and receive a \$10,000 bonus. You would ordinarily lose \$3,150 in tax. Alternatively, if you declare to have your bonuses paid directly into superannuation, you lose only \$1,500 in tax. That's a big difference of \$1,650. The 'catch', of course, is that you cannot get to this money until you're old enough to retire.

With superannuation, though, the tax-effective savings don't stop at the contributions level, as earnings derived from superannuation funds are only taxed at 10%-15%. After you have retired, it gets even better, as the earnings attract an unbelievable tax rate of zero! Further, the tax paid on superannuation payouts after the age of sixty (and retired) is again zero!

Earnings, too, in superannuation aren't counted as income for child maintenance, something further for you to consider (if appropriate) and discuss with your advisor.

There is simply nothing more tax-effective than superannuation, which is why nearly all accountants and financial planners keep pushing the superannuation barrow.

A general rule with contributions to superannuation is that *before* making additional salary sacrifice payments to superannuation, repay *all* your non-deductible loans (such as home loans, credit cards, etc) and other expenses prior to the age of fifty. Once beyond the glorious fifty - everything into super, in nearly all cases.

If you are over fifty, I strongly recommend that you consolidate loans and consider interest-only payments, salary sacrificing the extra amount into a safe super option, then paying out the balance of the loan tax-free at sixty-plus retirement.

As an advisor, I see a lot of resistance from people when considering the idea of contributing more to superannuation. This is because many people don't like managed superannuation funds (usually due to fee structures, poor performance in some cases, and the fees paid to financial planners). For these people, running a self-managed superannuation fund (SMSF) is the right answer.

Example:

Sometimes it is very difficult to advise someone who is resistant to superannuation investment to put \$200,000 into the XYZ Managed Fund. In these cases, it is much easier to offer an alternative: investing the \$200,000 in their own SMSF, which then buys a small factory (for example), and then rents it back to either the investor's business or someone else's. (Same strategy for residential property, except you cannot rent it back to yourself or an associate)

SMSFs provide investors with the ability to make investment decisions for themselves. As of September 2007, borrowing funds inside your self-managed super is now a reality through the prudent use of easily constructed instalment warrants. This, you will need to discuss with your accountant. I am well placed to advise on the benefits of using them

and SMSFs. These are both something I am particularly passionate about - so passionate, in fact, that my doctoral thesis was about SMSF leveraged investment.

Example:

Put \$100,000 into your own SMSF, then borrow a further \$100,000 through an instalment trust structure and buy a small factory or residential unit (but not renting it to yourself or an associate) and rent the property back to either the investor's business or anyone else's for long term capital growth at (conservative estimate) 5%.

In Closing...

Divorce is one of the more unsavoury, unproductive and debilitating experiences that anyone can go through, and the financial hardship associated with divorce will be one of the greatest and enduring hurdles that any divorced Mum will face.

There are a significant number of strategies beyond those covered here that will substantially enhance the financial recovery of those affected. And this is fundamental to the overall well-being of the Mum and her ability to raise the children as best she can.

It is all very achievable. Here's what you need to do:

1. Get advice first, and get it quickly.
2. Try to keep or buy a home - simple enough!
3. Invest, when kids are less demanding and you're in full time work.
4. Leverage the super power of superannuation (if relevant). Why? Because it's yours, it's protected, it has so many tax advantages and it will be instrumental in accelerating your wealth. Superannuation offers fantastic opportunities to recover from divorce:
 - a. Immediate tax-effective returns on your contributions.
 - b. Concessional tax rates on the earnings.
 - c. Tax free status at age sixty (and retired).
 - d. The ability to borrow through instalment warrants (enabling your SMSF to buy a home).

I wish each of you well during testing times and for the years ahead - make a time to see me or any good advisor, go forward and never look back - life's good!

Please feel free to share this article with anyone.

Dr. Steven Enticott, sje@ciatax.com.au
(DBA, MBA, FPNA, FTIA, DipFS & Registered Tax Agent)

The Full Book

“Tax Effective Investment” (Free download at www.ciatax.com.au). Covers strategies for:

- Rental properties.
- Buildings depreciation.
- Australian shares/Imputation credits.
- Superannuation.
- Primary production activities.

There are many more tax-effective investments beyond the above list, but these are the key ones which warrant your keen attention. Each one has a dedicated chapter in the book along with practical examples.

The book is reality-based, and written in a pragmatic style to clearly illustrate the benefits of tax-effective investment. Most importantly, though, it shows that whatever the type of investment, it must be a *good* investment. There is absolutely no point to tax-effective investment unless there is a profit (capital growth).

About the Author

Dr Steven Enticott ‘practices what he preaches’, and has invested (or still invests), in some way shape or form, using every method raised in this book.

Dr Enticott is a financial planner and tax specialist, and is the senior partner of CIA Tax (www.CIATax.com.au) and CIA Wealth (www.CIAWealth.com.au) in Melbourne.



A Fellow Professional Member of The National Institute of Accountants (FPNA) and a Fellow Member of the Tax Institute Australia (FTIA), he holds an Advanced Diploma of Business (Accounting), a Master of Business Administration (MBA), a Diploma of Financial Services (DiPFS), and a Doctorate (DBA-Swinburne University).