

**ASX**

AUSTRALIAN SECURITIES EXCHANGE

# Instalment Warrants – Investment Strategies within SMSFs

## Fact Sheet

Using ASX quoted Instalment warrants (Instalments) to offset non-franked income and expenses is a strategy that can increase the value of income and contributions within Self Managed Super Funds (SMSFs). Instalments are financial instruments issued by banks and other institutions, and are traded on the ASX. They are geared investment products that provide entitlements to some of the benefits of share ownership such as dividends and franking credits.

### Why can instalments be used to offset non-franked income and expenses?

Since SMSFs are unable to borrow money to invest, the possibilities of geared exposure are limited. Instalments are one of the few eligible forms of gearing available within an SMSF due to the limited recourse nature of the second instalment.

Geared exposure from instalments provides investors with the opportunity to:

- Enhance potential returns;
- Increase dividend income and yield; and
- Accrue additional franking credits.

In the case of SMSFs, when fully franked dividends are received associated franking credits can be used to create an earnings shelter. This shelter can be used to offset tax payable on both contributions and income streams generated by the SMSF.

### Case Study: Enhanced Earnings Shelter

The scenario:

ASX listed company XYZ has announced a \$2.00 dividend. As an alternative to purchasing XYZ shares you decide to purchase the following instalment:

- XYZ123 – A regular geared instalment.

The following table provides an example of the benefits of instalments within a SMSF. Comparisons are based on three investment choices.

Firstly an investment of 1000 shares in XYZ (\$50,000) compared with investing in 1000 instalments (\$25,000). The final choice is an example where 2000 instalments are purchased for the same capital outlay as our share investment.

	XYZ SHARES (\$)	XYZ INSTALMENTS (\$)	FULL DOLLAR AMOUNT EXPOSURE XYZ INSTALMENTS (\$)
<b>Investment amount</b>	\$50,000	\$25,000	\$50,000
<b>Price/unit</b>	\$50.00	\$25.00	\$25.00
<b>Units purchased</b>	1000	1000	2000
<b>Expense</b> Interest* \$28.00 x 10% pa	nil	-2800	-5600
Interest @ 5.75%** is deductible		-1610	-3220
<b>Income</b> Dividends \$2.00 after tax @ 30%	\$2,000	\$2,000	\$4,000
Franking credits (a)	\$857	\$857	\$1,714
Grossed up	\$2,857	\$2,857	\$5,714
After deductible expense*	\$2,857	\$1,247	\$2,494
<b>Tax</b> on net income @ 15% (b)	\$429	\$187	\$374
Excess franking credits [(a) minus (b)]	\$429	\$670	\$1,340
<b>Earnings and contribution off-set</b>	\$2,857	\$4,467	\$8,933

Figures have been rounded for ease of illustration, costs such as brokerage are not taken into account.

\* Interest rate used for this calculation is an example only.

\*\* Interest is deductible at the RBA indicator variable rate for standard housing loans (subject to variation).

Depending on your individual circumstances you may not be able to deduct the entire interest component.

# Instalment Warrants Fact Sheet

## The process explained:

- 1000 instalments or 2000 instalments are purchased at \$25.00;
- Total interest expense is calculated at \$28.00 x 10% per annum, this represents the borrowing component of the instalment;
- Interest is deductible at the RBA indicator variable rate for standard housing loans;
- Taxable income is calculated by adding dividends and franking credits before deducting interest expense;
- Tax on instalments is significantly lower than the tax on owning shares themselves due to the interest expense deductibility component.

## Strategy requirements:

- Research – Analysis will provide an estimate of dividends and franking credits leading up to the company announcement;
- Holding Period Rule (or '45 day rule') – To be entitled to franking credits you must hold shares 'at risk' for a certain period of time. For ordinary shares (or instalments) you must hold the shares at risk for at least 45 days in the qualification period, defined as the period starting the day after you buy the shares and ending on the 45th day after the ex-dividend date;
- For instalments, ensure to take account of interest and loan protection fee decay over the period.

## Key benefits of strategy

As demonstrated in the above example, this strategy provides the opportunity for an SMSF:

- To increase the earnings shelter that can be generated from instalments;
- To increase contribution off-sets and pre-taxable income that the fund can receive;
- To increased dividend yield and franking credits.

## Risks of strategy

Some risks of this strategy include:

- The income stream and franking credits are not as forecasted, reducing the income stream and the earnings and contributions shelter;
- The share price may fall, leading to leveraged losses (that is, your losses may be magnified in the event of an adverse market movement).

You should also refer to the relevant product disclosure documentation for risks relating to each particular instalment series.

## Investing in instalments

You should consult your professional advisor to ascertain the ability and suitability for investing in Instalments as part of your investment strategies.

You should also seek independent professional taxation advice prior to making any decision to invest in Instalments.

## Additional Information

- To learn more about trading warrants and for contact details of each of the warrant issuers, visit the ASX website [www.asx.com.au/warrants](http://www.asx.com.au/warrants)
- To be notified of upcoming warrants seminars register at [www.asx.com.au/keepmeposted](http://www.asx.com.au/keepmeposted)
- Prior to trading an ASX Instalment Warrant, please ensure that you have read a copy of the ASX brochure 'Understanding Trading and Investing Warrants', available from ASX Customer Service on **131 279** or email [info@asx.com.au](mailto:info@asx.com.au)

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