

Borrowing to invest, or gearing, has long been a popular wealth creation strategy. By enabling you to invest more money, gearing has the potential to improve your investment returns and help you reach your financial goals sooner.

A margin loan is a flexible investment loan that can be used for investment purposes such as investing in shares and managed funds. You simply provide existing approved shares, managed funds or cash as security for the loan. You can then use the borrowed money to access a greater range of investment opportunities, because you are not limited to investing your own capital.

Like other investment strategies, margin lending involves an element of risk. Just as there is potential for growth, there is also potential for loss. It is important that you determine if using a margin lending strategy is right for your particular circumstances.

Unlike investing in direct property, you don't need to borrow large sums of money to start (or build on) your investment portfolio.

Gearing and tax implications

Using margin lending to gear your investments may generally have the following tax consequences:

- The interest you pay on a margin loan may be able to be claimed as a tax deduction. Furthermore, if the interest (and other tax deductible costs) exceed the income from your investments (including franking credits), you may be able to offset these costs against other sources of assessable income.
- For a fixed rate loan, you have the ability to pre-pay interest on your margin loan for up to 12 months. This allows you to bring forward an expense that may otherwise be tax deductible in the following financial year. This additional tax deduction may then be used to reduce your taxable income in the current financial year. It is important to note that this may be subject to the special pre-payment rules and you should seek professional tax advice.
- By borrowing against existing assets, you may be able to take advantage of other investment opportunities without triggering a Capital Gains Tax (CGT) liability. This is because you don't need to sell your existing investments to use them as security for your margin loan.
- You may then be able to sell your existing (and your geared) investments at a time when your marginal tax rate is lower (e.g. in retirement). This can potentially help you to reduce or eliminate the CGT payable.



- If you invest the borrowed money in Australian shares and certain New Zealand shares, directly or via a managed fund, you may be entitled to valuable franking credits. Depending on your personal circumstances and subject to the 45 day holding period rule, these credits may be able to be used to offset some (or all) of the tax payable on the dividends or distributions.

Your tax position will depend on your personal circumstances. Therefore you should not rely on this information in relation to your own position.

Margin lending can help to build your wealth and increase your investment opportunities more quickly than if you rely on your own investment capital, with a larger portfolio potentially increasing your long term investment returns.

Risks

While a margin loan can increase your gains in a rising market, it can also magnify your losses when the market declines. Consequently, you should consider investing in a diversified portfolio of quality assets and ensure you have enough time (and discipline) to ride out the inevitable investment market fluctuations.

The security ratio assigned to an asset may change over time. By gearing conservatively, you can potentially reduce the possibility that a reduction in the security ratio could result in a margin call.

You should ensure that you have enough surplus cashflow to absorb any increases in interest payments. You could consider fixing the interest rate on some (or all) of your margin loan to offer protection.

Margin Calls

A margin call arises when the value of your loan exceeds a certain agreed ratio in relation to the value of the security. If you receive a margin call you have to correct it to the satisfaction of the Margin Lender.

You can satisfy a margin call by:

1. Reducing your loan balance by depositing cash;
2. Selling all or part of the security and use the proceeds to reduce the loan balance or;
3. Lodging additional managed funds, shares or cash as security.

Case Study

David chooses to invest \$50,000 of his own capital and borrow \$50,000 with a Margin Loan, investing the full amount in XYZ shares. Over 5 years, David's investment grows from \$5.25 (initial purchase price) to \$15.01 (end value of XYZ shares). During this time, David receives dividends of \$2.02 per share. The table below shows how David's margin loan helped him build greater wealth.

Without margin loan With margin loan

	Without margin loan	With margin loan
David's own capital	\$50,000	\$50,000
Margin loan value	Nil	\$50,000
Total investment portfolio	\$50,000	\$100,000
Dividends received over 5 years	\$19,238	\$38,476
Market value at the end of year 5	\$142,952	\$285,905
Total value at the end of year 5	\$162,190	\$324,381
Less borrowing costs over 5 years @ 9.90%	Nil	\$24,750
Less margin loan repayment	Nil	\$50,000
Net portfolio value at the end of year 5	\$162,190	\$249,631

The above case study is a hypothetical example only and does not take into account taxation. Due care and attention have been used in the preparation of forecast information and hypothetical examples. However, actual results may vary and any variation may be materially positive or negative. Source Investsmart

The gross borrowing costs have been covered by the dividends received. By using a Margin Loan, David was able to achieve an additional \$87,441 in the return of his portfolio. This example refers only to capital growth and dividends.

The example is before income tax, capital gains tax, fees and any potential franking credits.

Disclaimer

This Fact Sheet has been prepared for general information purposes only and not as specific advice to any particular person. Any advice contained in this document is General Advice and does not take into account any person's investment objectives, financial situation and particular needs.

Before making any investment decision based on this advice, you should consider, with or without the assistance of a financial adviser, whether it is appropriate to your particular investment needs, objectives and financial circumstances



Level 1, 4 Park Road, MILTON QLD 4064 | P.O. Box 1969, MILTON BC QLD 4064
Tel: 07 33667 6555 Fax: 07 3368 3998 | enquiries@iplan.net.au | www.iplan.net.au

iPlan Financial Services Australia Pty Ltd ACN: 106 591 833 as trustee for the iPlan Australia Trust
ABN: 58 928 175 252 is a corporate authorised representative of
iPlan Financial Services Pty Ltd ABN: 70 122 979 140 AFSL No. 311824