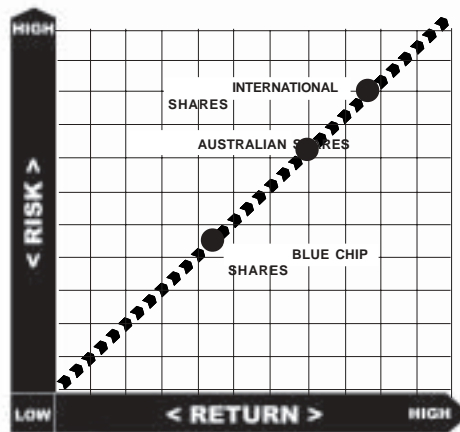




National Information Centre on Retirement Investments Inc.

# Shares



[www.nicri.org.au](http://www.nicri.org.au)

<http://moneymap.nicri.org.au>

# What Are Shares?

Public companies initially raise capital through the issue of shares. The stock market has two elements, a primary market where companies requiring capital seek out investors wishing to invest their capital efficiently and a secondary market where investors are able to buy and sell shares plus other securities which can be traded on the Stock Exchange. As a shareholder in a company investors become part owners of the company.

Shareholders accept the risks and responsibilities of ownership and are granted certain entitlements in return.

These include:

- to share in the company's profits in the form of *dividends*;
- to participate in rights and bonus issues;
- to vote at company meetings;
- to share in the company's growth as reflected in changes in the share price;
- to be kept informed about the company

The market price of a company's share is determined by supply and demand from buyers and sellers ie. market forces.

Shares may be purchased and sold on a stock exchange through a stockbroker. Minimum transaction amounts may apply and details are available from a stockbroker. With all share transactions now being processed electronically investors will have either a company issuer sponsor holding statement or electronic sub-register system (CHESS) holding statement detailing the opening balance, all transactions and the closing balance for the month a transaction occurs. A stockbroker can act as a CHESS sponsor and electronically register purchases and sales by reference to the investor's Holder Identification Number (HIN). It is possible to have issuer-sponsored shares which are recorded on the company's own sub-register using a Security-holder Reference Number (SRN).

Many financial institutions offer discount brokerage services by investors placing their transactions online. In these situations advice is not usually provided.

It is also possible to transfer shares directly from one party to another. This is known as an 'off-market transfer' and can be done through the company's share register.

When purchasing shares in a company for the first time investors must acquire at least one *marketable parcel* as defined in the Australian Securities Exchange (ASX) Business Rules. The minimum marketable parcel in any one company is currently \$500. After this initial purchase investors can buy or sell any additional amount they wish.

Stockbrokers may set higher minimum transaction limits or charge higher fees for transactions that do not meet their minimum transaction or trade value.

Different types of shares are available. The most common are ordinary shares. Other types of shares are variations of ordinary shares or preference shares. All have different rights, liabilities and obligations that should be fully understood prior to purchasing.

Shares are complex and professional advice should be sought before investing. Even the most researched and best-intended advice may result in a loss.

There are 5 different kinds of shares. They are Ordinary shares, Preference shares, Contributing shares, Bonus shares and Rights Issues.

Ordinary shares are the most common shares and their features are described on page 5.

Preference shares give the investor a right to a fixed dividend, not related to company profits, and are paid before the dividends to ordinary shareholders. However, holders of Preference shares do not have the same voting rights as ordinary share holders. While having the right to this special dividend, the company is not obliged to pay the dividend at a specific time, but where

it is not paid in a particular year it is normal practice that it would accumulate and be paid in a subsequent year. In the event of the *liquidation* of the company, Preference shareholders are usually entitled to be repaid their capital before Ordinary shareholders.

With Contributing shares dividends are paid in proportion to the paid up amount. Further contribution will be required in the future for the shareholder to own the full share and become an Ordinary shareholder. It is a way that investors can pay off share acquisitions over time.

Bonus issues of shares are new shares issued to existing shareholders, in proportion to their existing holding, at no cost. This does not change the proportion of the company they own but when the next dividend is paid they receive a larger payment as the dividend per share is paid on more shares. It is sometimes described as a cashless dividend because at the time of issue the shareholder does not receive a cash payment.

A **Rights Issue** is made when a company wants to raise more capital and an offer is made to shareholders to purchase extra shares. They have no obligation to accept the right. There are **Renounceable** and **Non-renounceable** Right Issues. Renounceable issues can be traded and as a result if an existing shareholder does not wish to purchase the shares they can still profit by trading them. Non-renounceable shares cannot be traded and if they are not taken up they are of no value to the shareholder.

## Features of Ordinary Shares

- Can provide income through dividends usually paid every six months;
- Provide taxation benefits through dividend imputation (*franking credits*) system;
- A well-balanced or diversified share portfolio can improve the chance for growth and reduce investment risk;
- Provide a balance between income and capital growth;
- There are no management fees;
- Shares are very *liquid* allowing investors to rearrange their portfolio at any time;
- Some companies provide dividend reinvestment plans (DRP) that allow dividends to be used to purchase additional shares without transaction costs; and
- Shareholders may be entitled to shareholder privileges or discounts.

## But Remember...

- Share prices are volatile and losses may occur upon sale no matter how well a portfolio is balanced or diversified;
- Income from dividends may vary and in times of low profits a company may reduce or pay no dividend. A company must be profitable or have retained profits to pay a dividend;
- Brokerage fees are charged to buy and sell shares and rates can vary between brokers. This can eat into gains particularly if small parcels are sold;
- If reinvesting dividends through a DRP, accurate records must be kept to ensure that the necessary calculations made under the capital gains regime are correct.

# Derivatives

While the majority of small shareholders own ordinary shares in individual companies, there is also a market for derivatives which are financial products that derive their value from a mix of other financial products. Derivatives refer to products using shares and include Options, Warrants, Futures and Contracts for Difference, to name a few. Derivatives are used as a means of earning extra income, protecting existing share portfolios and as a form of gearing into share investments. Further information can be obtained from the ASX at [www.asx.com.au/derivatives](http://www.asx.com.au/derivatives) or by telephoning 1800 028 585.

## Government Income Support

### Assets test

The market value is used to determine the total value of the shares for the assets test. If money has been borrowed to invest in shares and the debt is secured against an assessable asset the asset value of the shares may be reduced by the amount of the debt. If secured against the investor's primary residence (home) the full value of the shares are assessed as the home is an exempt asset and any debt against it is also exempt. Centrelink automatically updates individual shareholdings as at 20 March and September each year using values that may have been determined within the preceding month.

### Income test

Shares are assessed as financial assets with their full market value being added to other financial assets and the total being subject to the deeming rules. The market value is not reduced by any debt.

Centrelink will adjust pension or allowance payments to reflect the movement in the market value of shares held following the half-yearly review.

Further information is available from Centrelink Financial Information Service (FIS) Officers or your local Department of Veterans' Affairs (DVA) office.

## Taxation

### Dividend Imputation - Franking Credits

Dividends paid to shareholders must be included in their taxable income. Under the dividend imputation system shareholders who receive assessable dividends are entitled to a tax offset (rebate) for the company tax already paid (see example on Page 11). The current company tax rate is 30%. The amount of the dividend received is declared as income grossed up by the amount of the imputation credit, to establish taxable income. Tax and Medicare are also payable. The imputation credit is then taken off the tax payable.

Taxpayers with franking credits that exceed their tax payable will be entitled to a refund of any excess credits.

### Capital Gains

A comprehensive capital gains tax (CGT) regime exists in Australia. Individual taxpayers can discount the amount of capital gains by 50% for gains made on or after 21 September 1999 provided the shares have been held for at least 12 months. For shares acquired before 21 September 1999 the amount included is either 50% of the realised gain or the whole difference between the disposal price and the frozen cost base. The frozen cost base is the original acquisition price plus certain costs adjusted for the movement in the consumer price index (CPI)

between when the shares were purchased until 30 September 1999. The taxpayer can choose which method of calculation is used.

Shares acquired before 20 September 1985 remain exempt from CGT.

Due to the complex nature of the rules it is essential detailed records be kept and it is suggested you consult with a taxation adviser.

For shares inherited from a deceased person the date of death is taken as the date the shares were acquired. The value used is dependent on the date the deceased acquired the shares and the date of their death. Important dates are 20 September 1985 and 21 September 1999. Refer to the Australian Taxation Office (ATO) publications including 'Assets passing to a beneficiary or legal representative'.

## Brokerage

Brokerage fees can be charged as a flat fee up to specified amounts and as a percentage of the value of the share parcel over these amounts. The level of service provided may vary depending on the fee charged. If you have access to the internet the fee can be smaller as an online broker does not give advice.

## Investing With Safety

To reduce the chance of losing money investors may consider diversifying their share holdings to include different companies across different market sectors, eg. industrial or resource markets etc.

Shares are often classified as *blue chip*, *green chip*, *small cap*, *speculative* etc. While these terms attempt to describe the type, quality and size of a company it must be remembered that share markets can be volatile and investors need to fully accept the risks involved before investing in shares. For further information refer to NICRI leaflet called '*Safety, Risk & Scams*'.

A full investigation of the company's profile, performance, history and profit/loss forecasts should be made prior to any share purchase. If investors are not willing or unable to undertake the appropriate analysis a share broker can make some recommendations. If this all seems too difficult purchase of shares in a Listed Investment Company (LIC) or investing in a managed share fund may be more appropriate.

Indirect investment in shares is covered in a separate NICRI leaflet called '*Equity Trusts*'.

### Tax Effect of Dividend Imputation: An Example

Calculations are based on 2007/2008 tax rates and do not include the Medicare levy and other possible tax offsets. It is assumed that Person A has a total income of \$6 000 and Person B \$25 000 including the grossed up fully franked dividend.

	Person A	Person B
Fully franked dividend (received)	\$1 000-00	\$1 000-00
<u>Plus</u> imputation credit @ 30% (not received)	<u>\$ 429.00</u>	<u>\$ 429.00</u>
Taxable income from shares	\$1 429.00	\$1 429.00
Personal Tax Payable A @ 0%	\$ 0-00	
Personal Tax Payable B @ 15%		\$ 214.35
<u>Less</u> imputation credit (rebate)	<u>\$ 428.57</u>	<u>\$ 428.57</u>
Excess franking credit	\$ 428.57	\$ (214.22)

The excess franking credit can be used to offset any income tax or medicare payable - any unused amount will be refunded in cash. Therefore Person A receives the full franking credit in cash as they have no tax liability. Person B can use the extra \$214.22 to reduce their tax on other income.

# Glossary

**Blue Chip** – Larger, well established companies known for consistent, stable, long term returns

**Dividends** – Returns offered by a company for each share held and can be paid to the investor or reinvested to purchase more shares

**Franking credits** – (imputation) A credit amount paid to shareholders as part of the dividends to reflect company tax that has been paid

**Green chip** – companies involved with environmentally friendly activities

**Liquid** – assets easily sold or convertible to cash

**Liquidation** – The sale of company assets due to the company being wound up

**Marketable parcel** – An amount of shares that can be sold in one transaction

**Small cap** – smaller and emerging companies which may have the potential for growth in the future

**Speculative** – Companies that show characteristics that encourage trading in order to gain returns

## NICRI

The National Information Centre on Retirement Investments Inc (NICRI) is a free, independent, confidential service that aims to improve the quality of investment information provided to individuals who are investing for retirement or facing redundancy. NICRI works at arms length from both government and the finance industry to provide a completely unbiased source of information to the public. Funding for this consumer service is provided by the Department of Families, Housing, Community Services & Indigenous Affairs.

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