keeping an eye on finance

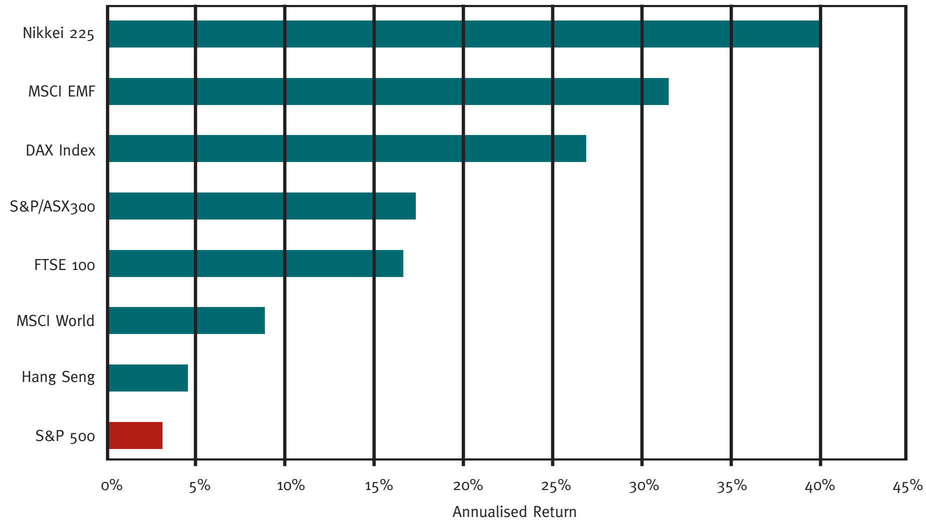
focus

Issue: Autumn 2006

in this issue

Global Returns

Stock Index % Change Calendar 2005 (local currency, ex dividend)



Splitting the difference

Australia's superannuation landscape continues to evolve, and more changes are on the horizon in 2006 that potentially will have significant advantages for many workers and their spouses.

We are all used to the concept of contributing to our superannuation in tandem with payments made by our employer. Now, measures introduced in the last Federal Budget, which came into effect on January 1, mean you do not have to be in the workforce to enjoy the benefits of superannuation.

The latest measures relate to the splitting of superannuation contributions between spouses, where income-earning partners will be able to request their fund to split their contributions so part of their super goes into their spouse's superannuation account. This is a more efficient process than the previous way to get money into a spouse's superannuation account.

Under the previous rules, a working spouse could make contributions to their spouse's superannuation but they could only use 'after tax' money. The contributing spouse was eligible for an 18 per cent tax rebate (up to a maximum of $540) as long as the recipient's income was below $10,800 for the full rebate or below $13,800 for a partial rebate.

What do all the new changes mean?

What the new changes mean is that, for the first time, a non-working spouse will be able to accumulate significant superannuation benefits via their working spouse, and be able to maximise the superannuation tax concessions every individual is entitled to.

Initially, couples will only be able to split their contributions after June 30, 2006, for the six month period between January 1 and June 30, 2006.

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Words of Wisdom

'Failure is success if we learn from it.'

- Malcolm Forbes, Publisher

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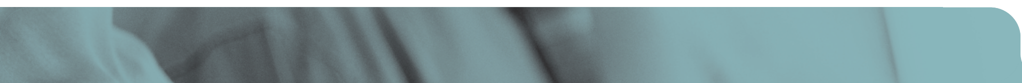

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After June 30, 2007 – representing a full financial year under the new rules – a super fund member will be able to request the splitting of all the contributions made between July 1, 2006, and June 30, 2007.

For low income and non-working spouses, the ability to split contributions allows them to participate fully in superannuation.

The legislation applies to compulsory employer contributions, tax deductible contributions by self-employed people and small businesses, salary sacrifice contributions and undeducted contributions. A contribution split cannot be made in favour of a spouse who has reached preservation age and has met a condition of release, or has turned 65 years of age.

The primary benefits of being able to split contributions are that it will enable a couple to benefit from two tax-free thresholds and reasonable benefit limits – the total they can have invested in superannuation before higher tax rates apply.

Effectively this will enable a couple to double the amount they can withdraw from their super on retirement as a tax-free lump sum, minimise excess amounts subject to higher tax rates and by using appropriate investment strategies they will be able to maximise their retirement tax-free income through a product such as an allocated pension.

How can contributions be split?

To split contributions, individuals will need to make a request to the trustee of their fund. It will not be compulsory for superannuation funds to offer contribution splitting. Individuals wanting this feature will be able to use their choice of fund capability to switch to a fund that does if it's not available via their existing fund.

The process for splitting will be simple if contributions are being split within the same fund structure, as technically no rollover to another fund is required. However, if the contributions are being split to a completely different fund, the amount split to the spouse will be classed as an eligible termination payment and rolled over to his or her fund.

How does it work for self employed people?

Self-employed persons and small business operators who pay superannuation contributions for themselves as an employee tend to make top-up contributions late in the financial year once they know how much tax they have to pay.

The issue of contribution splitting can become more complicated for self-employed persons.

Trustees will now need to be advised how much an individual will claim for a tax deduction out of the super contributions made, and then lodge a contribution splitting request. The trustee will then know how much money is left over after deducting the 15 per cent tax from those contributions.

If the paperwork is muddled up they cannot claim a tax deduction for contributions where a splitting request has already been received.

If you are interested in exploring contribution splitting, first check that your fund will offer it and then check if there will be any restrictions imposed.

When is the best time to consider splitting?

Now is the time to consider whether you want to split your contributions on July 1, 2006, and how much money you want to have available to move. It might be a matter of increasing your salary sacrifice contributions after January 1 so more contributions are made in the first six months of 2006.

Talk to one of our qualified financial advisers to find out more about contribution splitting based on your individual circumstances.

ATO clarifies Transition to Retirement position

The introduction of transition to retirement legislation has been one of the biggest changes introduced to the superannuation system in years.

It allows people aged 55 and over who want to scale back their working hours to perhaps reduce the number of days they work and supplement their lower income by tapping into their superannuation.

There is also the option under the new legislation of continuing to work full-time and salary sacrificing more income into superannuation, which can then be withdrawn on a concessionally taxed basis. Once accumulated funds are moved from superannuation into an allocated pension, the tax on investment earnings reduces from 15 per cent to zero.

The potential tax benefits of transition to retirement, if certain strategies are adopted, has prompted the Australian Tax Office to clarify its view on whether workers aged 55 and over who do make salary sacrifice contributions into super, and who at the same time draw down from their super at a lower tax rate, should be subject to the ATO's general tax-avoidance provisions.

The ATO says that "arrangements entered into in a straight forward way are consistent with the operation of the law, and we do not see grounds for applying anti-avoidance rules. For example, an eligible person may take out a pension under the transition to retirement rules. At the same time, that person may engage in an effective salary sacrifice arrangement and contribute to a complying superannuation fund for their own benefit.

"We would only be concerned where accessing the pension or undertaking the salary sacrifice may be artificial or contrived."

Individual taxpayers should seek further clarification about the consequences of their particular arrangements, which can be achieved by requesting a private ruling from the ATO.

Contact us if you require further guidance on this issue.

Growth pensions turn 100

The introduction of growth pensions in September 2004 gave Australian retirees more investment flexibility than ever before by enabling them to tap into higher growth investments, such as shares and property.

Because growth pensions are deemed as complying pension products, they can assist retirees to qualify for a higher limit on the amount of tax-favoured super benefits they can receive (known as the "pension reasonable benefit limit" or "pension RBL") as well as for a partial exemption under the age pension assets test.

Growth pensions have a similar account arrangement to a standard allocated pension, where payments are made on a regular basis, however, investors will receive payments for a fixed period based on their life expectancy.

In fact, life expectancy is the key to working out the term of a growth pension. The term of a growth pension is based on the investor's life expectancy at the commencement or on the life expectancy of someone the same gender but up to five years younger. The ability to choose a term based on the life expectancy of a younger person provides some additional flexibility to choose a longer term.

If they choose a reversionary beneficiary for the pension, such as their spouse, it is possible to set the term of the growth pension using the life expectancy of the reversionary pensioner if it is longer than the purchasing pensioner's.

The pre 1 January 2006 rules typically give a term that would run to about age 80 to 85 for men, and to 85 to 90 for women. For a male retiring at 65 who sets their growth pension out to the average life expectancy of 83, the income payments made out of their pension will be divided by 18 years.

However, from 1 January 2006, amendments to the existing legislation (commencing 1 January 2006) has increased the term of the pension from commencement date up to the age of 100, meaning retirees can take out their pension income over a much longer period, thereby reducing annual payments so their money can last longer.

To find out if you can take advantage of this change, please contact us today.

The importance of proper protection

When it comes to protecting against risk, most of us are optimists at heart.

We tend to believe that it's extremely unlikely that anything will ever happen to jeopardise our quality of life. Yet, the reality is, that bad things do happen, and when it comes to having adequate financial protection to cover unforseen events most of us are underinsured.

For most of us, having health insurance, car insurance and home and contents insurance are all types of protection we regard as mandatory. But what about having adequate life insurance or disability cover? Who will pay the other general insurance bills if you're not around? And, if you run a business, do you have cover in place to pay outstanding debts, wages and other liabilities if you are injured, become ill or worse?

There are various types of cover, but in a nutshell it really is vital that you and your family are financially protected against long-term sickness and, in the worst case, death of the main bread winner.

Under the Financial Services Reform Amendment Act, 2003, it is now mandatory for financial advisers to analyse their clients' life insurance needs.

While life expectancy rates are on the increase, there are still major health issues stopping people from earning an income.

In the past, life insurance was often the only financial product a family might have. Now people have access to a wide range of sophisticated investment products but sometimes forget about their protection needs.

Wealth protection, be it life insurance or an income protection product, is important to financial longevity.

Fast Facts

The average full-time salary for men in Australia is currently $52,000 and $44,500 for women.

Australian Bureau of Statistics, Year Book Australia, Earning and benefits, Jan 2005, Canberra.

One in two 40-year-old men will suffer from coronary heart disease in their lifetime and 25 per cent of stroke victims are under 65.

Australian Institute of Health and Welfare (AIHW) 2001, Heart, stroke and vascular diseases Australian facts 2001. AIHW Cat. No. CVD 13. Canberra: AIHW, National Heart Foundation of Australia. National Stroke Foundation of Australia

One in six of the working population is expected to suffer a disability from the age of 35 to 65 that causes a loss of six months or more from work.

Institute of Actuaries. Table IAD 89-93. White collar males and females.

When considering what sort of wealth protection product will best suit your family, the first thing to do is estimate the money your family would need if they didn't have the income from the main breadwinner.

As a rule of thumb you may assume you need an annual income of approximately 75 per cent of your current salary.[1] However this can change at different life stages, for example expensive school fees will increase expenditure.

It is also essential to estimate the amount of money needed to pay off debts, including medical expenses and mortgages. Right now, the average size of a home mortgage is $189,000,[2] and in most cases it is important to clear the mortgage.

For most people, life insurance is not an expensive option. A 40 year old, non-smoking healthy male will pay approximately $20 a week for Death and Trauma life insurance cover of $800,000 and women of the same age are looking at about $17 a week.[3]

It is important to get it right. A financial adviser can assist in creating a financial plan which considers all your wealth protection and investment needs.

1 Institute of Actuaries. Table IAD 89-93. White collar males and females.
2 Australian Bureau of Statistics, House Finance for Owner Occupier, Australia, November 2003, Canberra.
3 As calculated for a product from Aviva's Protectionfirst range as at 4 September 2005

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