PERSONAL FINANCIAL
STRATEGIES
YOUR PERSONAL GUIDE TO WEALTH CREATION

Superannuation borrowing strategies

Investors are taking advantage of superannuation property investment since a legislation change introduced five years ago. However, while many are seizing the opportunity to add to their rental portfolio, there are some important considerations to take into account.

Despite being introduced in 2007, there is still a cloud of confusion surrounding superannuation property investment and with tough policing from the ATO it is critical to be aware of your obligations.

Cashflow

All superannuation funds have limitations and specific provisions instated, including a restriction on the amount of money you can deposit into a superfund each year. Therefore, it is crucial to consider the cash flow within the fund to ensure that sufficient money is available for the year to meet repayments and other costs associated with the investment, as well as additional regular outgoings.

Access existing equity

Using your super fund for direct property investment is costly and ultimately could impose a significant cash burden on you. By using your fund, you can access your existing balance as seed capital to finance investments. To pay down debt, you can use future contributions which may qualify for tax concessions.

Concessional tax rates

If your superannuation fund is in pension phase then you will not be required to pay tax. However, as with all other super investment returns, gain on disposal of property, or rental income, you will be taxed at a maximum concessional rate of 15 per cent.

Diversification and size

It is a good idea to clarify the range and size of investments you can hold in your super fund, as there are often restrictions in place which limit the speed with which your fund can grow. Borrowing through the bank to

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acquire property means that your super fund can purchase an asset it normally would not be able to afford. The same goes with diversification – borrowing to buy a property may allow diversification within your scheme that would not normally be achievable.

Using your self managed superannuation fund to acquire residential or commercial property for investment purposes offers a number of benefits including:

- Rental income can be used to offset interest and other costs.
- No capital gains tax on transfer of the property to an investor or smsf.
- Ideal for investors who are no longer eligible to contribute, or have exceeded their super contribution caps and wish to enhance their retirement savings.
- Property value determined by independent valuation.
- Potential for greater returns through leveraging.

Taxpayer confusion over

One of the benefits of income protection is that premiums can be fully tax deductible. Depending on your policy however, they may not be, so it is important that you are aware of your deductibility.

When benefits are treated as income, rather than capital, at the time of claiming, then the Australian Taxation Office will provide a tax deduction on the premiums paid. This applies to all basic protection policies with simple benefits. However, in some cases, for more complex policies, this may not be the case.

Combined income protection and death/ disability policies

Combined income protection and death/ disability policies, which pay lump sum benefits in the event of critical illness, serious injury or death, may be ineligible for tax deductions. The benefits may be tax-free on claiming; however the premium assigned to these benefits will not be tax deductible. You may be eligible to claim a portion of your premium as a tax deduction.

Superannuation inclusive policies

Individuals who had superannuation schemes inclusive of income protection policies used to be able to claim tax deductions for income protection cover with benefits exceeding two years. However, last year the ATO decided that the deductibility of premiums would be dependent on the alignment of the policy terms with the 'temporary incapacity' condition of release in the SIS Regulations. This means that under the temporary incapacity definition, any proportion of a benefit payable from an insurance company to a super fund, which could not be released to the policy holder, would not be tax deductible. To be eligible for a tax deduction within your superannuation scheme, a benefit can only be paid for the period of incapacity and cannot have a residual capital value.

If you return to employment you may still be eligible for benefits. Benefits may be paid when the policy holder's income, plus the temporary incapacity benefits, does not exceed their original remuneration before illness.

Many income protection policies do not offset sick leave benefits. This is due to a potential insurance payment needing to be partially retained to avoid breaching the 100 per cent pre-disability income restriction under the SIS. This could mean the premium does not qualify for an entire tax deduction.

Under some policies you can claim payments for 'total disability' while still being able to work up to ten hours per week. However, the premiums may not qualify for a full tax deduction when benefits were paid resulting in the individual generating an income more than their pre-disability income.

There are three options available for superannuation members to find out how much of their income protection premium is tax deductible.

- Apply to the ATO for a private binding ruling.
- Determine how much of the premium is related to the tax deductible portion of the premium by obtaining an actuarial certificate.
- Do not claim the tax deduction.

Hybrid securities on the rise

Surrounded by an increasingly volatile global climate, hybrid securities' popularity and status is on the rise with more people selecting the flexible and diverse investment as their preference in lean times.

Hybrid securities were traditionally used in the wholesale end of the market, however in recent times they have gained momentum elsewhere. Like any investment, there is an element of risk attached with hybrid securities; however this risk lessens if the securities are held to maturity. Once matured, the security may be converted to cash, an ordinary share, a hybrid of both, or reset for another term. The key to hybrid investments is the quality of the asset. This will be evident by the credit rating and financial standing of the company in its ability to repay interest payments and capital on maturity or conversion.

Why hybrid securities?

Hybrid securities offer an alternative asset class to the traditional fixed interest investment options with the opportunity to enhance returns. They pay a predictable fixed or floating rate of return until maturity, where the investor is then presented with a number of options. Hybrid securities have a clear equity value attached unlike shares, and there is always an option to convert to the underlying equity. Because hybrid securities combine elements of both debt and equity, it is important to understand that they are all different. Some securities will be more characteristic of fixed interest-securities, while others will be more characteristic of shares.

What are the risks?

- Security prices may be affected by credit rating fluctuations.
- ·Sensitive to interest rate movements.
- Ranks behind traditional debt.
- Value may be affected by changes in the prices of the underlying shares.
- Subject to financial obligations of the issuer.

What are the benefits?

- Ranks ahead of equity.
- Potential tax benefits from franking credits.
- Due to the higher credit risk associated with hybrid securities, there are higher income yields compared to bonds.
- Potential to convert security to underlying share at defined intervals.
- Some downside protection if an option for cash back at issue value is offered at maturity.

More super for taxpayers

Legislation passed by the Senate on March 19 will see superannuation guarantee rise to 12 per cent by 2020.

Compulsory superannuation guarantee contributions will increase from nine per cent to 12 per cent over the next eight years after the minerals resource rent tax was passed last month.

The gradual increase will result in the average 30-year-old earning a full-time wage, earning an additional $108,000 in retirement savings.

The SG rate will increase gradually with initial increments of 0.25 per cent in 2013 and 2014, and further increments of 0.5 per cent annually until 2020.

The phased increase will ensure employers have adequate time to take the increase contributions into account when negotiating future wage settlements. Many employers will also benefit from company tax reductions.

The new increases are expected to add around $500 billion to the existing pool of superannuation savings. They are also expected to contribute to further increasing national savings by around 0.4 per cent of the GDP by 2035.

Capital gains tax - revisited

In November 2011 an amendment to the Capitals Gains Tax legislation was introduced by the Government, initiating a number of changes within the system.

With substantial CGT concessions available for taxpayers and businesses, it is important to familiarise yourself with the concessions available and the recent changes to ensure you take maximum advantage of them.

Changes include:

- Removing tax issues facing special disability trusts (SDT)
- Family members contributing to a SDT may access a concession from the social security or veterans' entitlements gifting rules of up to a combined total of $500,000.
- The beneficiary's ability to access income support payments will not be affected by assets of an SDT up to $578,500, including their place of residence.
- CGT exemption for a recipient of a principal beneficiary's main residence if their ownership interest ends within two years of the beneficiary's death.
- CGT exemption for an asset transferred into an SDT for no consideration.
- Extending temporary loss relief for merging superannuation funds
- Extension of the temporary loss relief for complying superannuation fund mergers by three months, from June 30 – September 30, 2011. This extension is provided for mergers that began in the income year July 1, 2010 and completed in the period July 1, 2010 – September 2011.

Establishing any business, particularly smaller enterprises, involves personal and financial sacrifice so it is integral that you make the most of CGT concessions. There are several qualifying tests to determine your eligibility for small business concessions.

Small business 15-year exemption

If you are aged 55 years or over and are retiring, or if you are permanently incapacitated, and you have owned an asset for 15 years, you will not have an assessable capital gain when you sell the asset.

Small business 50 per cent active asset reduction

The capital gain on your active business asset can be reduced by 50 per cent.

Small business retirement exemption

A capital gain from the sale of a business asset will be exempt up to a lifetime limit of $500,000. If you are under the age of 55, the exempt amount must be paid into a complying superannuation fund or a retirement savings account.

Small business roll-over

Your capital gain from selling a small business asset can be deferred for up to a year. This means the gain is not include in your income until a change in circumstances causes a CGT event to happen which crystallises the gain.

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.

The Bookshelf

Aftershock: Protect Yourself and Profit in the Next Global Financial Meltdown

Authors: David Wiedemer, Robert A. Wiedemer, Cindy S. Spitzer.

From the authors who predicted the domino impacts of the real estate, stock market, and other bubbles that led to 2008's market meltdown comes the definitive look at what is still to come and what investors can do to protect themselves

Just as many are wrongly forecasting a full recovery ahead, "Aftershock" now updated and revised, warns of a very different economic future. Home prices and stocks will continue to fall, inflation and unemployment will rise, and the current recession will not automatically cycle back to recovery. Unlike most books, "Aftershock" goes beyond the outdated notion of "market cycles" to help readers clearly recognise and quickly respond to the rapidly evolving economy. Instead of going back to how things were before, we are moving forward through uncharted territory, with new challenges and opportunities few people anticipate. The book explains how to: Protect assets before and during the second wave of the financial meltdown, make wise investment decisions regarding stocks, bonds and real estate, know which jobs, careers, and businesses will fare the best.

While it is difficult to predict macroeconomics, and just because they got it right once does not necessarily mean that they will do it again. The authors make some interesting points, particularly the argument that our economy is evolving, as opposed to repeating itself in a perpetual cycle.

"Aftershock" is easy-to-read, entertaining, and practical book guides readers to seek safety and profits in these evolving economic conditions.