

Tech Time



Perpetual's monthly technical guide

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These increases in deeming rates will effectively raise the amount of your client's income which will be assessed by Centrelink for the same level of assets. Consequently, it is worthwhile ensuring your clients are aware that this could be the reason for any decrease in the income support payments they receive.



Tech tip: While Centrelink conducts a revaluation of all shares and managed investments held by income support recipients every six months (20 March and 20 September), clients can also request an individual revaluation at any time.

Changes to deeming rates

To reflect the recent rising rates of return on investments following the global financial crisis, deeming rates, which are used to assess income from a range of financial investments held by pensioners and other income support recipients, have increased with effect from 20 March 2010. These are outlined in the table below.

| | Income threshold | Deeming rate |
|-----------------------------------|------------------|---|
| Single | \$42,000 | 3% up to this limit 4.5% over this limit |
| Pensioner couple* | \$70,000 | 3% up to this limit 4.5% over this limit |
| Non-pensioner couple [^] | \$35,000 | 3% up to this limit 4.5% over this limit |

* Pensioner couple – at least one member of a couple receives a pension.

[^] Non-pensioner couple – where neither member of a couple receives a pension.

Legislation introduced to change Centrelink's gifting rules

Legislation has been passed that changes the gifting rules so that gifts that have been returned within five years will not be assessed as a 'deprived asset' from the date of return.

Previously the gifting rules required that where a client disposed of one or more assets, with a total value over \$10,000 in a single financial year or \$30,000 over a rolling five year period, the value of the excessive disposed asset be assessed as a deprived asset regardless of whether the gifted assets were returned or not.

The new legislation makes it clear that, where the disposed asset, or consideration for the value of the asset, is returned to the client, deprivation should not apply. In addition, where a client partially re-acquires an asset that was previously disposed of by the client, deprivation should not apply in relation to the portion of the asset that has been re-acquired.

Government to provide consumer protection framework for superannuation borrowing arrangements

The Government proposes to amend the Corporations Regulations 2001 to provide that certain borrowing arrangements by superannuation fund trustees permitted by the Superannuation Industry (Supervision) (SIS) Act 1993 are financial products under the Corporations Act 2001.

'The measure will ensure that only licensed financial services providers offer these arrangements to superannuation funds,' said Chris Bowen, Minister for Financial Services, Superannuation and Corporate Law.

To allow product providers time to adjust to the new arrangements, the Regulations will come into effect three months after being made.

The Minister also announced that the Government proposes to amend the tax law so that a superannuation trustee who enters into a limited recourse borrowing arrangement to purchase an asset, as permitted under subsection 67(4A) of the SIS Act, will be treated as the owner of the asset for income tax purposes.

'The changes will ensure that trustees of superannuation funds who have entered into permitted limited recourse borrowing arrangements will not face capital gains tax obligations at the time the last instalments are paid,' Mr Bowen said.

Initial consultation will be undertaken on the design of these tax amendments with a consultation paper providing further information about this proposal available at www.treasury.gov.au

Recap on the new work bonus

The work bonus was introduced by the Government to encourage mature age workers to remain in the workforce. It was thought that the pension bonus scheme was complex and not well understood, so it was closed to new members from the 20 September 2009 and replaced with the work bonus.

The work bonus provides that 50% of the first \$500 per fortnight of employment income is disregarded under the income test for pensioners over age pension age.

Example:

Felicity is 65 and earns \$1,000 per fortnight from employment. Under the income test, \$250 per fortnight of her employment income (ie 50% of the first \$500 earned) will be disregarded leaving \$750 per fortnight (or \$19,500 pa) assessable.


Centrelink have confirmed that the work bonus only applies to pensioners. If the partner of a pensioner is over age pension age and is working but not receiving a pension (eg they may be accruing a pension bonus), their income will not be reduced by a work bonus.

Determining the amount of employment income

When calculating the work bonus, Centrelink will use the employment income that was earned in the fortnight before the pension is payable.

Employment income is defined as income from work undertaken by the person as an employee in an employee/employer relationship. The following table provides examples of the type of income that will be classed as employment income and the types of income that will be disregarded for work bonus purposes.

| Employment income | Not employment income |
|------------------------------------|---|
| Salary and wages | Profits or income derived from carrying on a business |
| Commissions | Leave payments |
| Employment related fringe benefits | Superannuation pensions |
| Bonuses | Compensation payments |
| | Investment income |

 **Tech tip:** Business income generated by sole traders or partnerships is not considered employment income. As a result, if a person is considered self-employed the work bonus will not apply.



Getting ready for the end of the financial year

The end of the financial year is fast approaching. Before long, 30 June will be upon us and it will be too late to implement any strategies to minimise tax, protect assets or maximise the wealth of your clients in the current financial year. Now is a great time to take stock of what opportunities are available to ensure your clients are well positioned in the lead up to the end of the financial year.

► Income splitting

This can be an effective strategy for the self-employed or small business owners where both members of a couple are working in the business.

Income splitting can also be effectively achieved through the use of a discretionary trust where income and capital can be distributed to suit the needs of your clients as their income levels change from year to year. Although the establishment and operating costs of the trust can be expensive where only small amounts are being invested, it does provide a great deal of flexibility with regard to distribution of income and protection of assets.

► Realise a capital gain or loss

The last couple of months of the financial year are a great time to take stock of any activity that has occurred throughout the year and assess the net tax position of this activity. Where losses have been realised it may be worthwhile considering whether it is time to re-weight your clients portfolio and realise some of those assets that have performed well. On the other hand, the realisation of some great gains may be just the incentive your clients need to finally part with those investments that may just never recover.

► Pre-pay expenses

In some cases it is worthwhile paying the expense costs for the next 12 months upfront to gain access to the deduction now. This strategy is particularly effective for clients who are expecting a decline in their income next financial year and for everyone else who values the time value of money.



Tech tip: The deduction is available in the current financial year provided it is for a period of not more than 12 months in total and the period ends in the next financial year.




► **Don't forget about super (take advantage of all the bonuses and make the most of the caps)**

Co-contribution

Nobody wants to miss out on a \$1,000 bonus payment into their super fund, however not all people who are eligible realise this or manage to get around to making the contribution to super.

It is worthwhile flagging this opportunity with your clients, particularly those with fluctuating incomes or those who have not worked for at least a portion of the year which effectively reduced their income. For example those who took a career break, maternity leave or retirement.

Even if your clients are not eligible, this may be a great opportunity to start a referral campaign with your clients, as their children, parents or neighbours may be.


 **Tech tip:** Eligible clients need to have earned at least 10% of their total assessable income plus reportable fringe benefits plus reportable superannuation contributions from employment or business income.

Spouse contribution tax offset

Provide your clients with a potential \$540 tax offset where a \$3,000 contribution is made on behalf of a low or no income-earning spouse (they need to have earned less than \$13,800 in assessable income plus reportable fringe benefits plus reportable super contributions) during the year.

Contribution splitting

The contribution splitting rules allows clients to split up to 85% of their concessional contributions with their spouse for the previous financial year. This can be a great way of ensuring assets are equally split between the couple to help guard against legislative risk. It can also be an effective way of moving contributions from a younger to an older spouse to allow earlier access to tax-free benefits.

 **Tech tip:** Remember your clients can only split once per year and can only split with a spouse who is less than preservation age or, if between preservation age and 65, cannot be retired.

Contributions as an eligible person

Contributions as an eligible person, which is those who earn less than 10% of their assessable income plus reportable fringe benefits plus reportable super contributions, are able to claim a tax deduction for their contributions to super. This can be a particularly effective strategy where clients have retired during the financial year and have realised some large capital gains. The following example highlights how effective this strategy can be.

Example:

Louise, aged 62, retired in July 2009. To help fund her retirement, she sold her investment property realising a capital gain of \$175,000.

She has just been to see her financial adviser who suggested she make a concessional contribution to superannuation to reduce some of the tax she may otherwise be liable to pay.

| | No super contribution | Super contribution |
|---|-----------------------|--------------------|
| Assessable capital gain | \$175,000 | \$175,000 |
| Contribution to super/deduction | Nil | \$50,000 |
| Contributions tax | Nil | (\$7,500) |
| Taxable income | \$175,000 | \$125,000 |
| Tax on taxable income (including medicare levy) | (\$56,575) | (36,825) |
| Net package | \$118,425 | \$130,675 |

As a result of taking his advice she has saved \$12,250 in tax for this financial year.

► Gear (where appropriate)

The reduction to the contribution caps this financial year has left a lot of clients with both surplus cash flow and a potentially higher tax liability. When combined with the renewed faith in the domestic economy, there appears to be an increased interest in the gearing options available to clients.

This strategy works best for clients on high marginal tax rates who want to negatively gear their investment portfolio (basically their costs exceed their expenses which effectively reduces their assessable income). Remember that interest can be pre-paid and that most associated expenses are generally deductible.

What options are available?

Gearing can take a number of forms, from investing in direct property with an investment loan, taking a margin loan over equities or managed funds, to a more packaged approach with a structured product. The main thing to ensure with any gearing strategy is that the client understands the risks involved and is driven by the investment and not the potential tax benefits.

It is also important to ensure clients have adequate liquidity to meet rising interest costs and/ or margin calls. Clients who are seeking to gear without the risk of a margin call can achieve this through a geared managed investment scheme. If they are seeking the additional benefit of capital protection, they may benefit from an investment in a structured product. The following example highlights the upfront tax benefit investing in a geared investment like a structured product can provide.

Example:

Sophie earns \$250,000 per annum and is looking to invest a portion of it and also reduce her tax liability. She invests \$200,000 through Perpetual Protected Investments – Series 4 (PPI4) using the 100% geared option.

| | Without PPI4 | With PPI4 |
|---|--------------|------------|
| Salary | \$250,000 | \$250,000 |
| Income from PPI4 | - | - |
| Less deductible interest (pre-paid at 30 June for 2010/2011) | - | (\$18,820) |
| Taxable income | \$250,000 | \$231,180 |
| Tax payable (including Medicare levy) | \$91,099 | \$82,348 |

As a result of making the investment she has \$200,000 invested in the market and has achieved a net tax saving of \$8,751 in this financial year.

This analysis has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL 234426 Perpetual Superannuation Limited (PSL) ABN 84 008 416 831 AFSL 225246 RSE L0003315 for the use of financial advisers only, it is general information and is not intended to provide you with financial advice. The technical interpretations expressed in the article are the opinions of the author at the time of writing and do not constitute a recommendation to act. Any information referenced in the article is believed to be accurate at the time of compilation and is provided by Perpetual in good faith. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.



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