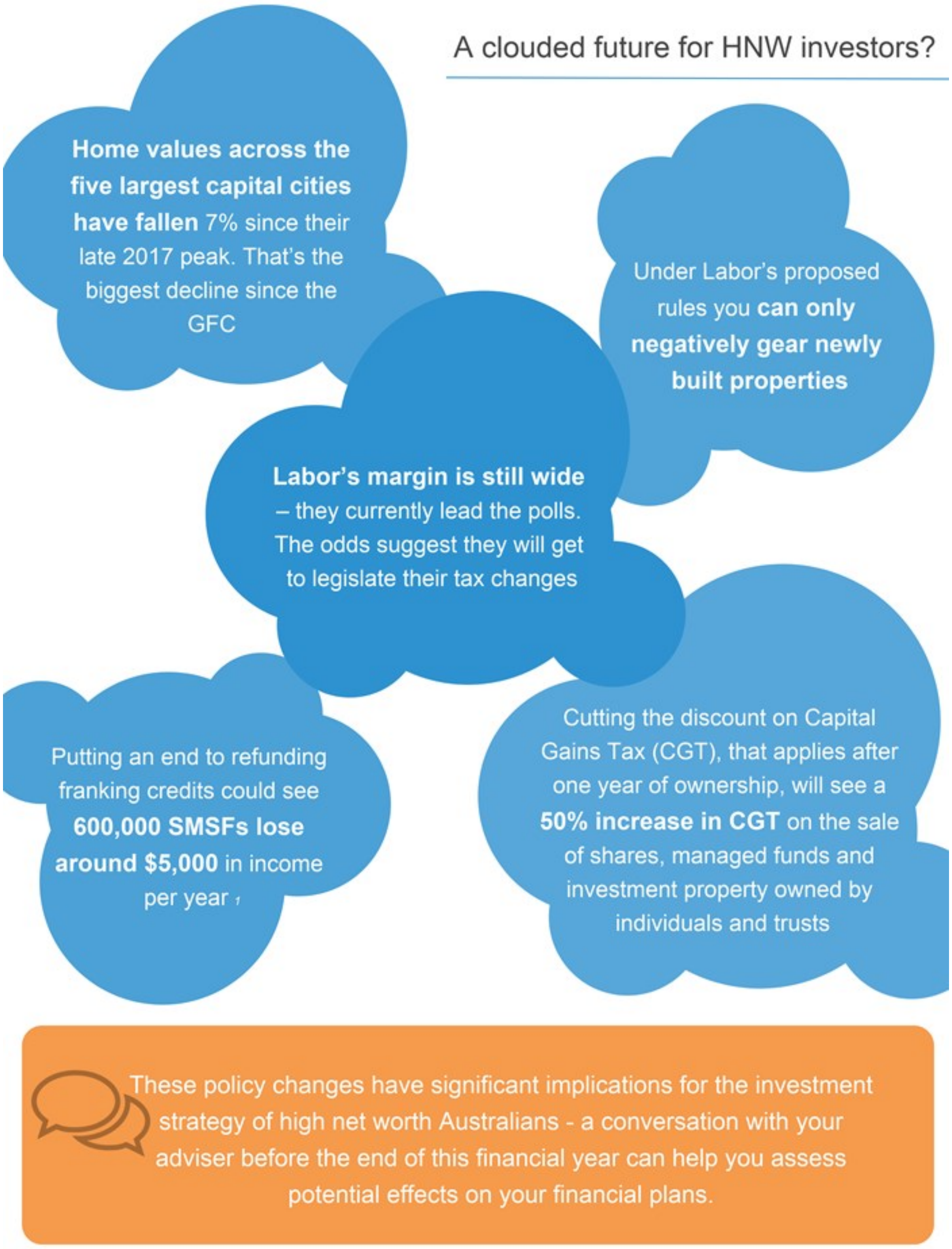
TAXES, PLUCKING, HISSING AND THE 2019 ELECTION

PERPETUAL PRIVATE INSIGHTS
04/03/2019

In the 1600s, French Finance Minister Colbert said: “The art of taxation is in plucking the goose to procure the largest quality of feathers with the least possible amount of hissing.” As a tax-focused election looms, we look at the plucking and hissing and implications for high net worth Australians

In this article, we look at how policy proposals affecting franking credits and property investment are shaping – and being shaped by - shifts in the investment environment.



This article, including any assumptions and conclusions, is not intended to be a comprehensive statement of relevant practice or law that is often complex and can change.

Have the election odds stopped Shortening?

January brought the Coalition a two-point Newspoll bump. However, polls often lean towards the sitting government over quiet political periods like Christmas. Labor's margin is still wide. In late February, Newspoll had their lead at 53-47. The odds suggest they will get to legislate their tax changes. Let's look again at two of the biggest changes – and some of the implications if you're a high income earner or use income from investment assets to pay the bills.

To be franking?

Labor proposes to end the refunding of franking credits to those paying low or no tax. Whilst charities and age pensioners are exempt, this measure will hit self-funded retirees and Self Managed Super Fund (SMSF) members who rely on franking credit refunds for income in retirement. RSM Financial Services Australia recently suggested that 600,000 SMSFs could lose around $5,000 in income per year[1].

As an election nears, the policy is under scrutiny. Will Labor water down the policy? It appears unlikely. Shadow Treasurer Chris Bowen calls the existing tax structure, a concession which "now costs the budget more than $5 billion dollars a year"[2].

The potential arrival of this tax change is already having some interesting outcomes. Some listed companies are trying to ensure they can maximise the franking benefits paid to shareholders. Opponents of the policy suggest it could push investors further up the risk curve in search of income. Others argue that the revenue gains will be illusory as some self-funded retirees will simply sell down assets and access the age pension instead.

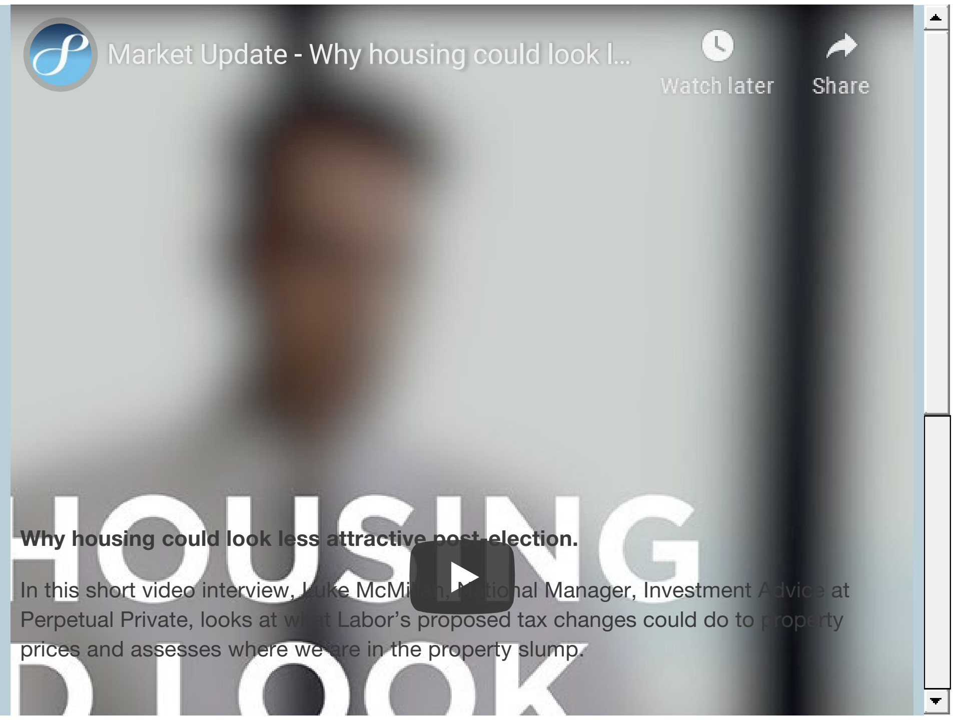
If you're an investor who relies on franking credit refunds for additional income, it may be time to talk to a Perpetual adviser. Whilst the tax changes are many months from being legislated (if this occurs at all), good advice could help you avoid moves that could adversely affect your income, estate planning or risk profile.

The negative gears are grinding

Labor's proposed changes to negative gearing policy are designed to improve housing affordability by reducing the "crowding-out" they believe occurs when tax-advantaged property investors compete with families for housing. Under their proposed rules you can only negatively gear newly built properties. However, they will "grandfather" properties acquired before the policy implementation date – i.e. if you bought a property prior to that date your tax benefits would not be affected.

Australia is a property-obsessed country, so these moves were always going to be pored over. This is especially true given recent moves in the housing market which have been affected by tighter credit conditions and more demanding bank lending practices:

- Luke McMillan, National Manager, Investment Advice at Perpetual Private notes home values across the five largest capital cities have fallen 7% since their late 2017 peak. That's the biggest decline since the GFC.
- Corelogic's national index has fallen over 13 of the past 15 months[3].
- Prices in Sydney are down 9.7% since January 2018 and Melbourne prices down 8.3%[3].



In addition to negative gearing changes, Labor is proposing to cut the discount on Capital Gains Tax (CGT), that applies after one year of ownership, from 50% to 25%. That's a 50% increase in CGT on the sale of shares, managed funds and investment property owned by individuals and trusts. As this CGT change has the potential to make owning investment property less attractive there are predictions that the policy could exacerbate property price falls.

RiskWise Property Research for example, predicts a Labor win could see house prices slumping a further 9% in Sydney and Melbourne[4].

Obviously, falls of this level could have significant implications for property owners – and not just Baby Boomers and Gen Xers who have much of their wealth bricked up in property. It's potentially likely to reduce the value of the property passed on to family members.

The advice implications

These policy changes have significant implications for the investment strategy of High Net Worth Australians. They could affect estate planning strategies as well as your approach to negative gearing into property to build long-term wealth. It's also likely to make buying residential property within your SMSF less attractive – indeed there is already evidence of investors turning away from this strategy.

Proposed policy is not policy

Getting advice on these proposed changes is prudent – all smart investors try to prepare for events that could affect their returns. However, making major strategic moves *now* may not be wise. There are a range of hurdles that need to be jumped before these policies start affecting your portfolios:

- Labor needs to win the election.
- Enacting this platform will also require passage of the Senate. That would almost surely involve significant horse trading with minor parties and Independents (the last time a Federal Government enjoyed a Senate majority was during the Howard years).
- If there was a Labor victory and the Senate was willing to pass the legislation, there would be a substantial period of legislative drafting and negotiation as well as industry and community consultation.

However, talking to an adviser about the long-term potential effect of these changes should form part of your next annual review. If your investment strategy relies heavily on property assets or franked income, a conversation with a Perpetual adviser before the end of this financial year can help you assess potential effects on the financial plans you've created to build your own wealth and protect the future lifestyle of your family.

We'll keep you up to date with the latest moves on these issues in the next few months – watch out for our Budget update in April. It's quite possible the Government will announce its own policy changes in the last Budget before the election.

1. https://www.afr.com/news/politics/labors-franking-plan-unfair-to-smsfs-likely-to-drive-industry-fund-membership-20190130-h1antk
2. https://www.chrisbowen.net/issues/labors-dividend-imputation-policy
3. https://www.corelogic.com.au/news/january-home-value-index-results-signal-weak-start-housing-market
4. https://www.riskwiseproperty.com.au/News/labor-taxation-changes-impact-existing-property

DO YOU HAVE THE RIGHT INVESTMENT AND TAX STRATEGY?

Crafting an effective investment and tax strategy doesn't have to be daunting. It starts with a simple conversation about your current circumstances and future goals. Perpetual's expert financial advisers can then build an investment and tax strategy calibrated to your unique needs.

GET IN TOUCH

Perpetual Private advice and services are provided by Perpetual Trustee Company Limited (PTCo) ABN 42 000 001 007, AFSL 236643. This information was prepared by PTCo. It contains general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable for your circumstances. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. The information is believed to be accurate at the time of compilation and is provided in good faith. This article may contain information contributed by third parties. PTCo do not warrant the accuracy or completeness of any information contributed by a third party. Any views expressed in this article are opinions of the author at the time of writing and do not constitute a recommendation to act. No company in the Perpetual Group (Perpetual Limited ABN 86 000 431 827 and its subsidiaries) guarantees the performance of any fund or the return of an investor's capital. Past performance is not indicative of future performance.