

# BLA BLA BLA

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Market update

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Clearly, 2008 was a year that most would rather forget. Failures in the US banking and insurance industry, coupled with a world economy sliding into recession, saw the largest annual falls in investment markets in a generation.

Year 2009 is off to an interesting start. The media continues to argue the positive and negative sides of the coin. The fate of General Motors and Chrysler in the US, damming updates from the International Monetary Fund, and ever-increasing world budget deficits paint a continuing bleak picture for 2009. Against this, some of the major US banks are returning to profitability, with suggestions that they will start repaying funds received through the Troubled Assets Relief Program over the next few months. Not surprisingly, the popular view within the media is still that there will be an economic recovery in late 2009 or early 2010, with continued volatility until then.

For investors who have held a long-term position, there is little to do other than maintain this approach, tweaking their portfolio as necessary. For those waiting to invest, or those who went to less defensive portfolios in 2008, the question is now one of picking the right time to get into the markets.

This timing becomes important given the alternatives available. In response to the slowing economy, the

Reserve Bank Board has cut official cash rates from 7.25% last September to 3% in April 2009. These cuts have been feeding through the deposit taking institutions, with most online cash accounts now paying around 2-2.75% annual interest. With annual inflation still running above 3%, staying in cash at these low rates is not a long-term option.

Clearly, when markets are declining, earning 2.75% in the safety of a cash account is desirable. But when markets are in a genuine recovery, far greater returns are available away from the safety of cash. One of the greatest risks for a cash investor is to stay in cash for too long, thus missing the early (and often most dramatic) aspect of a recovery.

The graph below shows the performance of the Australian All Ordinaries (AORD) and the US Dow Jones Industrial Average (DJI) over the past six months. The two lines continue to demonstrate a high degree of correlation. Of particular interest is the V-type movement of the indices over the past few months.

The US market touched its current bottom of 6547 on 9 March 2009. The Australian market's current bottom of



3125 occurred a few days earlier, on 4 March. Since then (until the time of writing), the US market has gained approximately 24% and the Australian market around 20%.

The most important term here is *current bottom*. Over the last 12 months we have seen numerous false starts, where the market appears to have bottomed, starts to move ahead, and then heads south again. You will be familiar with the concept of a dead cat bounce, where it is said that even a dead cat will bounce if it is dropped from high enough.

Clearly, if the current movement in the market is another dead cat bounce, we should not be too excited about moving into the market just yet, as a new bottom could well be around the corner. On the other hand, if early March really was *it* in terms of the market bottom, then sitting in cash for an annual return of 2–2.75% is clearly not the place to be.

This shows the difficulty of trying to move in and out of the market. There is always a risk of being caught with your pants down, that is, having too much exposure to a market when it falls. But on the other side, there is the risk of being caught with your pants up – not having enough exposure to the market when it rises.

This differential is substantial when you consider the movement of investments with a pure market exposure. For example, we have seen increases of up to 50% in unit prices of Australian geared share funds over the six-week period from 4 March to 17 April. These gains are welcome news for investors who saw significant falls in these investments through 2008.

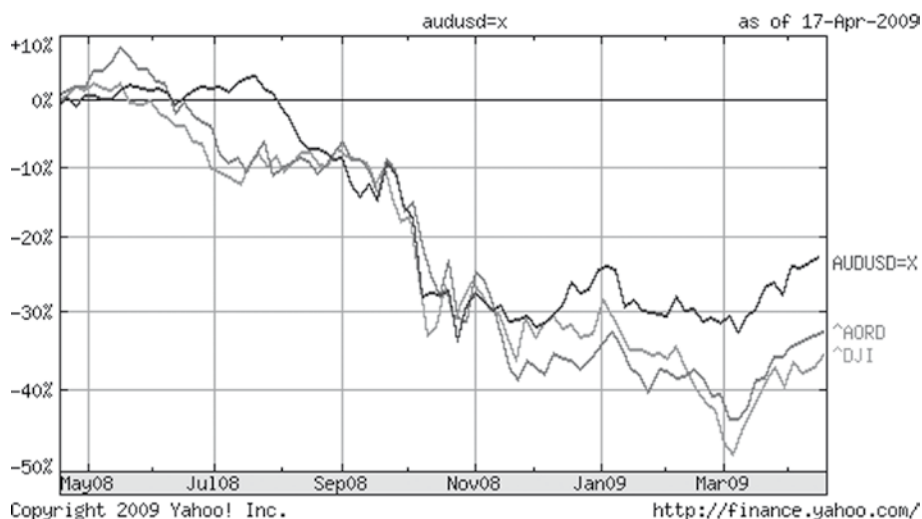
However, investing is like a wok full of marbles. You pull one marble out of the middle, and they all

change. Over coming months we have a Federal Budget and the growing possibility of a double dissolution election. These, together with countless other factors, could have a huge impact on the Australian economy and, along with it, the Australian share market.

It is also imperative to remember that the Australian share market makes up less than 2% of the world share market, so overseas factors will have a huge bearing on the state of our economy, and our share market.

One such factor is the state of the Australian dollar (\$A) against the US dollar (\$US), the yen and the euro. Although travellers bemoan the fact that the \$A buys far less foreign currency than it did a year ago, the falling \$A did help cushion falling share values held in overseas currencies. The risk now is that the \$A will continue to appreciate against other currencies, reducing the value of overseas assets. This means that right now, holding Australian shares carries the risk of shares prices falling, while holding international shares carries this risk, plus the additional risk of the \$A appreciating. How likely is this second risk?

The graph below shows a very strong correlation between the movement of the \$A (measured against the \$US (AUDUSD=X) and the Australian (^AORD) and US (^DJI) share markets. The graph clearly shows that the \$A declined in line with the share markets over the period July to November 2008, before stabilising over the period



to March 2009. Just as March was a good month for share markets, so too it was a good month for the \$A, which appreciated against the \$US and most other major currencies.

Between 9 March and 13 April, the \$A went from buying \$US0.63 to \$US0.73. It also went from 0.5013 to 0.5523 euros and from 62.4 to 73 yen. With little exception, the \$A was on the rise across the board. This appreciation, in an unhedged international share fund, would have produced a reduction in fund balances of around 15%. So although March was a good month for share markets around the world, a large part of these (international) gains would have been wiped out by the rising \$A. Those holding Australian assets in \$A were of course not affected by this rise.

There are perhaps two main reasons why the \$A has experienced such volatility over the last year.

1. In times of turmoil, investors follow a flock to safety approach. It is true to say that the \$A is not one of the world's major currencies, so it is understandable that it was sold down in preference to the euro, yen and \$US.
2. The \$A is largely still seen as a commodities currency. A slowing world economy meant that consumer demand would reduce, meaning less demand for commodities and therefore the \$A.

One could argue that these factors are now working in reverse. With considerable easing of pressure within the international financial system, the flock to safety element has eased. Additionally, with interest rates in Australia still comparatively high compared to those overseas (effectively, the US, Japan and the UK have zero rates of interest), overseas investors now see the \$A and the Australian banking system as being 'worth the risk'.

The March rise in share markets appears to be built on a growing confidence that there may be light at the end of the tunnel. As mentioned above, media reports suggest that world economies could recover by the end of 2009. If this is the case, demand for raw materials could push the \$A higher over coming months as the \$A effectively rides up any economic recovery. The reason why the \$A nearly reached parity with the \$US in 2008 was because of the

minerals boom. It is not impossible that a similar future demand for resources could again spark significant demand for the \$A.

So, what does this mean for our recommendations?

The volatility of the share market can swing both ways. As can be seen above, markets can turn very quickly. January and February were very gloomy months from a financial perspective, with markets in a daily downward trend. However, March and April (to the time of writing) have shown a significant rebound.

There is a wise old saying that likens investors to cavemen. They want to be out chasing the woolly mammoth when the sun is shining, but tucked up securely by their fire when night falls. It is not unnatural to want to be out there in the market when it is going well, but to be tucked back in the safety of a government guaranteed bank account when markets behave badly.

It would be an extremely courageous individual to state that this current rebound is definitely the return of the good times, but neither can this thinking be disregarded. We believe that there are still risks in holding too many international assets within the portfolio, for fear that the \$A may continue to rise with any international economic recovery. In terms of overall portfolios, however, we encourage the continued discipline of the three bucket portfolio, in order to avoid the possibility of compounding the poor results of 2008 by being caught with your pants up.

# DON'T THROW OUT THE BABY WITH THE BATHWATER

Over the last few months we have seen a number of clients reducing or stopping their salary sacrifice arrangements because of the falling returns inside their superannuation fund. We liken this to throwing the baby out with the bathwater. There are several ways to consider this.

In the first instance, it is important to remember that there are two aspects associated with salary sacrifice.

The first part is the tax saving created. The reason why people salary sacrifice is to take advantage of the arbitrage that exists between personal tax rates and salary sacrifice tax rates. This is best seen in the table below.

Taxable income	PAYG tax rate (%)	Salary sacrifice tax rate (%)
\$0–\$6000	0	15
\$6001–\$34 000	15	15
\$34 001–\$80 000	30	15
\$80 001–\$180 000	40	15
\$180 001+	45	15

For every \$100 earned above \$80 000, an individual keeps \$60 (\$58.50 once Medicare is included) from their net pay. Alternatively, if this \$100 is salary sacrificed into superannuation, only 15% tax will be payable, leaving a net \$85. Quite clearly, a net \$85 is a far better result than a net \$58.50, hence the initial attraction to the salary sacrifice strategy. Where individuals have become disheartened with the strategy is that this net \$85 has become a lower number, as their superannuation fund falls in value in line with the global financial crisis (GFC).

This is where it is important to remember the second part of the salary sacrifice strategy, namely, that you can define the investment strategy to be used, thus controlling what happens inside the fund.

For example, it is possible to instruct your superannuation fund to place all new salary sacrifice money in cash. This means that the \$85 net salary sacrifice money will

effectively sit inside a bank account in the superannuation fund, earning cash rates of interest (currently around 2%). This is not exciting, but it ensures that the tax advantage gained from salary sacrifice is not lost through investment returns.

Of course, this proves to be a very negative strategy when the markets do rise. As mentioned earlier in this newsletter, March and April (to the time of writing) have been strong months in the share market, with most superannuation funds experiencing good returns. The \$85 sacrificed into a balanced fund in early March bought units in that fund at a cost that is significantly lower than the units they purchase today. Thus, depending on the investment strategy within the fund, the \$85 sacrificed in early March could now be worth anything between \$90 and \$127.

One of the valuable features often overlooked with salary sacrificing is the fact that it is a graduated form of investment. By sacrificing into superannuation on a fortnightly basis, you are buying units in the fund at a fortnightly price. This concept, known as dollar cost averaging, takes away the risk of buying into any one market on the one day.

Some individuals have reacted to the GFC by salary sacrificing into cash, with a view to switching it into a second or third bucket portfolio at a later date – when things improve. This may be an easy thing to do now, but as the cash build up, it gives rise to a bigger decision – when do I shift?



## WATCH THE \$50K AND \$100K CONCESSIONAL CONTRIBUTION LIMITS

As the end of the financial year approaches, we urge those of you who are maximising your salary sacrifice strategies to ensure that you do not over-contribute, as harsh financial penalties apply.

A person who is 50 years of age or over during 2008–09 (or turns 50 during the financial year) can contribute a maximum amount of \$100 000 in concessional contributions. For a person aged below 50, the maximum is \$50 000.

It is important to appreciate that concessional contributions are not just salary sacrifice contributions, but include:

- salary sacrifice contributions
- superannuation guarantee contributions, and
- productivity superannuation payments.

Take the example of Ted, who is aged under 50. He has a salary of \$125 000 and sits on a tribunal, for which he is paid \$30 000 a year plus the 9% superannuation guarantee.

As Ted is under 50, his maximum concessional contribution limit is \$50 000. From his salary of \$125 000, he receives productivity superannuation (shown as EPSC on his payslip) of 2% (\$2500). From the tribunal, he receives superannuation guarantee payments of \$30 000 x 9% (\$2700). Thus Ted already receives concessional contributions of \$5200, so the maximum he can add through salary sacrifice is \$44 800. If Ted salary sacrifices more than this, only the first \$44 800 will be taxed at 15%, and the residual will be taxed at 46.5%.

After-tax contributions (like those made to the CSS and PSS) are considered to be non-concessional contributions, and are therefore subject to a different limit (\$150 000 per financial year).

## THE REDUCTION IN ALLOCATED PENSION PAYMENTS

In February this year the government announced that it would halve the minimum pension requirements from account-based pensions (allocated pensions). As holders of allocated pensions will be aware, there is a minimum withdrawal requirement each financial year, based on your age and the balance of the fund at 1 July each year.

Take the example of where an allocated pension recipient was aged 60 on 1 July 2008 and their account balance (on that day) was \$300 000. Their minimum pension payment throughout the 2008–09 financial year was \$12 000, as persons aged 55–64 (inclusive) had to withdraw a minimum 4% of their account balance.

With the government announcement in February this year, the minimum payment became 2% (half of 4%), so the minimum they were required to withdraw was now only \$6000.

If this person receives their pension payment once a year (say in June), it is simply a matter of notifying the fund to pay \$6000 in June, rather than \$12 000. However, if the \$12 000 is paid in \$1000 monthly installments, the individual would already have received \$8000 in monthly payments by the time the government announcement was made. Given that this is above the new minimum of \$6000, the individual has the option of stopping the pension payments for the remaining four months.

The logic behind the reduction is effectively to allow individuals who do not need the money to maintain a higher balance in their pension accounts. The government stressed that it took this measure because it appreciated the negative impact of the GFC on pension account balances, and that, at this stage, the reduction would apply only in 2008–09.

We regard it as highly possible that the arrangements will be extended to next financial year as well. In spite of the promising rebound in March–April, account balances will be lower than they were last July, remembering that the major falls associated with the GFC occurred in September–November 2008. Given that the pension funds have now put these administrative arrangements in place, it would appear short-sighted, under current financial conditions, for the government to not extend them into 2009–10.

Regardless of whether or not the reduced minimums will be maintained, the minimum payment for 2009–10 will be different to the current minimum. As the minimum pension is calculated on the account balance on 1 July each year, the minimum pension is likely to be lower this year, notwithstanding there are still two months for a possible recovery.

Importantly, this is only the minimum pension. The reduced minimum does not mean that you must take a reduced income, as you are free to receive an income above the minimum.

We will be in touch with more detail when it becomes available.

# NEW SUPERANNUATION LAWS APPLYING TO NON-RESIDENTS

Last December the Australian Government passed a new law which prevents all temporary residents (past, present and future) from leaving their superannuation in Australia when they leave. Under the new legislation, temporary residents are required to cash in their superannuation within six months of leaving, or the Australian Taxation Office (ATO) will seize the money and hold it in a 0% interest account until it is claimed. Regardless of whether the funds are claimed by the non-resident, or seized by the ATO, a 35% Departing Australia Superannuation Payment is due on the entire balance. This payment is in addition to the 15% contributions tax paid on entry to the fund.

Previously, the same rules applied to temporary residents and citizens, so temporary residents could top up their superannuation and leave it in Australia until retirement without incurring additional tax.

Several comments can be made about this legislation.

1. It will provide the government with an estimated \$800 million in income in the current financial year.
2. The effective tax rate (15% on entry and 35% on exit) means that a non-resident is paying tax on their superannuation akin to an individual with a taxable income of more than \$180 000.
3. The ability to leave the money inside superannuation until age 60 (at which point a lower tax rate applies) now disappears. The 35% tax is applied when the money is transferred to the ATO, six months after the non-resident's departure.
4. The 0% interest in the ATO account speaks for itself.
5. The retrospective nature of this legislation means that many individuals who have previously left the country will have no way of knowing that their superannuation benefits are now being taxed at 35%, and being transferred to the ATO to earn 0%.
6. The timing of the legislation is now forcing non-residents to pull out of their superannuation funds at a time when the market is significantly down. There is no opportunity, outside of six months, to let their funds ride out the turbulence.

The message for non-residents who intend leaving Australia is very clear. They should contribute the minimum amount possible to superannuation and ensure that it is paid to a cash investment strategy.

# SAME-SEX RELATIONSHIPS COMMONWEALTH LAWS

*The Same-Sex Relationships (Equal Treatment in Commonwealth Laws – Superannuation) Act 2008* received Royal Assent on 4 December 2008.

The Act amends the *Superannuation Industry (Supervision) Act 1993* ('SIS Act'), making it easier for regulated super funds to recognise same-sex relationships from 1 July 2008. The legislation removes discrimination in areas including superannuation, social security, taxation, Medicare, veteran's affairs, workers' compensation, and educational assistance.

## Effects of the legislation

From 1 July 2008:

- The definition of 'spouse', 'child' and 'relative' in the 'SIS Act' and other super legislation has been extended to include same-sex partners and their children.
- The definitions of 'dependant' and 'spouse' in the income tax laws have been amended to include same-sex partners and their children for anti-detriment payments made by a super fund.
- Same-sex partners and their children are treated as dependants for the purposes of the taxation of superannuation death benefits and death benefit termination payments.

The changes to the legislation impact on the following areas:

## Death benefit payments to dependants

### Lump sum death benefit

The dependants of a person in a same-sex relationship will now be able to receive a lump sum death benefit tax free if they qualify. The final decision on whether to pay super death benefits to a dependant rests with the fund's trustee, and is subject to the fund's governing rules and legislative provisions.

### Death benefit as an income stream

The dependants of a person in a same-sex relationship may now qualify to receive a death benefit as an income stream. The tax treatment depends on:

- the deceased member's age at the time of death

# IPS (EQUAL TREATMENT IN VS-SUPERANNUATION)

- the dependant's age at the time of the deceased member's death
- whether the fund was a taxed or untaxed fund.

For an Australian Government superannuation pensioner this legislation will ensure that a same-sex spouse will receive 67% of their spouse's pension, for the rest of their life, following the death of the superannuant.

## Anti-detriment deduction

If a member of a same-sex relationship dies after 1 July 2008, their fund can now pay their super entitlements to a qualifying dependant in a lump sum.

This payment may include an additional payment of any contributions tax that the fund had paid on taxable contributions made into the member's account.

The additional payment (also known as an 'anti-detriment' payment) may give rise to a deduction to the fund under the income tax laws.

## Death benefit termination payments

A death benefit termination payment paid to a dependant of a person in a same-sex relationship is taxed the same as if paid to a dependant of a person in an opposite-sex relationship.

## Spouse contributions

A member of a same-sex couple will now be able to make contributions to their partner's super. The contributions (known as spouse contributions) are to be treated as non-concessional contributions, and the super fund should not pay income tax on the contributions.

## Excess contributions tax

If a member of a same-sex couple makes contributions on behalf of their spouse, these contributions count towards their spouse's non-concessional contributions cap. If the spouse's total non-concessional contributions exceed the spouse's non-concessional caps, the spouse may have to pay excess contributions tax at the rate of 46.5% on their excess non-concessional contributions.

## Contributions splitting

People in a same-sex relationship can now apply for contributions splitting. 'Contributions splitting' allows a super fund member to apply to their fund to transfer certain concessional contributions made for the member's benefit (commonly employer contributions) to their spouse's super account. This allows the member to boost their same-sex spouse's retirement savings.

Despite being transferred to the spouse, these split contributions will all continue to count towards the member's own concessional contributions cap, rather than that of their spouse.

## Self-managed super funds (SMSFs) lending money or providing direct financial assistance

SMSFs are prohibited from lending money or providing direct or indirect financial assistance (including the provisions of credit) from the SMSF to a member or a member's relative. A member's relative includes a member's spouse or a member's (or spouse's) child.

Prior to 4 December 2008, a spouse included a de facto spouse - that is, another person who, although not legally married to the person, lived with the person on a genuine domestic basis as a husband or wife of the person. This did not include those in same-sex relationships.

From 4 December 2008 a spouse includes:

- another person (whether of the same sex or a different sex) with whom the person is in a relationship that is registered under a law of a State or Territory
- another person who, although not legally married to the person, lives with the person on a genuine domestic basis as a couple.

## Centrelink benefits

From 1 July 2009 Centrelink will recognise same-sex relationships affecting both members of same-sex couples and children of same-sex relationships. A person affected by the same-sex amendments should advise Centrelink so Centrelink can, where appropriate, re-assess the person's benefits.

# 2009/10 CONTRIBUTION LIMITS AND BENEFIT CAPS

The Australian Taxation Office has released the contribution and benefit caps that will apply in the 2009/10 financial year. These caps relate to superannuation contributions and benefits, and employment termination payments.

Other rates and thresholds such as the co-contributions thresholds, tax-free redundancy amounts and the maximum contribution base for superannuation guarantee purposes are likely to be released in early June.

	2008/09	2009/10
Low rate cap <sup>1</sup> (for lump sums paid from taxed schemes)	\$145 000	\$150 000
Untaxed plan cap <sup>1</sup> (for lump sums paid from untaxed schemes)	\$1 045 000	\$1 100 000
Employment Termination Payment (ETP) cap <sup>1</sup>		
· Life benefit termination payments	\$145 000	\$150 000
· Death benefit termination payments	\$145 000	\$150 000
Transitional ETP cap (until 30/6/12)		
· Lower cap amount <sup>1</sup>	\$145 000	\$150 000
· Upper cap amount <sup>2</sup>	\$1 000 000	\$1 000 000
Concessional contributions (CC) cap		
· Under age 50 <sup>1</sup>	\$50 000	\$55 000
· Over age 50 (until 30/6/12) <sup>2</sup>	\$100 000	\$100 000
Non-concessional contributions (NCC) cap <sup>3</sup>	\$150 000	\$165 000
Capital Gains Tax cap <sup>1</sup> (lifetime limit for eligible business owners)	\$1 045 000	\$1 100 000

1 These thresholds are indexed in line with movements in Average Weekly Ordinary Times Earnings (AWOTE) in increments of \$5 000 (rounded down).

2 This cap is not indexed.

3 This cap is equal to three times the CC cap. People under age 65 can take advantage of the 'bring forward' provision in 2009/10 by making NCCs of up to \$495,000 over a three-year period.

# NEW 'INCOME' DEFINITION FOR GOVERNMENT BENEFITS

Legislation to amend the definition of 'income' for various tax levies, offsets and Government benefits has recently been passed by Parliament. These changes take effect from 1 July 2009 and could result in higher taxes and/or the loss of benefits for some BL&A clients.

## Background

Under the current rules, there is no consistent definition of 'income' when assessing a person's eligibility for Government benefits and tax offsets, or their liability for various tax levies. This has allowed many people to structure their affairs (eg through salary sacrifice or negative gearing) to qualify for benefits that would otherwise not be available to them if their full remuneration and investment losses were taken into account.

Similarly, the current income test arrangements are unfair to many people who do not have the ability to package their salary.

To overcome these equity issues and provide more consistency, the Government announced in the 2008/09 Federal Budget that it would amend the definition of 'income'. After a period of industry consultation, legislation has now been made to amend the income tests for various Government benefits, tax offsets and levies to broadly include:

- Assessable income (or Taxable income),
- Reportable fringe benefits (or adjusted fringe benefits),
- Reportable super contributions, and
- Total net investment losses.

These changes will apply from 1 July 2009 (ie in respect of the 2009/10 financial year onwards). It is important to note, however, that the actual definition of income for each benefit, tax offset or levy will not always align with the above components.

For example, some income tests are based on family income (rather than personal income) and may include a modified definition of both reportable fringe benefits and reportable super contributions. Furthermore, in some

cases, other items will be included in the income test, such as tax-free benefits paid from a taxed super scheme for the Commonwealth Seniors Health Card.

Before summarising what is (and isn't) included in each income test, it's worth examining the newly introduced concepts of 'reportable super contributions', 'total net investment losses' and 'adjusted fringe benefits' in more detail.

## Reportable super contributions

Reportable super contributions for a particular income year will basically comprise the following:

- 'Reportable employer super contributions' (including salary sacrifice and certain other employer contributions), and
- Personal deductible contributions.

## Reportable employer super contributions (RESCs)

RESCs need to be identified by employers and included on an employee's Payment Summary.

RESCs are broadly defined as super contributions made by an employer (or an associate of the employer<sup>1</sup>) on behalf of an employee where the employee has, had or might reasonably be expected to have:

- The 'capacity to influence' the size of the amount contributed, or
- The ability to direct their employer to reduce their assessable income (ie via a salary sacrifice arrangement).

While salary sacrifice contributions will be relatively easy for employers to identify and report, other employer contributions will be more difficult to classify.

As a general rule, given that an employee does not have the 'capacity to influence' mandated contributions (such as Super Guarantee contributions or employer contributions required under an industrial award) these amounts will not be counted as RESCs.

<sup>1</sup> An entity will generally be considered an 'associate' of the employer if it might reasonably be expected that the employer would act in accordance with their directions, instructions or wishes.

However, voluntary employer contributions which exceed the mandated level may be counted, depending on the amount of 'influence' the employee has over the contributions.

The Explanatory Memorandum to the legislation gives a number of examples where an employee might be considered to have the necessary 'capacity to influence' the (additional) employer contributions being made.

This would include situations where the employee is given a choice by their employer as to how their remuneration package is structured (ie they may be able to elect or negotiate to have more employer voluntary contributions paid on their behalf).

## Personal deductible contributions

Personal deductible contributions will also be included in the new definition of 'reportable super contributions'.

The only exception will be those Government benefits that are based on assessable income, such as the Government co-contribution and the spouse contribution tax offset.

This is because the inclusion of the deductible contributions (which is already included in assessable income) would result in double counting. The income test for these benefits will instead include only 'reportable employer super contributions'.

The ATO will obtain details of the client's personal deductible contributions in their annual tax return.

Personal contributions which are not claimed as a tax deduction will not be included in the definition of 'reportable super contributions'.

## 10% test for personal deductible superannuation contributions

Also effective from 1 July 2009 the "10% test" which applies for the purposes of claiming a tax deduction for personal superannuation contributions in a particular income year will include salary sacrifice superannuation contributions.

Individuals who hold an office, perform functions or duties, engage in work, or do other things that cause

them to be treated as an employee for the purposes of the Superannuation Guarantee provisions, must meet the 10% test to claim a tax deduction for their personal superannuation contributions.

That is, for the 2009/10 and later income years, less than 10% of the sum of the following amounts for the year must be attributed to the above listed activities:

- assessable income;
- reportable fringe benefits; and
- salary sacrifice superannuation contributions.

This measure may impact on those unable to fully utilise their concessional contribution cap because of a limitation on the amount they can salary sacrifice, and especially those with an employment arrangement and substantial other assessable income.

## Total net investment losses

Although 'income' for many tax and Government assistance programs currently includes net rental property losses, this concept will be expanded to include 'total net investment losses'.

The revised definition will relate to investments in rental properties, shares<sup>2</sup> and interests in managed investment schemes to the extent that they are subject to an investment loan.

A total net investment loss will arise in an income year where:

- The client's deductions for their financial investments exceeds the gross income from these investments, and/or
- The client's deductions for their rental property exceed the gross income from the rental property.

The total net investment loss is the amount by which the deductions exceed the gross income.

For this purpose, deductions include the costs of borrowing, management fees and allowable rental property expenses, while gross income<sup>3</sup> includes franking credits.

<sup>2</sup> Includes shares in an Australian or foreign company. It is not a requirement that they be listed on a stock exchange.

<sup>3</sup> Although the Act and the Explanatory Memorandum do not provide guidance on 'gross income', we believe it would include franking credits.



## Adjusted fringe benefits

While many definitions of 'income' currently include 'reportable fringe benefits', a modified (or grossed down) version of this concept will apply in relation to the Senior Australians Tax Offset.

The adjusted fringe benefits total can be calculated for an income year using the following formula:

$$= \text{Reportable fringe benefits total} \times (1 - \text{FBT rate})$$

In other words, it is equal to the individual's reportable fringe benefits total multiplied by 53.5%.

This definition of 'adjusted fringe benefits' is currently used in relation to family tax benefits, the baby bonus and the child care benefit.

### Example:

Steve (aged 42) and Wendy (aged 41) are married with two dependent children aged 5 and 7. Wendy is currently not working.

Steve is an employee and receives a total remuneration package of \$135,800 comprising:

Salary	\$100,000
Salary sacrifice contributions	\$20,000
Super guarantee (9%)	\$10,800
Reportable fringe benefits	\$5,000
<b>Total</b>	<b>\$135,800</b>

He has also undertaken a negative gearing strategy in his own name into Australian shares. The deductions from his investment loan (\$12,000) exceed the gross dividend income - including franking credits - from his share portfolio (\$8,571).

As shown in the following table, Steve and Wendy currently receive \$3,551 in Family Tax Benefit – Part A.

This is because their 'income' for this benefit of \$99,246 is below the relevant cut out threshold.

From 1 July 2009, however, Steve and Wendy will not be eligible for any Family Tax Benefit – Part A. This is due to the fact that the revised test for this benefit will now include Steve's 'Reportable super contributions' and his 'total net investment losses'.

	2008/09	2009/10 <sup>4</sup>
Taxable income <sup>5</sup>	\$96,571	\$96,571
Adjusted fringe benefits <sup>6</sup>	\$2,675	\$2,675
Reportable super contributions	N/A	\$20,000
Total net investment loss	N/A	\$3,429 <sup>7</sup>
Income for FTB-A	\$99,246	\$122,675
<b>FTB-A entitlement<sup>8</sup></b>	<b>\$3,551</b>	<b>\$Nil</b>

To determine if you are subject to the Medicare levy surcharge, the definition of 'income' for this purpose will be expanded to include:

- Taxable income<sup>9</sup>,
- Reportable fringe benefits,
- Reportable super contributions, and
- Total net investment losses.

However, while this definition will be relevant in determining whether you are subject to the Medicare levy surcharge, the 1% levy itself will continue to be applied against your taxable income and reportable fringe benefits only.

In other words, where you do not have private health insurance and your 'income for surcharge purposes' exceeds the relevant thresholds (currently \$70,000 for singles and \$140,000 for couples) a 1% levy will apply to the total of their taxable income and reportable fringe benefits.

<sup>4</sup> Assumes that his salary package and gearing details remained unchanged in the 2009/10 financial year.

<sup>5</sup> Calculated as salary of \$100,000 plus assessable dividend income of \$8,571 less allowable deductions of \$12,000.

<sup>6</sup> Calculated as Reportable fringe benefits x 53.5% (ie \$5,000 x 53.5% = \$2,675).

<sup>7</sup> This is the excess of loan deductions (\$12,000) over gross income (\$8,571).

<sup>8</sup> Figures are based on the FTB-A rates current at 20 March 2009.

<sup>9</sup> For this purpose, any amount on which family trust distribution tax has been paid is included in taxable income. In some cases, exempt foreign employment income may also be included.

## Commonwealth Seniors Health Card

Probably the most significant impact to BL&A clients will be in regards to the number of changes to the income test in qualifying for the Commonwealth Seniors Health Card (CSHC)<sup>10</sup> from 1 July 2009.

The first – which has just been passed by Parliament – is to incorporate ‘total net investment losses’, rather than the more narrow definition of ‘net rental property losses’.

The second – which is contained in a separate Bill that is yet to be passed by Parliament – will see the income test expanded to include:

- Reportable super contributions, and
- All benefits paid from a taxed super fund (whether in the accumulation or pension phase).

This last item will include tax-free pension payments and or lump sum withdrawals for clients over age 60, as well as any Tax Free component lump sums paid out to clients under age 60.

The super measures are due to be debated again in the May sittings of Parliament. If the Bill is passed in its current form, it may result in many BL&A clients losing access to the Health Card.

## Assessment of superannuation income and voluntary salary sacrifice to superannuation

The proposed changes mean that all benefits paid from a taxed superannuation fund to a person who has reached age 60, whether as an income stream or as a lump sum withdrawal, will be treated as income for the CSHC.

This includes both the taxable and tax free components of the benefit paid to the member.

Therefore should the proposed legislation pass in its current state any BL&A clients in receipt of a CSHC and planning to draw a lump sum amount within the next 12 months may be better off arranging to withdraw funds before 1 July 2009 otherwise if the withdrawal occurs after 1 July 2009 they may become ineligible for the CSHC.

Similarly, a person who is currently voluntarily salary sacrificing to superannuation will have those amounts assessed as income for the purposes of the CSHC adjusted taxable income test.

Any taxation implications are entirely separate to the CSHC income test.

## Taxed and untaxed sources

Since 1 July 2007, superannuation benefits paid from a taxed source, either as an income stream or as a lump sum, have been tax free for people aged 60 and over. A taxed source is one in which contributions, and earnings on these contributions, have already been taxed at the rate of 15 per cent in the fund. A superannuation income stream with a taxed source can be an account based superannuation pension (also known as an Allocated Pension).

In some superannuation funds no employer contributions are made until the person is ready to retire, and hence no contributions or earnings tax has been paid on this element of the member’s benefit. Employer-funded benefits from these superannuation funds, such as CSS and PSS defined benefit schemes are considered to be from an untaxed source and are already assessed for CSHC purposes. These superannuation pensions are not tax exempt on receipt and continue to be assessed as a person’s taxable income.

### Example 1

#### Eligibility to CSHC Pre 1 July 2009

Henry is 66 years of age and single. He draws an annual pension of \$35,000 from his taxed allocated pension fund. However, Henry’s adjusted taxable income (ATI) is nil as his pension is considered non-assessable, non-exempt income. He is therefore eligible for the Commonwealth Seniors Health Card.

#### Ineligible to CSHC Post 1 July 2009

Henry decides to upgrade his motor vehicle and withdraws \$30,000 as a lump sum from his allocated pension account in August 2009. Unfortunately, Henry’s ATI is now assessed on the \$35,000 allocated pension income plus the \$30,000 lump sum withdrawal benefit, so he will no longer be eligible for the Card as the total amount is above the CSHC single threshold of \$50,000.

<sup>10</sup> The CSHC uses a modified definition of ‘assessable fringe benefit’ which is contained in section 10A.(2) of the Social Security Act 1991.

# THE INS AND OUTS OF THE ECONOMIC STIMULUS PACKAGE

After much debate, the federal government's second stimulus package was passed in the Senate earlier this year with amendments. The Household Stimulus Package (No 2) 2009 Act and the Tax Bonus for Working Australians (No 2) 2009 Act became law on 18 February 2009. The government has also announced other changes that may allow tax deductions for small businesses.

## Tax bonus for working Australians

Eligible taxpayers will receive a one-off tax bonus from April 2009. Despite the fact the government is calling it the "tax bonus for working Australians", a person does not need to have worked or be working to receive this type of bonus. To be eligible, a person must:

- be an Australian resident for taxation purposes,
- have a taxable income of less than \$100 000 in 2007/08,
- have a tax liability for 2007/08,
- lodge their tax return by 30 June 2009, and
- not be a minor with unearned income, unless they are an excepted person.

The amount of bonus will be based on taxable income received in the 2008 financial year and will apply as shown in the table below.

Bonus (\$)	Taxable Income (\$)
900	Up to 80 000
600	Between 80 001 and 90 000
250	Between 90 001 and 100 000

The bonus payment is non-assessable, non-exempt income, which means it is not taxable and does not count as income for the recipient. The Australian Taxation Office (ATO) will automatically make payments of the bonus from April.

## Household stimulus package

The household stimulus package provides one-off bonus payments to low and middle-income households currently entitled to Centrelink benefits. The bonus payments are

## Example 2

### Eligibility to CSHC Pre 1 July 2009

Greg and Mary have combined CSS indexed pensions of \$60,000 per annum plus draw a combined annual pension from their allocated pension accounts of \$30,000. They are both over age 60 so the allocated pension income is not assessed under the current eligibility test for the Commonwealth Seniors Health Card and their CSS indexed pensions are below the couple threshold of \$80,000.

### Ineligible to CSHC Post 1 July 2009

From 1 July 2009, however, Greg and Mary will be ineligible for the CSHC as their combined CSS pensions and allocated pension incomes will exceed the couples threshold of \$80,000.

## Conclusion

The revised 'adjusted taxable income' definition for many Government benefits (excluding Age Pension), tax offsets and levies could mean that some BL&A clients will no longer be eligible for certain benefits or be subject to a higher rate of taxation. It also means that strategies, such as salary sacrificing in order to qualify for Commonwealth Seniors Health Card or a superannuation co-contribution, will no longer be possible.

non-taxable and are not counted as income for social security purposes.

Eligibility for the bonus payments are based on individual's Centrelink entitlements as at 3 February 2009. The Centrelink bonus payments include the:

- single income family bonus,
- back to school bonus,
- farmers' hardship payment, and
- training and learning bonuses.

### Single income family bonus

Single-income families eligible for family tax benefit (FTB) part B on 3 February 2009 will receive a one-off bonus regardless of age of the children. Only one bonus payment per eligible family will be paid regardless of the number of children the family has.

### Back to school bonus

A one-off bonus will be paid per school age child (age 4 to 18) to families who are eligible for FTB part A on 3 February 2009. The bonus will also be available to people who receive the disability support pension or carer payment where the recipient is younger than 19 on 3 February 2009.

### Farmers' hardship payment

A one-off bonus will be paid to farmers and farm-related small business owners who are in receipt of the:

- exceptional circumstances relief payment for farmers and small businesses,
- farm help income support,
- transitional income support, or
- interim income support – payments to farmers and small businesses.

### Training and learning bonuses

A one-off training and learning bonus will be paid to students and people who were eligible for certain income support payments on 3 February 2009. The eligibility for the bonus will be split into a:

- one-off training and learning bonus (those in receipt of youth allowance, Austudy, Austudy living allowance, sickness allowance or special benefit),
- one-off training and learning bonus – family tax benefit (those in receipt of FTB part A with a child aged 21 to 24 who is a full time student),
- education entry payment temporary supplement bonus (Centrelink recipients who normally qualify for the education entry payment or youth allowance looking for work will be eligible to receive a supplement of \$950.

### Amount of household bonuses to be paid

The government has already started paying some Centrelink bonus payments. The table below shows how much individuals can expect to receive, depending on the type of bonus.

Type of bonus	Amount of bonus (\$)
Single income family bonus	900
Back to school bonus	950
Farmer's hardship payment	950
Training and learning bonus	950

### Receiving multiple bonuses

Some people will receive multiple bonus payments. For example, it may be possible for people to receive the tax bonus, as well as some of the Centrelink bonuses. However, a person who is eligible to receive the back to school bonus will not be eligible to receive a training and learning bonus as well.



# COLONIAL FIRST STATE INCOME FUND UPDATE

## Small business and general business tax break

The government has also announced an investment tax break for businesses in the form of an investment allowance. The investment allowance provides:

- an additional tax deduction of 30 per cent of the costs of eligible new depreciating assets acquired under a contract or started to be constructed after 13 December 2008 and before the end of June 2009 and installed and ready for use by the end of December 2010, and
- an additional tax deduction of 10 per cent of the cost of eligible new depreciating assets acquired under a contract, or started to be constructed, between 1 July 2009 and 31 December 2009 and installed ready for use by the end of December 2010.

For both periods, small businesses (with an annual turnover of \$2 million or less) will be able to claim a tax deduction for eligible assets over \$1,000. Other businesses can only claim a tax deduction if they have spent at least \$10 000 on eligible assets.

As all Colonial First State Income fund investors are aware Colonial First State suspended applications, withdrawals and switches effective 3pm 24 October 2008.

On 3 December 2008 all Colonial First State Investment investors only were sent a letter with an offer to make a withdrawal or switch from the Income fund. The withdrawal/switch offer period was open from 3 December 2008 to 31 December 2008.

Up to 20% of Colonial First State Income fund investors elected to withdraw or switch their funds. Based on the cash available in each relevant option/fund and to meet withdrawal/switch requests made during the offer period Colonial First State processed all withdrawals/switches on a proportional basis. All investors received a minimum payment of \$1,000 for all requests, or all of their fund balance if less than \$1,000.

The actual percentage proportion of all withdrawal/switch requests processed are outlined in the table below.

Product/option name	Approximate pro-rata payment amount
FirstChoice Investments Colonial First State Income	48%
FirstChoice Wholesale Investments Colonial First State Income	30%
Managed Investment Funds - Entry Fee Colonial First State Mortgage Income	58%
Managed Investment Funds - Nil Entry Fee Mortgage Income	70%
Bricks & Mortar	100%
Wholesale Guaranteed Mortgage Fund	100%
FirstChoice Personal Super Colonial First State Income	37%
FirstChoice Wholesale Personal Super Colonial First State Wholesale Income	45%
FirstChoice Pension Colonial First State Income	53%
FirstChoice Wholesale Pension Colonial First State Wholesale Income	54%
Rollover & Superannuation Fund - Entry fee Income	39%
Rollover & Superannuation Fund - Nil entry fee Income	45%
FirstChoice Employer Super Colonial First State Income	39%

Importantly last December the above funds had a large investment in cash. However cash levels were reduced in January following income distributions and withdrawal offer payments. The amount of money which is expected to be available to satisfy the second investment withdrawal offer is \$50 million for the Wholesale Investment Income Option and \$3 million for the Investment Income Option or approximately 3% of the fund. This amount is less than the cash available for the previous withdrawal offer. Therefore depending on the number of requests received and amounts requested Colonial First State anticipate paying out lower amounts for the second quarterly withdrawal/switch offer ending 14 April 2009 with payments commencing from Monday 4 May 2009.

The following key points still apply to Income fund investors:

- Income distributions will continue to be paid monthly as usual for investment investors.
- For FirstChoice Pension or FirstChoice Wholesale Pension investors will continue to receive pension payments.

Where super and pension investors requested a withdrawal/switch of 100% prior to a previous cut-off, and where these requests were only partially paid, a 100% withdrawal request will be applied by Colonial First State during the coming window. Where investors previously requested less than 100% and their requests were partially paid, Colonial First State will contact them to clarify their current withdrawal/switch intentions. Super and pension withdrawal/switch requests that are received after 3pm Tuesday 14 April 2009 will be processed in subsequent windows.

The next available quarterly withdrawal/switch offer will be in July 2009.



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