

## 2004 SPRING NEWSLETTER

This newsletter is full of news you can use. Please take a few minutes to look through the various topics covered and make a note of any issues that relate to your circumstances. Feel free to mention this newsletter to relatives and friends who may benefit from our experience.

### **When is tax planning, tax avoidance?**

This subject has been the subject of endless debate ever since the Tax Act and the associated regulations came into being. Part 4A of the Act provides that is an offence to enter into an arrangement that has the dominant purpose of avoiding tax. The critical element is “dominant purpose”. If a taxpayer can point to arrangements that are clearly allowable in other parts of the tax legislation, the general conclusion is that tax avoidance was not the dominant motive.

Since our last newsletter the Australian Taxation Office (ATO) has clarified how it will treat taxpayers who adopt a superannuation re-contribution strategy. In simple terms, this strategy involves withdrawing a lump sum from a superannuation fund at the time of retiring, and paying little or no tax at the time. The funds are then put back into a superannuation fund resulting in a greater tax-free portion of subsequent income streams. The ATO have made it clear that this is not tax avoidance.

### **A new retirement income product gets the green light**

Ever since allocated pensions were approved 10 years ago, the government has been struggling with devising a better form of pension. Allocated pensions suit many people, but they do not meet the strict rules that apply to “complying pensions”. Complying pensions provide investors with significant planning opportunities if they have an assets test problem that reduces their age pension, or if they have a large superannuation benefit that exceeds the lump sum Reasonable Benefit Limit (RBL).

The existing range of complying pension products are all based on cash and fixed interest investments. In times of low interest rates the rates of return are relatively poor, and the rate once set, does not vary.

The new “growth” pension regime that will be ushered in from the 20<sup>th</sup> of September 2004 provides for a pension product based on growth investments that can include shares and real estate investments. Over the long term shares and real estate typically produce superior returns.

Growth pensions are complex in many ways and each case requires careful research. Life expectancy plays a critical part in the new regime, and investors can select a term based on their life expectancy at the time the pension commences, or life expectancy plus an extra five years. The term selected then determines the annual pension factors used to calculate the annual pension that must be taken. There are no minimum or maximum factors that apply to allocated pensions. Taxpayers who pass away before the end of the selected term of the pension, do leave a residual capital sum to their beneficiaries or estate.

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The new growth pensions are treated as complying pensions, and from the 20<sup>th</sup> of September 50% of the capital invested will be exempt from the age pension assets test. Taxpayers who have a RBL problem can use these new growth pensions to take advantage of the higher pension RBL.

We have developed software that enables us to devise planning strategies that maximise client outcomes using these new products.

### **Did you know?**

The Australian retirement savings market is the fifth largest in the world when measured by asset value. With more than 90% of the working population now covered by superannuation, the money invested in superannuation in Australia exceeds \$550 billion. In ten years time the figure is projected to be \$1,300 billion.

### **New ruling on residential rental property**

A new draft ruling from the Australian Taxation Office has increased the number of items that can be depreciated, and in some cases changes have been made to the period of time over which deductions can be claimed for certain items.

While the changes may benefit some taxpayers, others will find that claims made in the past are no longer allowable. There are two broad categories of allowable tax deductible claims, namely items classed as Capital Works (eg kitchen cupboards, hardwired light fittings and bathroom fixtures), and items that can be depreciated (eg dishwasher, carpet, solar garden lights).

Capital works are eligible for a 2.5% annual tax deduction. Depreciable items attract a tax claim of up to 20% (eg free standing light fittings). Readers should ensure that their tax accountant checks the new tax ruling before lodging the 2004 tax return.

### **The hunch factor and the crunch factor**

The way investors behave is attracting increased attention in academic circles around the world. Professional investors and fund managers are being studied with a view to gaining a better understanding of how good investment decisions are made. Successful investors who have a track record of making good decisions combine analytical skills (the “crunch” factor), with emotional intelligence (the “hunch” factor).

We have started employing more detailed risk tolerance testing using questionnaires for new clients. Regardless of how good we may be when investing, we can all be fooled by randomness!

### **Property securities funds are changing**

A property securities fund invests in share market listed companies and trusts that own investment property. The property may be local or international office blocks, shopping centres, industrial buildings, leisure facilities or even caravan parks.

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Recent takeover and merger activity in the Australian listed property sector has seen the emergence of several very large groups. The big players have structured their investments as “stapled securities”. This form of investment means that the underlying investment is structured using a trust (that receives and distributes the rental income), and a company (that earns income from management rights and perhaps even property development). The investor owns a share in a company and a unit in a trust, and the two are stapled together.

Several commentators have drawn attention to the fact that over the last ten years the level of risk associated with listed property investment has risen due to higher levels of gearing. Listed property investments that include a property development arm also carry additional risk, being the developer risk.

Listed property investments appeal to those who require a relatively high level of stable income. Despite the changing risk profile of this sector of the market, the outlook for stable income returns is promising in Australia.

### **Why housing matters**

65% of all household wealth in Australia is tied up in the houses we live in. Across Australia 60% of the total wealth is tied up in two cities, Melbourne and Sydney.

The demand for housing fuels a significant industry and when the demand falls Australia will face a challenge because in recent times the housing industry has supported an abnormally high proportion of new jobs. In the two years leading up to 2003, 66% of all new jobs were in the property industry, and 36% were in the public sector.

Perhaps this is the real reason why the Reserve Bank is keeping interest rates low. If the housing market gets hit too hard, unemployment will rise.

### **New website helps small business**

The Federal Government has developed a useful new resource that aims to assist small business and home based business operators. The website [www.smallbusiness.gov.au](http://www.smallbusiness.gov.au) provides government information that is designed to save business operators both time and money.

### **Satisfied customers are our best**

We thank our clients who refer new clients to us. Some clients refer individuals while others have kindly referred companies, Rotary Clubs, Probus Clubs and superannuation funds that require speakers for seminars etc.

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## **Inheriting a dwelling and capital gains tax**

The law provides that Capital Gains Tax (CGT) does not apply if the inherited dwelling is sold within two years of the deceased's death. The property could be rented during this period. CGT will apply after two years has expired unless the property becomes a principal residence for the beneficiary.

It is always wise to get a professional real estate valuation close to the time of death because it may be unclear whether the property will be retained or sold, and the time involved in winding up the estate may be longer than originally anticipated. CGT tax law becomes more complex if the property in question was used by the deceased, as a rental property or part used for business purposes. Small farms that exceed 2 hectares are also potentially caught for capital gains tax on part of the property assuming the value has risen.

## **Changing allocated pension providers**

It has come to our attention that some clients are unaware that you can change from one Allocated Pension to another. There are cases where it is desirable to combine several pensions and perhaps even add new superannuation money or Eligible Termination Payments (ETP's).

Before going down this path, it is wise to seek advice on any tax and reasonable benefit limit implications. When a new pension commences a new set of tax calculations are made based on the taxpayers current life expectancy. This generally results in a smaller annual tax-free component of the income stream.

## **We are all living longer**

The Australian Government Actuary has released new life expectancy tables showing that a typical retiree is expected to live 1 to 2 years longer. From the beginning of next year all complying pensions and annuities will be based on the revised figures.

## **Quote**

"You can have everything in life you want if you'll just help enough other people to get what they want! **Zig Ziglar**

## **Disclaimer**

This newsletter is for general information only. Tax, Social Security and Investment Laws change frequently and may affect different persons in different ways. You should not act solely on information in this newsletter.