



Welcome

A new year and stock market anxiety persists. In this issue we discuss strategies to assist you in a falling market, and how to borrow to invest in a broad range of investments inside a SMSF.

You can now register for the upcoming Self Managed Superannuation and Investment Market Update seminar by visiting the "News and Events" page on our website at www.cutcher.com.au

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Strategies in a falling market



As the stock market continues to prove extremely volatile, many superannuation funds will finish the financial year with negative earnings and a decreased fund balance.

This has a number of implications depending on the circumstances of the superannuation fund, however below are some strategies to combat the problems of money 'leaking' out unnecessarily.

Resetting Pensions

There is a possibility that some pensioners may have to draw a minimum pension which is in excess of their living requirements, resulting in money being invested outside of superannuation and taxed at higher rates. However, these pensioners are able to take advantage of their current pension account balances by 'resetting' their pensions.

This is achieved by commuting a pension account back to accumulation during a market downturn and immediately re-commencing the pension with the lower balance. This results in a lower minimum pension, increasing the amount of benefits retained within the fund to invest.

Negative Earnings

There also exists an opportunity for members who are in accumulation phase to take advantage of a suffering market and decreased member account balances. With the ability to start a pension from as early as 55 years of age, members can now enter into a pension with the benefit of obtaining a higher percentage of Tax Free monies. This opportunity results from the fact that all earnings within an accumulation account are allocated as a Taxable Benefit, and therefore will result in the erosion of the Taxable Benefit if losses are incurred.

Example

Daniel is 58 and has \$500,000 in accumulation made up of \$50,000 Taxable and \$450,000 Tax Free Benefit. In 2007/08, Daniel's account had negative earnings of \$85,000. As all earnings are allocated to the Taxable Benefit, Daniel's balance is as follows:

	Taxable Benefit	Tax Free Benefit
Opening Balance at 01/07/07	\$ 50,000	\$ 450,000
Allocation of Earnings	(\$ 85,000)	—
Closing Balance	(\$ 35,000)	\$ 450,000
Total Balance at 30/06/08	\$415,000	

If a pension was then started, the pension balance plus any future earnings would be made up of 100% Tax Free Benefit resulting in nil tax payable on the pension from age 55-59 and significant estate planning benefits.

(continued on page 2...)



Strategies in a falling market

In-specie contributions

As a result of the declining share market, many client's are taking advantage of their diminishing share portfolios by transferring these shares into their Self Managed Superannuation Fund. These transfers are generally made via in-specie contributions, the lower values meaning more shares can be contributed into the Fund without breaching the member's contribution limits.

This also means that people who wish to sell their shares to their SMSF can do so without incurring a large capital gains tax liability as they would have prior to the share market downturn.

By transferring shares into the concessional tax environment of superannuation (either via purchase or in-specie contribution), any investment earnings and income are taxed at a maximum of 15% (capital gains potentially at 10%) whilst the investments fund an accumulation account. The rate is then significantly reduced to 0% once the investments are funding a pension account. Thus the earnings and income are concessional tax rather than taxed at the member's individual marginal tax rates of up to 46.5%, resulting in significant personal tax savings.

Centrelink benefits

Excluding the family home, superannuation generally makes up the majority of assets for those who are approaching retirement or who are already retired. With superannuation balances at their lowest, many of these people may not realise that, unlike before, they may now be eligible for the government Age Pension.

In order to receive the Age Pension, individual's must satisfy both the assets and income test, where their superannuation balance will be included in the assessments. The assets test for homeowners and non-homeowners are as follows:

Status	For Full Pension	For Part Pension
Single Homeowner	Up to \$171,750*	Less than \$550,500
Single Non-Homeowner	Up to \$296,250*	Less than \$675,500
Couple Homeowner	Up to \$243,500*	Less than \$873,550
Couple Non-Homeowner	Up to \$368,000*	Less than \$998,000

NB: Your principal family home is exempt from the assets test.

*Age pension is reduced by \$1.50 for every \$1,000 over the threshold

Therefore, people may now find that the drop in their superannuation balances allows them to satisfy this asset test, entitling them to either a greater amount of pension, or payment of a part-pension.

Example

At 1 July 2008 John is 65 (i.e. of Age Pension age). He is single and owns his home and he applies for the Age Pension. John's superannuation balance (John's only asset, apart from his home) is \$650,000 and as such, he is ineligible for the Age Pension.

However, as at 1 January 2009, John's superannuation balance has fallen to \$450,000. John would now be entitled to an Age Pension, calculated as follows:

Maximum fortnightly payment for singles =	\$562.10
John's excess assets (\$450,000 - \$171,750) =	\$278,250.00
Reduction in maximum pension (279 x 1.50) =	<u>(\$418.50)</u>
Total fortnightly Age Pension	\$143.60

Many retirees may not realise that they are now entitled to the above benefits.

Gearing in your SMSF – a unique opportunity!



The amendments to the borrowing provisions of the superannuation legislation were enacted in September 2007. Since that date, there has been a steady surge in interest in the benefits of gearing within your SMSF.

To re-cap the new rules:

- The borrowing is used to acquire an asset.
- The asset must be an asset that your SMSF could have invested in prior to the amendments in September 2007.
- The investment must be permitted by your Trust Deed (the governing rules of the fund) and your investment strategy must allow the investment.
- The asset must be held “in trust” using a debt instalment trust. This trust has legal ownership while your SMSF has beneficial ownership until the last payment (see Figure 1 below).
- Income from the investment is received by the SMSF and all expenses in relation to the investment are paid by the SMSF (the trust is effectively a “bare” trust).
- The lender’s recourse against the SMSF trustee in the event of default is limited to the rights relating to the asset.
- The lender may be a related or unrelated entity.

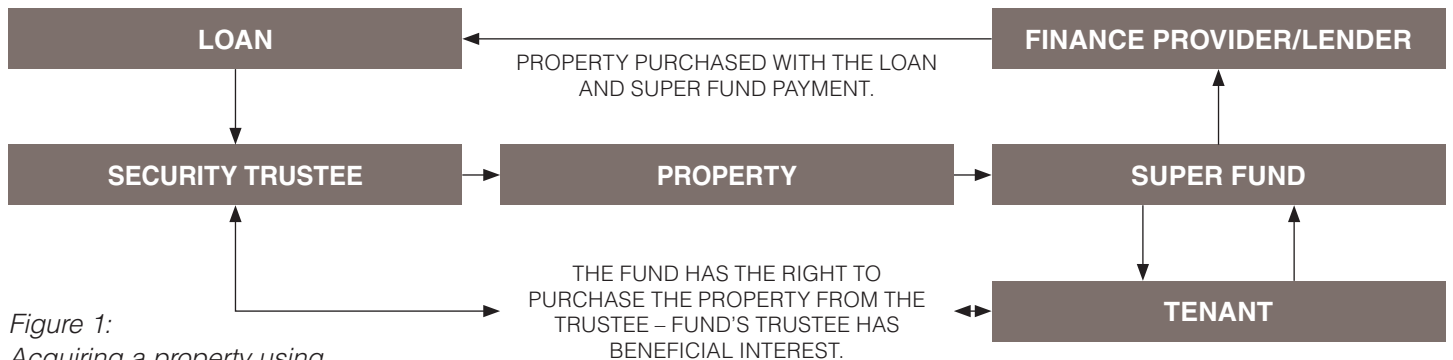


Figure 1: Acquiring a property using an instalment warrant.

The following scenarios may be considered:

- Someone with \$400,000 in their SMSF that would like to purchase their business premises (worth \$1m). The business entity would then pay rent to the SMSF (taxed at 15%) and the business entity receives a tax deduction for the rent (possibly at 30% or potentially 46.5%). Also, the property is being repaid out of \$0.85 after tax dollars rather than \$0.535.
- Someone with \$2m of listed shares in their personal name that have zero or minimal capital gains due to the current market downturn. They may “warrant up” the portfolio using the member as the related party lender (on arms length terms). The benefits of income and growth in those shares will now be in the SMSF (potentially at 0% tax if the member is in pension phase).
- Anyone that may consider the purchase of a residential property in their investment strategy (provided it is not already owned by the member).



Separate superannuation interests

Under certain circumstances, members of a superannuation fund are able to separate their Tax Free Benefits from their Taxable Benefits. Taxable Benefits are those made up of concessional (tax-deductible) contributions and any earnings and income received by the fund whereas Tax Free Benefits are made up of non-concessional (undeducted) contributions.

Separation is achieved by commencing a pension account using just the Tax Free Benefits and has many advantages including:

- The member will have a 100% Tax Free income stream, which will remain Tax Free for the life of the pension.
- Any earnings and income within pension accounts are prorated between the benefits of the account and as such will be entirely allocated to the Tax Free Benefit (opposed to being allocated to the Taxable Benefit).
- Income and earnings attributable to pension accounts are received tax free.

Prior to 1 July 2007, when members could pick and choose which of their benefits they used to commence a pension or draw a lump sum, this was a simple exercise, however, on 1 July 2007 the **proportionate draw-down system** was introduced to superannuation. This means that any benefits drawn from superannuation, or used to commence a pension, must be made up of the same proportion of Taxable/Tax Free Benefits as the entire member balance i.e. no 'cherry picking' of preferred benefits. For example:

John's member balance is \$400,000 as at 1 July 2008, consisting of \$200,000 (50%) in Taxable Benefits and \$200,000 (50%) in Tax Free Benefits. If John were to commence a pension, or draw a lump-sum payment (of any amount), they would be made of the same 50-50 proportions.

Therefore, a member's account balance must be structured appropriately in order to allow the separation of any Tax Free Benefits. Before making a large non-concessional contribution a member must ensure that:

- they have no Taxable accumulation balances (as a result of prior concessional contributions and/or earnings and income); and
- they do not make any concessional contributions

on the day the non-concessional contribution is made i.e. it is essential to make concessional contributions on different days to when any non-concessional contributions are made (this is also the case for any in-specie contributions).

Failure to do so would allow the non-concessional contribution to mix with other Taxable Benefits and prohibit the segregation of the Tax Free Benefits, as a result of the proportionate draw down system.

To further reduce the possibility of benefits mixing, Non Concessional Contributions should be made on either 1 July or 30 June of each year.

Segregated investment strategy

Unlike accumulation accounts, where investment earnings and income are taxed at a maximum of 15%, any income or earnings attributable to a pension account are received Tax Free.

For a fund with both accumulation and pension accounts, a segregated investment strategy can be utilised in order to increase the amount of income attributed to the pension account, resulting in significant tax savings. In a segregated investment strategy, certain assets are segregated between accumulation and pension accounts. The trustees may then specify which assets are put to accumulation or pension. Ideally, all high income yielding assets are placed in the pension account (and subsequently income earned will be Tax Free) and remaining low income yielding and growth assets will be left in accumulation (whereby minimal earnings will be made, and therefore, taxed).



Examples of different assets and possible segregation

Accumulation Phase

- Artworks
- Land
- Low income earning assets
(eg. shares with no cash dividends)

Pension Phase

- Rental property
- High income earning assets
(eg. shares with cash dividends)

By placing assets that gross a high amount of income each year in pension phase and leaving the low income yielding assets in accumulation, taxation in the fund is kept to a minimum. Another benefit of this strategy is a decreased pension payment if a portion of the pension account is commuted back to accumulation phase and therefore not subject to the minimum pension requirements.



Super way to cut tax

As an incentive for small business owners to become self-funded retirees, a number of Capital Gains Tax "CGT" exemptions and discounts are available when they sell their business or active assets (not investment assets) used in their business such as commercial property.

Providing they meet all the tests to exempt the gain under the CGT Small Business Concessions they are able to contribute \$1.045m (indexed figure for 2008/09) under the CGT Cap. Amounts under the CGT Cap are not counted towards the concessional and non-concessional contribution caps.

The contributions allowed under the CGT non-concessional exemption cap are:

- Up to \$500,000 of capital gains that are disregarded under the CGT retirement exemption.
- Capital proceeds from the disposal of assets that qualify for the 15 year exemption.

There is also an important distinction between the CGT retirement exemption, where only the exempt capital gains fall within the CGT cap, and the 15 year rule, where the actual proceeds from the disposal fall within the cap.



Contributions splitting

Contribution splitting allows members to split up to 85% of their concessional (taxable) contributions to their spouse each financial year.

This is extremely beneficial where there is a significant age gap between the couple or where one spouse has a lower preservation age (the age at which you can access your superannuation) than the other.

Example 1

John was born in June 1960, and as such has a preservation age of 55 (allowing John access to his superannuation in 2015). His wife Kim, was born in July 1964 and as such, has a higher preservation age of 60 (and can only access her superannuation from 2024). Although there is only a four year age gap between John and Kim, John can access his superannuation nine years earlier than Kim.

By splitting contributions from Kim (the younger spouse) to John (the older spouse), John's member balance can be increased, allowing John access to a greater amount of superannuation benefits at an earlier date than if they were kept in Kim's name.

It is important to note that a maximum 85% of a member's concessional (taxable) contributions can be split to their spouse for each financial year and the actual split occurs in the following financial year to which the contributions were made.

Example 2

As at 30 June 2008, John and Kim's balances and contributions for the year are as follows:

- **John:** \$120,000 member balance including \$50,000 in concessional contributions and \$5,000 in non-concessional contributions made during the year
- **Kim:** \$100,000 member balance including \$50,000 in concessional contributions and \$20,000 in non-concessional contributions made during the year.

On 1 July 2008, Kim makes an application to split her contributions made during the 07/08 financial year to John. She is only able to split 85% of her taxable contributions ie. \$42,500 ($\$50,000 \times 85\%$).

Following the split, John and Kim's member balances are as follows:

- **John:** \$162,500 ($\$120,000 + \$42,500$)
- **Kim:** \$57,500 ($\$100,000 - \$42,500$)

Bankruptcy



With the current economic crisis occurring throughout the world, bankruptcy and insolvency activity is well on the rise. For many Australians, superannuation will represent their largest asset – so it becomes an increasingly vital issue to understand how superannuation is treated when bankruptcy occurs. Many recent changes in legislation and case law rulings have seen a transformation of the superannuation/bankruptcy relationship.

Previously, protection of a bankrupt member's interest in a regulated superannuation fund was limited to their Pension Reasonable Benefit Limit "RBL" (approximately \$1.2m). With the abolition of RBLs from 1 July 2007, the Bankruptcy Act has been amended so that there is now unlimited protection for a bankrupt in terms of their superannuation benefits in the fund. Theoretically a person can now be considered bankrupt and have \$1 million dollars in superannuation which is fully protected from creditors.

Contributions are now protected so long as they were not made to prevent, hinder or delay creditors from access. Factors looked at to determine the purpose of the contribution include:

- timing of the contribution, for example if made when a person was or was about to become insolvent; and
- the pattern and history of the person making the contributions.

For Superannuation benefit payments, the Bankruptcy Act has been further amended so that any Lump Sum received is protected from creditors. However, income streams (pension payments and annuities) that are in excess of a certain threshold amount are not protected. The exact levels of protection afforded to these income streams are adjusted for inflation twice a year, but as at 22 October 2008 the levels are:

No. Of Dependants	Income Limit (\$)
0	41,250.30
1	48,675.35
2	52,387.88
3	54,450.40
4	55,275.40
More than 4	56,100.41

These levels are important when dealing with the new Account-Based Pensions that were introduced as part of the government's Simpler Super strategy from 1 July 2007. Previously with Allocated Pensions there was a maximum drawdown in place and any monies taken over the excess would be treated as a partial commutation (i.e. a lump sum). Unlike the Allocated Pension, Account-Based Pensions have no maximum drawdown provided the member is over age 60 and has met a condition of release. Therefore, any income withdrawn over the above amounts will typically be available to creditors if a person is insolvent.

Diary Dates

February

28 2007/08 Annual return + payment of 2007/08 tax liability due for SMSFs established within the last 12 months

March

31 2007/08 Annual Return + payment of 2007/08 tax liability due for Fund's with total income in excess of \$2 million in previous lodgement

May

12 January – March 2009 (Third Quarter) Pay As You Go Instalment due

15 2007/08 Annual Return + payment of 2007/08 tax liability due for all other Fund's not satisfying the previously discussed conditions

August

11 April -June 2009 (Fourth Quarter) Pay As You Go Instalment due

Did you know?



Co-contributions

The Superannuation Co-Contribution Scheme is an incentive provided by the Government to encourage people to make voluntary contributions into their superannuation funds and maximise their retirement benefits.

This means that if your income is less than \$30,342 pa., you can receive \$1.50 for every \$1 you contribute to superannuation from after-tax earnings (up to a maximum co-contribution of \$1,500).

When you earn more than \$30,342 pa. but less than \$60,342 pa. your Co-Contribution will be adjusted based on your income and how much you contribute.

Some clients have asked whether they are able to make the \$1,000 contribution on behalf of their children (who are more than likely earning less than the \$30,342 pa., and as such, entitled to the entire \$1,500 co-contribution). As long as the child is in receipt of eligible employment income e.g. employed on a casual basis, they will be eligible for the co-contribution.

STOP PRESS: 50% reduction in minimum pensions for 2008/09

In a bid to prevent retiree's superannuation from rapidly depleting as a result of the current economic downturn, the federal government is temporarily decreasing the minimum pension requirement for the 2008/09 financial year.

The announcement, made on 18th February 2009, means that retirees need only draw 50% of their required 2008/09 minimum pension. For example, if your minimum pension for the 2008/09 financial year was \$40,000, you're 'new' minimum pension will be \$20,000.

The relief addresses the concern over minimum pension amounts being based on asset values at 1 July 2008, when the values of superannuation funds were much higher. It also reduces the risk of retirees having to sell investment assets, and subsequently realise losses, in order to fund their pension payments.

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