WEALTHMATTERS

YOUR PERSONAL GUIDE TO WEALTH CREATION

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INSIDE

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Keeping it in the family

While the ATO continues to crackdown on tax minimisation strategies, quite a few legal pathways to paying less tax while preserving wealth for retirement or estate planning purposes still exist.

Family trusts have significant tax saving abilities that make them an attractive tool for wealth creation. Family trusts are discretionary trusts that are set up to hold a family's assets or run a family business.

They are commonly used by families where there is a high income earner, a low income earning spouse and children studying full-time. The trust structure allows non-personal income from business and investments (income and capital) to be streamed to beneficiaries in lower tax brackets.

Streaming income allows trustees to place a high proportion of the trust's earnings into the names of their spouse and children. Using the $18,200 tax-free threshold and lower marginal rates, family income can be minimised with franking credits offset and possibly refunded. However, if the children are below the age of 18 it may not be worthwhile to use this strategy since any investment income they earn above $416 attracts a much higher tax rate.

Those using family trusts for tax purposes may be able to take advantage of the tax-free thresholds by allocating investment income to younger members in the trust. Allocating a high proportion of capital gains and franking credits to low income earners can generate significant tax savings.

Family trusts can also be used for estate planning purposes, since assets can be left to beneficiaries without the need to change ownership of those assets. Additionally, they may be used to protect a family's group assets from the liabilities of one or more family members, such as bankruptcy or insolvency. In most circumstances, the trust's assets will not be at risk.

While family trusts can be a great option for minimising a family's overall tax burden, they are complex entities, so if you are considering establishing a trust, seek professional advice.

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Insurance traps in your super

Insurance arrangements in super can create a few surprise outcomes for members who leave big superannuation funds to start their own self-managed super fund yet leave a portion in their old fund.

Members need to be wary of the traps that can cause a loss of cover. As insurance is a complex financial product members need to understand the benefits, risks and the costs entailed when entering into insurance cover in large superannuation funds.

Even though it may seem advantageous to access low cost insurance with a large super fund there are some circumstances that may cease insurance cover including:

Minimum balance requirements are not met

Most large super funds will require members maintain a minimum balance in their account to retain cover which can range from as low as $1,000 and up to $10,000.

Although most funds allow insurance cover to be kept providing premiums can be automatically deducted, some funds may cease cover once the account balance falls below the threshold.

No employer contributions

Some superannuation funds that offer automatic income protection insurance will terminate a member's insurance cover if employer contributions cease for six months. Other funds may cease income protection insurance cover after 13 months from the date of the last employer contribution regardless of the account balance.

No longer working for a particular employer

If you change employers or no longer work in a particular industry you may risk losing your insurance cover. Funds may require that a particular employer makes contributions to the account to retain total and permanent disability (TPD) and income protection cover.

No longer working in the public sector

Members who cease to work in the public sector may risk losing their cover from the day they officially cease employment with the relevant public sector. These public sector funds generally do not accept further contributions or rollovers if the member is no longer working for the relevant public sector employer.

Terminal illness payouts

Some super funds may pay out insurance at the TPD level upon terminal illness, which reduces any remaining life cover paid on death. This may result in a deprivation of funds to account for medical or palliative care before death. This style of cover is in stark contrast to other funds that pay out 100 per cent of life cover upon terminal illness.

Super boost for business owners

Changes announced in the 2016 Federal Budget grant small business owners the right to use the sale of their business to contribute more to their super than the introduced $500,000 lifetime after-tax contribution cap.

As the small business retirement exemption will continue, small business entities can contribute up to $500,000 of sale proceeds into their superannuation in addition to the new cap of $500,000. This provides small business owners with the opportunity to potentially double their contributions.

Small business owners will qualify for the exemption providing they have a net worth of less than $6 million or a business turnover, which currently stands at less than $2 million. Taxpayers must contribute the $500,000 to their superannuation fund before they lodge their annual return.

In addition, eligible taxpayers can make super contributions that do not count towards their non-concessional contributions cap, providing the contribution is the sale proceeds from the CGT asset that is exempt from capital gains tax.

CGT withholding regime

An introduction of a 10 per cent non-final withholding tax on payments made to foreign residents that dispose of specific taxable Australian property will come into effect from 1 July 2016.

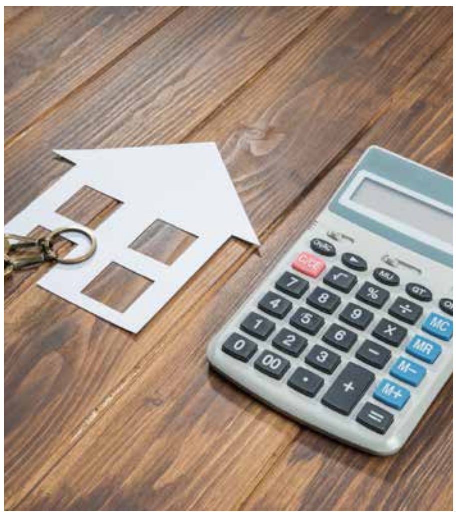
The new legislation will impact on any property transaction where the purchase price is more than $2 million. The withholding regime will apply to:

- Australian real property - land, buildings, residential and commercial property
- Lease premiums paid for the grant of a lease over real property in Australia
- Mining, quarrying or prospecting rights
- Indirect Australian real property interest
- Options or rights to acquire such property or interest

The legislation is aimed at vendors that are 'foreign persons' to ensure their capital gains tax liability is retained. Any sale contract entered on or after 1 July 2016 will require the purchaser to withhold 10 per cent of the purchase price and pay that amount to the ATO. The vendor then applies for a tax credit for the amount withheld by the ATO following settlement.

The purchaser must withhold 10 per cent of the purchase price unless the vendor shows the purchaser a clearance certificate from the ATO. The ATO will only issue a clearance certificate to Australian resident vendors.

Where the vendor is a 'foreign person', the purchaser must withhold 10 per cent of the purchase price and pay that to the ATO unless the vendor provides a 'Variation Notice' in which case the purchaser must withhold the revised amount. A 'foreign person' vendor can obtain a Variation Notice from the ATO.



Alternatives to building your nest egg

The prospect of putting less into superannuation has prompted many Australians to start looking for other ways to boost their retirement savings.

Jumping on the offensive by seeking out other tax-effective ways to increase retirement savings isn't always easy, with complications such as fees, administration and confusing terminology attached to saving outside of super.

Nonetheless, there are existing strategies predicted to experience a resurgence following the introduction of contribution caps set out in the 2016 Federal Budget. Below are three options for savers looking to alternative measures to protect their wealth:

Insurance bonds

For those in the top tax bracket, insurance bonds (also known as investment bonds) can be used as a wealth-building strategy. They are a type of a life insurance policy with the features of a managed fund sold through life insurance companies and building societies.

All earnings within the structure attract the corporate tax rate of 30 per cent. After ten years no further tax is payable.

Investors can top up the amount in the fund as long as their subsequent investment does not exceed 125 per cent of the initial investment. Doing so triggers the 125 per cent rule which sets back the 10-year benefit to year one for the newly invested amount.

Instalment warrants

For those who have at least 20 years or more until retirement, instalment warrants may be a viable alternative to salary sacrificing. Instalment warrants are similar to a lay-by on an asset like shares i.e. similar to putting down a deposit or a part-payment and repaying the remaining amount on the listed asset in instalments over time.

A key selling point of an instalment warrant is that the taxpayer receives all the benefits of owning shares, such as dividends and franking credits. The interest component of the loan and the borrowing fee can also be offset against tax.

However, since instalment warrants can be a relatively aggressive strategy, they may be better suited to those who have a longer investment horizon so they can ride out the volatility.

Family trusts

When used correctly, family trusts can be an effective way to add to super. They allow higher-earning family members to distribute income to lower-earning family members to even out the tax burden among the family and protect assets for future and current generations.

The strategy is also beneficial where

one partner is on a lower tax bracket. Additionally, family trusts are suitable for adult children as you are not able to use the strategy for children under 18, as investment income above $416 is taxed at a higher rate, resulting in an insignificant tax benefit.

Family trusts are accessible before retirement and can safeguard assets for nominated people and purposes, which can help prevent the assets falling into the wrong hands in the case of death or divorce.

However, with annual running costs of around $2000 and set-up costs of about $2000, family trusts are more appropriate for those who can build up $200,000 or more within five years.

ATO imposes stricter guidelines for SMSF borrowing

Self-managed super funds (SMSF) have until 30 June 2016 to conform to the ATO's new rules on related-party loans.

A guidance paper released by the Tax Office stated that related-party loans e.g. family trusts or private companies to SMSFs now must be at interest rates of 7.75 per cent for shares and 5.75 per cent for property.

The loan-to-value ratio must be 50 per cent for shares and 70 per cent for property.

Originally, SMSF trustees were able to borrow at an interest rate that was less than what a bank would traditionally charge, meaning more money could be kept in the super fund. Earnings on assets that are held by super funds are also taxed more favourably.

Income that is acquired from assets that fail to meet the ATO's new requirements will be taxed at 47 per cent, which is the highest marginal rate.

The new rules are designed to ensure funds are run for the sole purpose of providing super benefits to members when they retire. The Tax Office also wants to ensure loans are established and maintained on terms that are consistent with an arm's length dealing.

An arm's length transaction means that investments must be conducted on a commercial basis as if there was no relationship between the parties. For instance, the purchase price of an asset should be at market value.

For an asset that is publicly available, the arm's length price would match the price advertised to the public. For assets that are not publicly listed, independent valuations should be obtained to ensure the market value is adequately reflected in the purchase price.

Considerations before moving into aged care

The decision to move into an aged care home is often a difficult one. With the loss of autonomy, and often the family home, it is an emotional time for the person moving and their family and friends.

Planning ahead is essential to maintaining control and choice and minimising stress as there are a lot of financial issues to consider. Unfortunately, there is no rule of thumb when working out how to finance residential aged care but understanding the fee structure can help to make an informed decision.

Costs

The Australian Government subsidises a range of aged care services, however, you will contribute towards the cost of care if you can afford to do so. The level and range of fees will depend on the individual's financial situation. In residential aged care, you may need to pay one or more of the following fees:

- A basic daily fee: covers living expenses such as food, electricity, cleaning and laundry services. This may be the only fee some people are required to pay.
- A means-tested care fee: is an additional cost which may be payable based on an assessment of income and assets by the Department of Human Services.
- A full or partial accommodation payment: this will depend on your assessment of income and assets. Some people will have their costs met by the Government, while others will need to pay the agreed accommodation price set out by the aged care facility.
- Fees for additional services: such as higher standard of accommodation or extra services, ie. a larger room or wine with meals. These fees will vary from home to home.

Structuring finances

One of the major decisions faced when entering into residential aged care is whether or not you should sell your family home. The decision will depend on your individual circumstances such as the value of your home, income and other assets, and the accommodation payment required.

- Selling the family home to pay for aged care

The family home will be considered an asset unless:

- your partner or dependent child lives there
- a carer who is eligible for an income support payment has been living there for at least two years or
- a close relative who is eligible for an income support payment has been living there for at least five years.

For those who retain their home but are required to pay a refundable accommodation payment, a periodic payment may be provided by the aged care provider. If you do not sell your home when entering into an aged care facility it will be exempt from the age pension assets test for two years from the date you entered into care. This two year exemption will vary if you are or were a member of a couple at the time you moved in.

- Renting the family home to pay for aged care

From 1 January 2016, new aged care residents will have any rental income from their recently vacated home included in their resident's income for the purpose of calculating their means tested care fee. Rent will continue to be exempt for those people who entered residential aged care before this date and whose former home has been retained and rented out to help pay the refundable accommodation payment.

Changes set for transition to retirement

Transition to retirement (TTR) arrangements are set to be overturned or converted into full pensions following changes released in the 2016 Federal Budget.

Under the proposed rules set to commence 1 July 2017, the tax on earnings in TTR pensions will change from zero to 15 per cent, the same earnings tax that applies to money in the accumulation phase of super. This removes the tax incentive for most individuals between the age of 56 and 59 to be in a TTR arrangement.

Transition-to-retirement pensions are currently used by individuals in their late 50s and early 60s who are building up to their retirement while working part-time.

The scheme has enabled individuals over the age of 55 to balance the benefits of working and accessing their super, without losing the incentives of either.

High income earners will be the most affected as many have used TTR arrangements as a tax minimisation strategy. Taxpayers who have previously injected money withdrawn from transition accounts straight back into these accounts will now be subject to the $500,000 lifetime limit on after-tax contributions.

The proposed changes would see TTR arrangements useful only for those individuals who need extra cash while they reduce their working hours, or those who can make larger contributions to super than they might otherwise would.