PERSONAL FINANCIAL STRATEGIES

YOUR PERSONAL GUIDE TO WEALTH CREATION

Caution with salary sacrifice

Tax cuts for personal income earners have done little to reduce the enthusiasm of many seeking greater tax benefits through salary sacrifice. Despite there being many legitimate salary sacrifice schemes, there are those who seek to push the envelope and run the risk of the taxman's wrath.

The ATO recently released warnings concerning salary sacrifice plans and salary deferral schemes. They indicated that people involved in, or considering these schemes, should be warned that they face close examination by the tax office.

What is salary sacrifice?

Salary sacrifice is an arrangement between an employer and an employee in which the employee agrees to sacrifice part of their future entitlement to salary or wages in exchange for the employer providing them with benefits of a similar cost (to the employer).

What are the requirements for an effective salary sacrifice arrangement?

There are many acceptable and entirely legal salary sacrifice arrangements in place which the ATO accepts as meeting the requirements of the law. An appropriate salary sacrifice arrangement can be a very tax effective way to structure remuneration. Before entering into any salary sacrifice arrangement, some basic guidelines must be understood.

The arrangement should be agreed to before the work is performed. If the arrangement is put into place after the work has been performed, the salary sacrifice arrangement may not be effective. Salary and wages, leave entitlements, bonuses or commissions that accrued before the arrangement was entered into, cannot be part of an effective salary sacrifice arrangement.

Agreement between the employee and employer. It is important that both parties are clear on the terms of the salary sacrifice arrangement and that it be documented. Generally, subject to the terms of any contract of employment or industrial agreement, parties can renegotiate a salary sacrifice arrangement at any time.

No access to the sacrificed salary. The sacrificed salary must be permanently forgone for the period of the arrangement. If a fringe benefit that has not been provided is cashed out at the end of a salary sacrifice arrangement period, its value is taxable as normal income.

Salary sacrifice requires planning in order to be effective. Before entering into arrangements, it may be advisable to first contact the office for advice.

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We can help you keep your personal finances and wealth creation strategies on track.
Call us now and we'll arrange a meeting to discuss:

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- Planning for retirement
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Hybrid securities: Best of both worlds?

New forms of hybrid securities are gaining momentum as short term uncertainty in equity markets continue. While at first glance they look complicated, the underlying principles are quite straightforward.

What are Hybrid Securities?

The term 'hybrid securities' refers to a broad classification for a group of securities used by listed companies that combine elements of both **debt** and **equity**.

Hybrid securities pay a predictable (fixed or floating) rate of return or dividend until maturity. At that time the holder has a number of options including converting the securities into the underlying share or resetting the security for another term.

Therefore, hybrid securities have a 'known' cash flow, unlike shares. But unlike fixed interest securities such as debentures or bonds, there is an option to convert to the underlying equity. The most common types of hybrid security are convertible notes and converting preference shares.

Hybrid securities are tradable securities which have characteristics of both debt and equity instruments. It is important to understand that hybrid securities are not all the same and that some behave more like fixed interest securities and others behave more like the underlying shares that they may be converted into.

Why do companies use 'hybrids'?

Hybrid securities are generally used by large, reputable companies to diversify their funding sources. Because "hybrids" generally constitute a cheaper form of capital than equity, using them improves shareholder returns.

How secure is the rate of return?

As with any investment, risk needs to be taken into consideration. Some key specific features that may be considered include:

Early Redemption Risk – Whether the issuer has the right to redeem the securities.

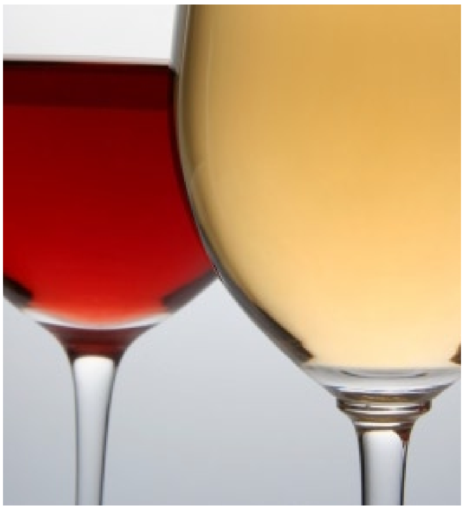
Conversion Risk – What are the terms and conditions in which does the issuer has the right to convert these 'debt' securities into 'equity.'

Subordination - The securities' ranking in the event of winding-up of the issuer.

Regulation Risk – Does a Corporate Regulator have the right to intervene to fulfil unsatisfied obligations by the issuer for investors?

Hybrid Securities and SMSFs

Self Managed Super Funds trust deeds require investments in a range of asset classes. Hybrid securities are one class of investments that may satisfy this requirement.



Fixed returns and the potential for fully franked dividends can potentially deliver benefits to a SMSF. The 15% tax rate super funds experience mean that excess franking credits accruing from fully franked dividends can potentially be used to offset tax obligations from other income streams within a SMSF.

In addition to tax management, there are a number of points to take into account when considering hybrid security selection. These include the security rating, the extent to which dividends are franked, and the extent to which dividends are fixed or floating.

Don't be intimidated by hybrid securities. As long as one understands the fundamentals and the tax implications, they may represent a useful investment option.

How do Hybrid Securities Compare?

	Advantages	Disadvantages
Shares	• Low cost of entry • Easily traded • Potential benefits for franking credits	• Greater risks associated with returns • Ranks last in event of winding up • Greater volatility
Bonds and debentures	• Fixed rate of interest • Return of capital at maturity • Ranks ahead of equities and hybrids for the payment of interest and capital	• Return can be lower than equities. • Limited secondary market • Minimum cost of entry
Hybrid securities	• Generally higher income yields • Potential to convert security to underlying share at defined intervals • Potential tax benefits from franking credits • Ranks ahead of equity	• Ranks behind traditional debt • Interest rate changes may impact value • Value may be affected by changes in the prices of underlying shares

Reporting relief for closely held trust

Reporting requirements under the former ultimate beneficiary rules have been simplified. From 2008-2009 income tax year trustees of closely held trusts will only be required to identify and report details of those trustee beneficiaries presently entitled to net income and tax preferred amounts.

The new reporting requirement will not apply to trusts that have made a family trust election or an interposed entity election or a wholly owned family trust.

Prior to the change, trustees of closely held trusts were required to report the identity of the ultimate beneficiary. This was often difficult and required the determining distributions through a chain of trusts.

When completing a correct trustee beneficiary statement (TBS) a trustee must identify each trustee beneficiary and advise the Commissioner of a number of details.

For beneficiaries who are residents at the end of the year of income, these details include:

- name and tax file number (TFN) of the beneficiary
- amount of the untaxed part of their share and /or
- amount of their share of the tax / preferred amount.

Details required for non-resident trustees include:

- name and address of the trustee beneficiary
- amount of the untaxed part of their share and/or
- amount of their share of the tax / preferred amount.

A TBS must generally be provided to the ATO within the same period the trustee is required to lodge the trust income tax return.

The new rules apply from the 2008–2009 income year. That means trustees of closely held trusts making interim distributions of income or untaxed amounts from this time will be required to lodge a TBS. It is important that trustees review the details currently held for beneficiaries.

The new rules also provide for a non-disclosure tax (TBNT) which may be payable where:

- a correct statement is not provided within the required period, or
- the trustee becomes presently entitled to an amount that a beneficiary has also been made presently entitled to.

SMSF Trustees: Can you explain the Sole Purpose Test?

Greater apparent flexibility with investment choices for Self Managed Superannuation Funds has created a dilemma for many Trustees. With the Government having approved a means by which super funds can borrow to invest through non-recourse loan arrangements, some trustees have confused the degree to which SMSF can actually be self managed.

A recent ATO survey revealed that almost one third of self managed superannuation fund (SMSF) trustees did not understand the sole purpose test, arguably the single most important rule for SMSF trustees.

The sole purpose test is a fundamental aspect of the superannuation laws. It prohibits trustees from maintaining a self-managed super fund (SMSF) for purposes other than the core or ancillary purposes specified under the law. The core purposes essentially relate to providing retirement or death benefits for fund members. A trustee who manages a SMSF for other purposes, such as improving lifestyle or helping a business out of a financial crisis, runs the risk of falling foul of the superannuation law.

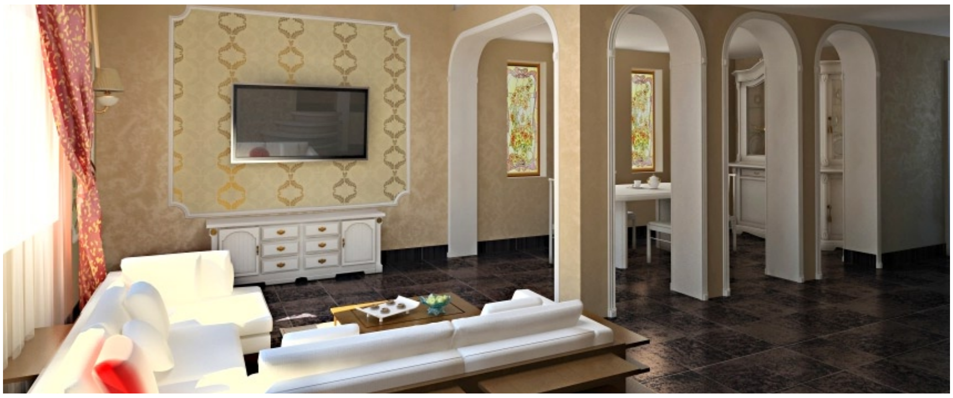
The ATO has identified many instances where retirement savings, through an SMSF, have been deliberately used for questionable purposes. Recently the ATO has identified instances where the member or trustee has used funds to purchase the family home. In another situation, the ATO found a fund where a trustee lent nearly all of its assets in cash to make an undocumented loan to a member's failed business venture, losing the full amount of the investment.

It is because of examples like these that the ATO is planning on auditing 10,000 SMSFs this year alone. The focus of the audits will be on trustees and their understanding of their basic legal obligations. In addition, SMSF auditors will be targeted to ensure that they are correctly auditing SMSFs and identifying breaches of the SIS Act.

What's the big deal?

Failing the sole purpose test can result in the super fund losing its complying status, and therefore its tax concessions. A breach of this test may also result in the fund trustees being subject to administrative, civil and criminal penalties, with fines of up to $220,000 and five years in prison.

Breaching the sole purpose test can have significant consequences and fund trustees need to take this matter seriously. ATO audits are increasing and the Commissioner is aware of problem areas and is prepared to take action. It is advisable to seek expert advice early on if in doubt about any of these issues.



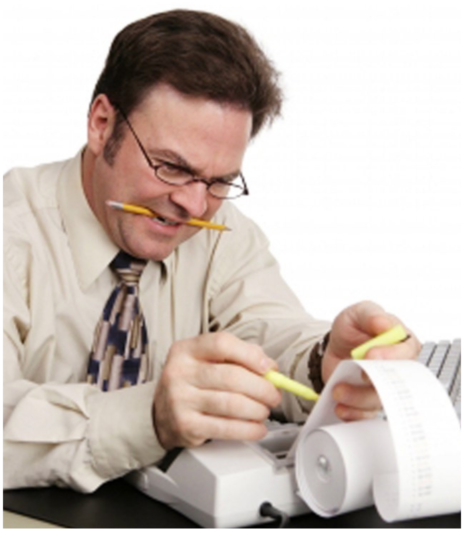
Tax office hit list

Each year the Australian Tax Office releases their compliance programme. In other words, a list of who it will be targeting for the year. It's a valuable warning for taxpayers.

Whilst the official programme has not been issued, the ATO has recently given a preview of some of the areas that its program for 2008-09 will be addressing and an overview of its tax time focus for individuals and small businesses.

Rental properties

With nearly $24 billion claimed in rental deductions over the last year, it comes as no surprise that rental properties are a significant issue for the tax office. Common errors are regularly being made. The ATO plans to contact investors who claimed rental deductions for the first time last year, providing additional guidelines about acceptable practices when it comes to property expense claims.



The ATO also plans to contact investors who have been identified because they have some statistically unusual characteristics. These include unusually high rental deductions; disproportionately low rental income compared to rental deductions; high interest expenses claims and unusually high borrowing expenses deductions.

Dividends and interest

Taxpayers can easily overlook interest or dividends when accounts are closed or income is received into a bank account that is used for everyday use. Whilst a taxpayer may lose track of the income, the ATO's data-matching system will identify any anomalies.

Small business

The tax office will be focusing on a range of issues including the disposal of assets and investments, overseas income, and employer obligations, particularly superannuation.

In many instances errors are unintentional. Despite this, a little prevention can save costs and extra efforts if taxpayers find themselves under scrutiny. If you are unsure about the implications of the ATO's compliance programme, or if there are issues you feel may place you under scrutiny, please call our office.

The basics of margin calls

An investor's portfolio of shares or managed funds provides security for a margin loan. The risk is that market variations reduce the portfolio's value to a level that in inadequate in terms of security. Once the underlying values have fallen to the extent that the ratio of the loan to the portfolio value exceeds the maximum set by the lender, it will step in and make a "margin call".

The lender requests additional funds or assets to bring the loan-to-valuation ratio (LVR) back below the maximum allowed. Investors that are unable to make the extra loan repayment or contribute other acceptable assets as security may be forced to sell part of their investment.

One strategy for investors to avoid margin calls and reduce risk is to avoid borrowing up to the maximum LVR in the first place. Most lenders do allow a "buffer" of 5 per cent above the maximum LVR which acts to prevent margin calls when the LVR is only slightly exceeded.

The Bookshelf

Affluenza: The All-Consuming Epidemic

Authors: John De Graaf, David Wann and Thomas H. Naylor (Berrett-Koehler Publishers)

Society tells us that 'bigger is better'- but it seems the only thing that's growing are our debts, dissatisfaction and our waistlines. In an age where we have more money to spend but higher repayments than ever, it's no wonder a brave few have finally questioned what most of us refuse to accept: that our society is in the grip of a crippling illness.

Affluenza cleverly borrows from medical terminology to explain the rampant consumerism virus killing the spirit of everyday consumers. In constantly pursuing celebrity lifestyles and the American Dream, the authors claim that we have become overworked and complacent to the damage we have caused our environments, families and communities.

Plotting the symptoms, causes and cure of the disease, **Affluenza** will make you think twice next time you reach for your credit card. Although primarily concerned with the American overconsumption frenzy, this book resonates with Australia just the same. One need only look to our soaring interest rates and inflation to realise we're on the fast track to the same problems - and **Affluenza** offers a solution. This sharply written wakeup call is enough to make your purse strings a little tighter, and your life a little calmer.

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.