

## Ideas, April 2006

In the first newsletter for advisers, Jo McCreery and Lisa Faddy, they look at ways to increase your wealth with a particular emphasis on managing tax. In particular, we highlight **recent changes** from which you can benefit.

### 1. Kick-start your savings plan

Like borrowing money to invest in a property, **borrowing to invest** (gearing) into shares and managed funds can be a tax effective strategy. It can help you **grow your savings faster than a simple ungeared (no borrowing) savings plan**. This type of strategy can be effective for two reasons: it allows you to increase your ownership of growing assets and the interest on the loan is tax-deductible. This tax-deductibility reduces the cost of borrowing.

Investing in shares and managed funds is a good complement to investing in residential property because it adds diversification to your holdings. If your main assets are your home and perhaps an investment property, you are only exposed to one type of asset. There is a risk that this asset doesn't perform as well as others.

We see **many advantages to gearing into shares and managed funds**. These include:

- the ability to tailor the size and risk of your investment to your own needs;
- the ability to spread your investment over a wide range of assets from international companies to commercial property;
- the opportunity for tax effective income such as franked dividends on Australian shares and tax-deferred direct property trust income.

Moreover, **right now, we believe that the potential for growth is higher for a well structured managed fund portfolio** than a residential property investment.

#### Start prior to 30 June and benefit

If you are thinking of starting a geared investment, doing so prior to 30 June is worthwhile due to the immediate access to the tax deduction on prepaid interest.

Remember the **tax thresholds change 1 July**, so a deduction may be worth more to you this year than next year.

To kick-start your savings plan, we find that capital protected, geared investments can work well. They don't require a large capital commitment; the only investment you need to make is the annual tax-deductible interest on the loan.

### 2. Pay less tax on investment income

It's not just the investment strategy, but **what you invest in that matters** from a tax management perspective. Some investment approaches will result in a larger annual tax bill than others.

A fund manager might claim to have delivered, say, a 15% return for the year on your \$50,000 investment. If that return came from aggressive buying and selling of shares, that is, making short-term capital gains, you may end up paying away much of this return in tax.

For example, if this 15% return were made up of 4% from fully franked dividends and 11% from the realisation of short term capital gains, you would have a \$3,196 tax liability if you were on the top marginal tax rate (MTR). \$2,668 of this amount would be capital gains tax. Your after-tax return would be only 8.6%.

If, on the other hand, the manager only returned 13%, but realised no capital gains, you would pay only \$529 in tax. Your after-tax return would be higher, at 11.9%.

**The lower returning, more tax efficient manager can often give you the better after-tax result**

### 3. Consider increasing super contributions

Now that the **15% surcharge on super contributions made by high income earners is gone**, it is worth re-evaluating your super contribution strategy. This strategy is now significantly more tax effective than it used to be.

Remember that if you are under 65, you no longer have to be working to contribute to super. This means that if you or your spouse are not working but receive investment or trust income, that person may be able to reduce tax payable by making a tax-deductible super contribution.

### 4. Review whether you can get some of the super co-contribution

As the super co-contribution income threshold has gone up, it is worth checking whether you can now benefit from it. If your assessable income, plus reportable fringe benefits, is **less than \$58,000** this year and you make a personal super contribution, you may be eligible to receive a Government co-contribution.

The maximum co-contribution is \$1,500 if you make a \$1,000 personal contribution and earn less than \$28,000. This is an immediate 150% return on that \$1,000 contribution.

Note that you must be working to be able to receive this benefit.

### 5. Parents - start benefiting from the Government's 30% tax rebate on approved childcare

Parents with children in approved childcare can begin claiming the Government's **new tax rebate** on childcare costs **in this year's tax return**. This is a 'non-means tested' tax rebate of up to 30% of out of pocket expenses for approved child care, up to a maximum of \$4,000 per child (indexed up each year). To receive this rebate, you need to be receiving the Government's Child Care Benefit (CCB) for approved care and meet the CCB work/study/training test of 15 hours per week. Note that a minimum amount of CCB is available to most working people using approved childcare.

#### Product Review - Macquarie International Private Equity Securities Fund

Offers: access to unlisted, emerging companies around the world.

Benefits of sector: expected to out-perform the listed share market over the long term; low correlation with other asset classes.

Benefits of product:

**Immediate exposure** - this fund invests in listed as opposed to unlisted private equity funds. Typically, when you invest in retail private equity funds they invest in unlisted funds and until the manager identifies these funds, a large part of your investment is held in cash. This approach reduces your exposure to the sector. This fund overcomes that issue by investing in more fully invested, listed funds.

**Diversification** – risk is controlled through the fund's multi-manager structure. As the variation in manager returns is significant in this sector, this is an important feature. The fund invests globally, so it also offers good diversification of assets from that perspective.

**Manager expertise** – the Macquarie team invest over \$2 billion in private equity assets and are regarded highly for their expertise in private equity investing.

Overall: we will be recommending this fund to clients who can tolerate a certain amount of investment risk and who have long investment horizons.

You claim this rebate in respect of the prior financial year's costs, so you can potentially claim costs from 1 July 2004 to 30 June 2005 in your 2005/06 tax return. The rebate is transferable, so you have the option to transfer any unused rebate to a spouse.

## 6. Married couples - consider super splitting

Married couples can now share super contributions. Splittable contributions include employer contributions, salary sacrifice and personal tax-deductible contributions. **If there is one primary income earner**, that person can now direct up to 85% of these super contributions to their spouse.

The new law only applies to contributions made on or after 1 January 2006. To use this strategy, you first need to check whether the primary income earner's super fund allows super splitting. If it does, then after the 1<sup>st</sup> of July each year, the account holder can request they direct some of the contributions made in the past financial year to their spouse.

The benefit of directing some of the primary income earner's super to the spouse is that it can help even up superannuation balances available on retirement. Evening up super balances allows married couples to:

- potentially withdraw **a greater amount from super tax-free**. Each person can currently withdraw \$129,751 from their super fund on retirement and pay no tax on it. If you have been able to build up both super funds, then both people can access this tax-free amount.
- **more evenly split income in retirement**. Income splitting helps to reduce the amount of tax you pay.
- **make use of two Reasonable Benefit Limits**, giving you a larger amount of super that is taxed at a lower rate in retirement.

**By using a super splitting strategy, couples with one primary income earner can significantly improve their after-tax retirement income.**

**Please contact us if you would like to discuss any of these ideas:**

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