

Financial Directions, June 2017

How might the latest superannuation changes affect you?

With several major changes to Australia's superannuation system due to take effect from 1 July 2017, here's a summary of the main ones. These changes involve a lot of fine detail, so if you think you may be affected make sure you seek qualified advice sooner rather than later.

New \$1.6 million cap on retirement balances

This move limits the sum that retirees can invest in tax-free pensions. It will also apply to current pensions, so if you have more than \$1.6 million in retirement stream products on 1 July 2017 you will need to roll the excess back to an accumulation phase account where earnings will be taxed at 15%.

This cap will be indexed in line with inflation, in \$100,000 increments. The Federal Government estimates this figure will grow to \$1.7m by 2020-21. Also, once the income stream is established within the applicable limits, subsequent earnings will not be subject to the cap.

If you are intending to set up a pension account before 1 July 2017, take this cap into account to avoid creating additional headaches.

New non-concessional contributions cap

The current limit on non-concessional (i.e. after tax) contributions is \$180,000 per annum or \$540,000 over three years. From 1 July 2017, the limit is reduced to \$100,000pa or \$300,000 within any three-year period. In addition, people who have reached their retirement balance cap (initially \$1.6 million) at the start of each financial year will be unable to make non-concessional contributions.

If you plan on making large non-concessional contributions, perhaps from the sale of a property for example, be aware that the current caps apply until 1 July 2017.

Concessional contributions cap reduced

Current annual caps on pre-tax contributions are \$30,000, or \$35,000 for over-49s. From 1 July 2017, these reduce to \$25,000 per annum, irrespective of age.

This measure is softened in that, from 1 July 2018, if you have a super balance of less than \$500,000, you will be able to carry forward any unused cap for up to five years.

As for this financial year, if you currently contribute less than your current cap you may want to up your salary sacrifice or self-employed contributions prior to July 2017 if appropriate.

Reduced income threshold for additional contributions tax

The annual income threshold above which superannuation contributions are taxed at 30% (rather than the usual 15%) will be reduced from \$300,000 to \$250,000.

Tax-deductions on super contributions extended to all

From 1 July 2017 all residents under 65, or between 65 and 74 if they meet the work test, will be able to claim a tax deduction for superannuation contributions they personally make. This is a win for workers whose employers don't allow salary sacrifice contributions, and some individuals who are both self-employed and employees. Don't forget that the concessional contribution cap will still apply.

Tax on earnings to be applied to Transition to Retirement (TTR) pensions

The current tax-free status of TTR pensions will be removed, so earnings within the fund will be taxed at 15%. The tax treatment on pension payments to individuals will remain unchanged.

Linked to this, individuals will no longer be able to treat certain superannuation income stream payments as lump sums for tax purposes. Currently such lump sum payments are tax-free up to the lifetime threshold low rate cap (\$195,000).

Extended spouse tax offset

Currently, an individual who makes a superannuation contribution for a spouse earning less than \$10,800 per year can claim a tax offset of up to \$540. The threshold will rise from \$10,800 to \$40,000, increasing the number of people able to claim the offset.

Removal of anti-detriment rule

Super funds will no longer be able to claim a tax deduction for a portion of a death benefit paid to a dependent. An anti-detriment payment represents a refund of the 15% paid on contributions made by the deceased member over their lifetime. The government claims the current provision is inconsistent with parts of tax law.

Tax exemptions extended to additional retirement phase products

Deferred lifetime annuities and group self-annuitisation products will receive a tax exemption on earnings in the retirement phase, bringing them into line with other retirement income streams.

The importance of advice

These changes will affect us all in different ways, and as they do little to simplify the superannuation system, it's critical to seek expert advice to ensure that you continue to make the most of your retirement savings.

[Are you ready for June 30?](#)

When it comes to getting the most (money) from your annual tax return, there is always a lot to think about, so we've provided a short checklist of options that could open the door to some opportunities. The key here is to plan ahead.

Tax deductions—lower your liability

Pay now for some of next year's expenses

If you have some spare cash available, paying for certain expenses early could mean you also get your tax break back from the ATO earlier. Expenses that are met in July could leave you waiting more than 12 months for the return. A popular expense in this category is interest on an investment loan, but be careful because not all expenses qualify you for a tax deduction in advance.

Cash back for some of your insurance premiums

Except for income protection, most life insurance premiums are not tax deductible at a personal level. But holding your death or permanent disability cover through a superannuation fund can achieve a similar outcome. This is an important consideration when setting up a new policy. Or in some cases you may be able to replace an existing policy with one inside superannuation, which is particularly helpful when cash flow is tight.

Super contributions—don't waste the limits

June 30 is not just about deductions for expenses. It's also a good time to consider the superannuation contribution limits that may be wasted if you don't act soon, particularly as both concessional and non-concessional limits reduce significantly from 1 July 2017.

Salary sacrifice or concessional contributions

The annual limit for these types of tax-deductible contributions in 2016/17 is \$30,000 for those aged under 49; and \$35,000 per year for people 49 and over. From 1 July, a cap of \$25,000 per annum applies, regardless of age.

If you're an employee, this limit covers both employer super guarantee and salary sacrifice contributions. Do you need to review and adjust your current arrangements?

After-tax contributions

Anyone under 65 (whether working or retired) can contribute \$180,000 each year to super as non-concessional contributions. You can also contribute \$540,000 in a single year by bringing forward the limit for the following two years. From 1 July, the annual cap reduces to \$100,000 or \$300,000 over three years.

These are just a few ways to manage how your money is taxed. Depending on your circumstances, other options may be available. Your licensed financial adviser can work with you to help you achieve what is best for you this financial year. But please don't leave it too late.

Transition to Retirement Strategy – down, but not out

Thanks to changes to superannuation, from 1 July 2017 Transition to Retirement (TTR) pensions will lose a little of their gloss. Instead of the earnings on the investments that support the pension being exempt from tax they will be taxed at 15%. This applies to both new and existing pensions.

However, that's about the extent of the bad news. For those over 60, the pension payments will remain tax-free and TTR strategies can continue to provide a number of benefits for people nearing retirement. Let's look at some options available to 62-year-old accountant, Brian. He works full time and is on an annual salary of \$100,000.

Easing into retirement

First up, Brian might consider reducing his hours as he prepares for retirement. Dropping from five to three days a week will see his \$100,000 annual salary reduce by \$40,000 to \$60,000. But as his tax bill also falls, from \$26,632 to \$12,147, his net income only drops by \$25,515. Subject to minimum and maximum pension payment rules, and as the pension payments are exempt from tax, Brian only needs to start a TTR pension paying \$25,515 each year to maintain his current lifestyle.

One thing to be aware of: based on Brian's reduced hours his employer's super contributions will decrease by \$3,230 after contributions tax of 15% is taken into account. Most simply, Brian could add this amount to his pension payments, and make a non-concessional contribution to his super.

Bridging a gap

TTR pensions can also help bridge the gap if household income takes a hit. What if Brian has no plans to reduce his hours, but illness prevents his partner from working for several months? He could start a TTR to tide them over and help meet mortgage repayments or medical expenses. However, once the crisis has passed the TTR pension will need to continue, as it can't be withdrawn as a lump sum. Alternatively, it can either be converted to a regular account based pension when Brian either turns 65 or permanently retires, or rolled back into the accumulation phase.

Boosting super savings by reducing tax

With his partner restored to health and back at work, and Brian still working full time, what can he do with the now surplus income from the TTR pension? One strategy is to make salary sacrifice contributions to super.

From 1 July 2017 Brian will be able to salary sacrifice up to \$15,500 of his pre-tax income to superannuation (the difference between the concessional cap of \$25,000 less compulsory employer contributions of \$9,500). Taken as salary, \$5,932 of that \$15,500 would go in tax. Make a concessional contribution to super and the tax could be reduced to just \$2,325, a difference of \$3,607!

If there's still money to spare after the salary sacrifice contribution is made Brian can look at making non-concessional contributions to superannuation where earnings will only be taxed at 15%, significantly less than his marginal tax rate.

Getting it right

The tax benefits of TTR pensions may be reduced after 1 July 2017, but all the other benefits remain in place. If you're approaching retirement, it's worth checking out what a TTR strategy may be able to achieve for you. It's a complex area, so make sure you talk to your licensed financial planner before you act.

How the family home can affect aged care fees

Residential aged care is playing an increasing role in helping many older Australians enjoy comfortable and carefree lives. However, one of the tasks for anyone assisting an elderly relative with the move into aged care is to investigate the various fees and charges, some of which are subject to both assets and income means tests. As the family home is often the largest asset and can be a source of income if rented out, it's particularly important to understand how it is treated in relation to these tests¹.

Assets test

For individuals entering aged care after 1 July 2014 the value of the family home is **not** counted as an asset if it is occupied by:

- a partner or dependent children,
- a carer who is eligible for government income support and who has been living there for at least two years, or
- a close relative who is eligible for income support and has been living there for at least five years.

However, even if that is not the case, the value of the family home that is counted as an asset is capped at \$162,087 (as at 20 March 2017). If the actual value is less than the cap then market value applies.

For a couple where neither partner is living in the family home, half of the net market value of the home will be included as an asset for each of them, up to the cap.

Income test

For people who entered aged care between 1 July 2014 and 31 December 2015, rent on the family home is exempt from the income test only if they are paying some level of daily accommodation payment.

Where aged care commenced after 1 January 2016, net rental income is assessable.

¹ Note that there are some important differences in the way the family home is assessed by Centrelink and the Department of Veterans' Affairs (DVA) for aged pension or DVA pension purposes. This article only covers the rules that apply to aged care.

Split by health

Eric, 85, and Wendy, 87, own a home valued at \$650,000. In February 2016, poor health made it necessary for Eric to move into aged care. Wendy remained in the family home so the house was exempt from the assets test, and as there was no rental income, there was no impact on the income test.

Reunited

In March 2017, Wendy's increasing frailty also saw her entering residential care, fortunately in the same nursing home as Eric. Their former home was rented out and became assessable as an asset. As the value of the home is more than twice the current cap, they each have \$162,087 included in their assessed assets.

Under the income test, half the net rental income is applied to each of their assessments.

Expert help

Aged care is a complex area requiring important decisions to be made at a time of high emotional stress. Expert advice can help to reduce that stress so talk to your qualified financial adviser early in the process of moving a loved one into aged care. It will make everything just that little bit easier for all concerned.

Building your 'Family Future Fund'

How much does it cost to raise a child?

Obviously, the answer is highly dependent on individual circumstances. However, as a guide, a 2013 national study² found that a typical middle-income family would spend about \$812,000 on raising two children from birth to age 24.

At that time child-raising costs were increasing at around 9% per annum, so it's a reasonable estimate that these days the cost of getting two kids to the point where they're ready to leave home (that's not to say that they will) is closer to \$1.1 million! And that's a middle of the road figure.

For low and middle-income families transport is, perhaps surprisingly, the biggest single cost, but for high income families, education takes top spot. Along with childcare, it eats up over a quarter of the household budget. And that's largely due to the costs of private education.

The Australian Scholarship Group, (ASG), estimates that providing just one child with a private education from pre-school to the end of high school will cost close to \$487,000³. Opt for the Catholic system and that drops to around \$239,600, while a

² Conducted by the National Centre for Social and Economic Modelling (NATSEM) in conjunction with AMP.

³ Figures estimated by ASG relate to a child educated in a capital city.

government education comes in at roughly \$68,600. Supporting a child through university adds substantially to these costs.

Creating a 'Family Future Fund'

Being forewarned about the costs of children, particularly educating them, provides an opportunity to prepare for the hit to the family budget.

Take Ben and Laura, a young professional couple with a combined after-tax income of \$150,000. They plan to start a family in a few years and after allowing for other financial commitments, decide to set aside 25% of their net income for their 'family future fund'.

Opting for the safety of a high interest savings account their return after tax is 2% per annum. When baby Rose arrives five years later, they have a head start of just over \$195,000 in meeting future child-raising costs. But babies and toddlers are relatively cheap to support compared with older children, so Ben and Laura don't need to dip into their fund just yet. This is just as well as they are forced to stop their regular contributions when unpaid parental leave puts a dent in their income. When Rose is ready to start school at age five the family fund has grown to \$215,463.

Matt and Sara, on the other hand, only begin to think about their future family costs when their first child Thom is born. To match Ben and Laura's savings balance by the time Thom starts school, Matt and Sara would need to save \$41,400 per year – for them, and most young couples, an impossible challenge.

Savings options

A child's 'future fund' is not something to speculate with. This means opting for 'safer' investments such as cash, term deposits or bonds, despite their generally lower returns. Alternatively, tax benefits may be gained by investing in insurance bonds or a friendly society education plan.

Another possibility is to pay the savings into a mortgage offset account. This will provide a return closer to the home loan rate, which is likely to be higher than interest rates currently available elsewhere. Funds can then be redrawn as school fees or other costs require.

While every family is unique, the costs of raising children are quite staggering. The sooner you talk to your licensed financial adviser about how you can plan the financial side of family life, the more enjoyable parenthood can be.

Implications of the UK election

**By Wouter Sturkenboom, Russell Investments*

Neither Conservatives nor Labour get a total of 326 seats (for a majority win)

- The lack of a Conservative majority realises a hung parliament. The impact of this on Brexit is hard to predict.
- Markets are likely to move into 'risk-off' mode seeing a decline in sterling, UK equities and gilts.
- Investors should prepare for increased market volatility as we expect a chaotic and difficult time for Westminster.
- Russell Investments' Multi-Asset funds have no structural overweight allocation to UK assets.

The campaign

The election campaign turned out to be a lot more interesting than many expected when Prime Minister May announced her wish to hold a snap election. At the time, the Conservatives were almost 20% ahead in the polls and it seemed as though the British public overwhelmingly favoured Theresa May over Labour-leader Jeremy Corbyn to deliver Brexit negotiations. As a result, the media and political analysts widely expected a resounding victory and an increased Conservative majority in the House of Commons to more than 100 seats.

But then the campaigns got under way...To everyone's surprise the Conservatives were quickly put on the defensive about hot topics like social care, while Labour found traction on issues such as education and housing. This reversal and subsequent narrowing of the polls turned a coronation into a battle. In the end, however, that battle was not clearly won.

Brexit negotiations

A hung parliament has now kickstarted a very chaotic and difficult time for Westminster, the outcome of which is difficult to envisage. Could we see Labour and the SNP cobble together a coalition (maybe with the help of the Lib-Dems)? In any case, the UK's departure from the European Union looks set to be delayed or turned into a very Soft Brexit.

What are the implications for UK assets?

Sterling

Since the referendum on 23 June 2016, the British pound exchange rate has been the best barometer for the market's perception of the risks and opportunities. After falling more than 15% in trade-weighted terms during 2016, sterling recovered almost 8% over 2017. However, it quickly fell back by 3% in May as the Conservative polls started to narrow during the run up to the election. Looking ahead, we think the pound will fall initially, but the downside is limited by favourable valuations (see chart).

Equities

Equity markets will fall on the back of heightened political uncertainty. The fall in equity markets is likely to be softened by a weaker pound, but the medium-term outlook for stocks very much depends on how the political uncertainty is resolved. Overall, the outlook for UK stocks is also closely linked to global economic prospects.

Gilts

In such an environment, we project that 10-year gilt yields will fall in a risk-off move. If the formation of a government is delayed significantly, this may eventually lead to a review of the UK's credit rating and higher yields.

Economic outlook

Our bottom line is that whilst this general election result feels like a crucial event for those in the UK, it does not carry with it the same market significance as others have over the past year, namely the French or Italian elections. Indeed, the post-Brexit economy has done well so far, but we continue to believe that the slowdown in corporate and housing investment, in combination with downward pressure on real wage growth, will slow economic growth in 2017 and 2018.

Defying mortgage stress

Technically speaking, if more than 30 percent of your pre-tax income goes towards paying your mortgage, you meet the common definition for being 'mortgage-stressed' – and it's more common than you think!

When thirty-something professionals Harry and Sally were house hunting for their first home they were on high incomes and had saved a healthy deposit. Even so, they cautiously did their homework, entering their information into several bank online calculators to determine their borrowing capacity.

They entered:

Borrower	Couple
Dependents	1
Reason	Residence
Pre-tax salary	\$190,000 annually
Living expenses	\$4,000 monthly
Current loan repayments	\$0.00
Personal loan repayments	\$600 monthly

Credit card limits	\$15,000
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How much?

The highest amount suggested by one of these calculators was around \$976,000 with monthly repayments of \$4,650 over 30 years. Based on their current combined income this would take up 29.3% of their pre-tax income.

It's natural to want the best home affordable. "We're on good money. We figured we could afford it," Harry said during our first meeting.

"But it's a lot of money to owe," Sally added as she started to understand what other costs might be involved. "A larger house costs more to maintain and furnish; plus higher council rates."

When inflation is low and wage growth is next-to-nothing, households with large mortgages could be in real strife when costs of living go up or interest rates rise - regardless of the Reserve Bank of Australia's (RBA's) management of the cash rate. Already banks are increasing the rates on home loans off their own bats.

Online calculators generally use limited information to give applicants an idea of what **might** be available to them. Supporting a mortgage up to thirty years requires more detailed consideration than credit card limits and pre-tax earnings.

The banks' calculations would take Harry and Sally perilously close to the 30 percent threshold. Increased living expenses, or small interest rate rises would tip them into the danger zone.

Together we looked at an independent mortgage calculator on the ASIC MoneySmart website at www.moneysmart.gov.au. By working on the couple's AFTER tax income of \$140,536⁴ and applying 25% of this to calculate monthly repayments of \$3,000, MoneySmart's calculator returned a more realistic estimate of \$629,000⁵.

Though disappointed, they pragmatically decided to continue growing their deposit and even looked at ways of increasing their saving potential.

Options for increasing a loan deposit

Harry's friend is saving for a home deposit by being a 'house-sitter'. Initially popular for grey nomads, house-sitting has become a growing trend for potential home-buyers to live rent-free in exchange for caring for pets and plants. While this sounds idyllic, the nomadic lifestyle doesn't suit everyone, and Harry's friend occasionally ends up on his mum's couch between sitting engagements. With a small child, this was not an option for this couple.

⁴ \$100,000 + \$90,000pa = \$190,000pa combined income after tax and Medicare levy.

⁵ Calculated at 3.99% interest over 30 years, not including fees or charges.

Alternatively, they could rent their spare room to Sally's niece studying at a nearby university. That appeared more workable, not to mention a free baby-sitter!

And managing risk

Finally, we talked about insurance. It's imperative that the couple's income – their most valuable asset – be protected. Additionally, life cover, to provide for their daughter should anything happen to either of them was vital.

Unfortunately, too many people are in over their heads. If you're experiencing mortgage-stress or you're losing sleep worrying about an interest rate rise, speak with your licensed adviser about a strategy to relieve the pressure.