

your money your future

FINANCIAL PLANNING NEWSLETTER SUMMER 2007

Merry Christmas & Happy New Year!

Welcome to the final edition of HPH Hotline for 2007.

What an exciting and eventful year it has been. It was quite a year in terms of change and to end the year, we have a change in government and with a new federal government comes a new policy agenda. For the remainder of this year and throughout 2008, we look forward to keeping you informed of any relevant issues that may affect your circumstances.

We would like to say "Thankyou" for your continued support and we wish you and your families a Merry Christmas and a happy, healthy and prosperous New Year!

Cheers Rob, Adam and the HPH Team.

Secrets to great health and vitality in your retirement

Have you ever wondered how some people seem able to maintain an active and fulfilling lifestyle in retirement? The secrets to great health and vitality include a balanced diet, regular exercise and medical checkups.

Proactive health maintenance

Good nutrition and exercise are key ingredients for maximising your enjoyment of life in retirement. Not only does exercise keep you physically fit, it improves mental alertness, enhances feelings of wellbeing and is an effective way of preventing age-related diseases. Proper nutrition, strength training and cardiovascular activity assists the entire body, including your heart, lungs and bones.

Regular exercise

Motivating yourself to exercise when you have never exercised before or have had a serious physical injury can be difficult. The key is to find something that you enjoy, or invite a friend to join you so that you can share an activity while keeping fit.

Medical check-ups

Regular medical checkups become increasingly important as you age, particularly if you have a known genetic predisposition toward a certain condition. Early diagnosis is the key to prevention for many illnesses, so seeing your doctor may mean that you have a longer retirement to enjoy the fruits of your working life.



The HPH Hotline Newsletter

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Maximising the benefit of co-contributions

To date, the Australian Federal Government's co-contribution scheme has injected over \$2.2 billion into the super funds of approximately 1.2 million working Australians to help them save for their retirement.

Are you making the most of this 'free' money to boost your retirement savings?

If you're eligible and your total income is \$28,980 a year or less, the Government will contribute \$1.50 for every \$1 of personal contributions you make, up to a limit of \$1,500 a year. The maximum co-contribution will reduce by 5 cents for each dollar of income above \$28,980, and phase out completely at an income of \$58,980.

How you can maximise your entitlement?

Here are some strategies you may consider to boost your entitlements:

Salary sacrifice or co-contributions – or a bit of both?

In some situations, you may be entitled to make salary sacrifice contributions into superannuation and also to receive a Government co-contribution. Depending on your income level, one strategy may work better than the other. In other instances,

a combination of both will provide the greatest benefit.

The table below outlines possible strategies at a range of income levels, assuming that all of the necessary conditions are met in each case.

Spouse contributions or co-contributions – or a bit of both?

It is possible for a couple to receive both a spouse contribution tax offset and a Government co-contribution. The maximum benefit available in 2007/08 is \$2,040 (made up of a \$540 spouse contribution tax offset and a \$1,500 Government co-contribution).

Case study

John earns \$120,000 per annum working as a store manager. His wife Lucy works part-time as a secretary earning \$10,000

per annum. They agree to boost their super by \$4,000 during the course of the 2007/08 year in addition to the contributions made by their employers.

John and Lucy decide to take advantage of both strategies to maximise their entitlement.

John makes a spouse contribution of \$3,000 for Lucy, generating a tax offset of \$540; while Lucy also makes a personal contribution of \$1,000, entitling her to a co-contribution of \$1,500. By contributing \$4,000 to their super savings, John and Lucy receive a \$2,040 boost to their superannuation. This is effectively a guaranteed return of over 50 per cent.

Speak to your financial adviser today to see how you can also maximise your entitlements and boost your super.

| Total income per annum (assessable income and reportable fringe benefits) | Strategy |
|---|---|
| Less than \$28,980 | You should consider making personal superannuation contributions of up to \$1,000 to attract a Government co-contribution (on a \$1.50 for \$1 basis) of up to \$1,500. |
| Between \$28,980 and \$58,980 | In addition to making a personal superannuation contribution, consider salary sacrificing into superannuation to reduce your total income and increase the amount of the co-contribution. |
| Over \$58,980 | You may be able to salary sacrifice into superannuation to reduce total income to less than \$58,980 and qualify for a Government co-contribution. |



'She'll be right' ... but will it?

A new global survey has confirmed that Australians are among the most carefree and optimistic nations in the world.

But our 'she'll be right' attitude also means many of us are underinsured and unprepared for the consequences of life risks.

The 2007 AXA Protection Report is an international study that examined the attitudes people have towards life risks, such as serious illness, accidents, financial problems, unemployment, terrorism and plane crash. It interviewed a wide variety of people from Australia, Belgium, France, Germany, Hong Kong, Italy, Japan, Spain, Switzerland, the UK and the USA.

The report found that 64 per cent of Australians are underinsured. And, on average, we are underinsured by \$112,000.

What was most surprising, however, was the finding that many people know they're taking risks but are failing to take action to adequately protect their financial future. In fact, two in three Australians are aware that their level of insurance coverage is either inadequate or nonexistent. While 29 per cent of Australians are aware and actively avoid taking risks, a staggering 61 per cent either don't like thinking about them or can't see the point of thinking about them.¹

The things we worry about

Compared internationally, Australians don't worry about life risks much at all. Looking at ten specific life risks, including serious illness, crime, work accidents, plane crash and terrorism, Australia ranked either last or second last when compared against other countries.

The French were more worried than all other nations about everything except plane crashes. The Germans, too, were significantly more concerned than other nationalities. And the Spanish were comparable to Australia in their relaxed attitude to life risks, with the exception of their heightened concern about terrorism.

The reality of life risks

In contrast to the 'she'll be right' attitude many Australians seem to have when it comes to life risks, the rates of incidence when it comes to injury, illness and premature death highlight the commonality of life risks. The statistics reveal the reality:

- Of the 132,508 deaths reported in 2004, around 25 per cent of male deaths and 15 per cent of female deaths were of people aged less than 65.

- In 2003–04 more than 370,000 people were admitted as inpatients to Australian hospitals as a result of injury.
- One in sixteen Australian has a severe or profound core activity limitation. This means they sometimes or always need personal assistance with self-care, mobility or communication.
- One in three Australian males and one in four females will be diagnosed with cancer before the age of 75.

You never know what is just around the corner

For John Maher, his wife Ange and their four daughters, Sunday 4 April 1993 seemed like just any other day. John was on his way to a local cricket function. But he would never reach his destination.

John was involved in a horrific car crash. Emma, the driver of the other car, was killed instantly and John suffered serious head and neck injuries that would leave him with pain and short-term memory loss for the rest of his life.

Not just emotionally, but financially too, John's family now faced an uphill battle. Previously, John was a senior manager and earned more than \$100,000 a year. He and his wife had a substantial mortgage and other loans and children at university and private schools.

John found himself unemployable and stopped working. Fortunately, 10 years prior to the accident John had taken out income protection. Over the period of his cover he'd paid \$9,800 in income insurance premiums.

Income insurance has proven to be the Maher family's financial lifeline. Over the last 14 years, John has received more than \$1.1 million and he will likely continue to claim his monthly benefit until age 65. His projected income insurance benefit is approximately \$1.8 million.

As John says, "Insurance was my greatest ever investment. I remember thinking at the time that nothing was likely to happen to me – but you never know what lies around the corner."

To protect yourself from the financial consequences of life risks today, speak to your financial adviser.

| A plane crash | Serious financial problems |
|---|--|
| 1 Switzerland | 1 France |
| 2 Hong Kong | 2 Germany |
| 3 Japan | 3 Belgium |
| 4 Belgium | 4 Italy |
| 5 Germany | 5 Japan |
| 6 Italy | 6 Switzerland |
| 7 France | 7 USA |
| 8 UK | 8 Hong Kong |
| 9 Australia  | 9 UK |
| 10 Spain | 10 Spain |
| 11 USA | 11 Australia  |

| Terrorism | Serious illness |
|--|--|
| 1 Spain | 1 France |
| 2 France | 2 Japan |
| 3 Germany | 3 Switzerland |
| 4 Italy | 4 Germany |
| 5 USA | 5 Belgium |
| 6 UK | 6 Italy |
| 7 Belgium | 7 USA |
| 8 Japan | 8 UK |
| 9 Switzerland | 9 Spain |
| 10 Australia  | 10 Australia  |
| 11 Hong Kong | 11 Hong Kong |

| Unemployment | Crime |
|--|---|
| 1 Germany | 1 Belgium |
| 2 France | 2 Italy |
| 3 Hong Kong | 3 France |
| 4 Japan | 4 Switzerland |
| 5 Switzerland | 5 UK |
| 6 Italy | 6 Germany |
| 7 UK | 7 Japan |
| 8 Spain | 8 USA |
| 9 USA | 9 Australia  |
| 10 Belgium | 10 Hong Kong |
| 11 Australia  | 11 Spain |

¹ Of the remaining, 5 per cent "believe in taking risks" and 5 per cent said "none of these".

Create wealth by legally paying less tax

Understanding our tax system, and seeking qualified financial advice, can help you to arrange your finances legally so you pay less tax and maximise your wealth. Australia has a progressive tax system, where our individual tax rate increases as our income increases. Our Medicare levy of 1.5 per cent is levied on taxable income. The tax rates for resident individuals at 1 July 2007 are:

| Taxable income | Tax on this income |
|----------------------|---|
| \$0 – \$6,000 | Nil |
| \$6,001 – \$30,000 | 15c for each \$1 over \$6,000 (15%) |
| \$30,001 – \$75,000 | \$3,600 plus 30c for each \$1 over \$30,000 (30%) |
| \$75,001 – \$150,000 | \$17,100 plus 40c for each \$1 over \$75,000 (40%) |
| Over \$150,000 | \$47,100 plus 45c for each \$1 over \$150,000 (45%) |

Holding money in cash

The interest we earn on our savings is taxed at our marginal income rate. For many individuals, holding large sums in cash does not necessarily produce the most beneficial financial outcome.

Consider Sally, a 27-year-old single woman, who works as an IT consultant and earns \$110,000 a year. She lives at home with her parents and is able to save \$2,000 per month, which she deposits into an online savings account, paying 7 per cent per annum. At the end of the financial year, Sally earns \$930 in interest, of which she needs to pay \$385 in tax.¹

Investing in shares

Depending on Sally's goals, she may achieve a better wealth creation and tax outcome if she chooses to invest her savings into a share portfolio. Depending on the shares purchased and the performance of the portfolio, Sally may receive a higher rate of return, together with dividend income. Franking credits will actually reduce the amount of tax Sally needs to pay.

Investing in shares produces most benefit when utilised as a long-term strategy, taking into account that selling shares incurs capital gains tax. The impact of capital gains tax is reduced when shares are held for a year and a day, as tax is only payable on 50 per cent of any capital gain.

Capital gains tax is less substantial than the tax incurred on interest earnings in the online savings account. This is because capital gains tax is not payable until shares are sold. If Sally holds shares over a relatively long period of time (for example, five years) she effectively defers paying capital gains tax, and when it is payable, she is entitled to a 50 per cent concession.

Salary sacrifice

At first, Sally is reluctant to salary sacrifice into superannuation, as she is unable to access her superannuation funds until she reaches 60 years of age. However, Sally discovers that if she invests \$1,000 in superannuation she automatically has 45 per cent more to invest. In addition to this, the earnings on her investments within her super are taxed at 15 per cent instead of her marginal tax rate of 45 per cent. Over time, the difference in tax rates and the effect of compounding will make a significant difference to Sally's total wealth, as well as minimising her tax.

| Pre-tax | Tax rate | Non-super | Super | Difference in return |
|---------|----------|-----------|-------|----------------------|
| \$1,000 | 0% | \$1,000 | \$850 | (15%) |
| \$1,000 | 16.5% | \$835 | \$850 | 1.8% |
| \$1,000 | 31.5% | \$685 | \$850 | 24.1% |
| \$1,000 | 41.5% | \$585 | \$850 | 45.3% |
| \$1,000 | 46.5% | \$535 | \$850 | 58.9% |

Splitting income

One way to maximise wealth within a family unit is to hold assets and investments in the name of the lowest income earner. Take the situation of a married couple with a young child. Jarrod earns \$110,000 per annum, and his wife Kylie has an assessable income of \$5,000 per annum from casual employment. Jarrod and Kylie would like to purchase a new car. Instead of borrowing, they decide to delay the purchase and open a high-interest savings account in Kylie's name, so that the interest on their savings is not taxed. After some calculations, Jarrod and Kylie see that this strategy means that if they earn \$1000 in interest, they are 71 per cent better off.

They also decide to hold their investment portfolio in Kylie's name, so that they pay less tax than if it was held in Jarrod's name.

| | Tax rate | Interest earned before tax | Interest earned after tax |
|-----------------------------|----------|----------------------------|---------------------------|
| Investment in Jarrod's name | 41.5% | \$1000 | \$585 |
| Investment in Kylie's name | Nil | \$1000 | \$1000 |
| Difference in return | 71% | | |

Another option for Jarrod and Kylie to enhance their wealth is to use superannuation.

Jarrod already salary sacrifices at the maximum level into his own superannuation fund, and decides to make a spouse contribution to Kylie's superannuation. Jarrod can access the maximum spouse contribution tax offset of \$540 by contributing \$3,000 into Kylie's superannuation, which is effectively a guaranteed 18 per cent return.²

It's important to work with a qualified financial adviser to assess your own situation and determine how to best structure your financial affairs to generate wealth.

¹ Assumes interest is paid at the beginning of the month, and that each month has the same number of days.

² To use this strategy, both the receiving and contributing spouse must be Australian residents, and the receiving spouse's assessable income and reportable fringe benefits must be less than \$13,800 per annum. The maximum tax offset is 18 per cent on the first \$3,000 contributed to the spouse's superannuation fund.