

# your money your future

FINANCIAL PLANNING NEWSLETTER Edition 1, 2008

## New Super Rules

Welcome to the Autumn edition of HPH Hotline for 2008.

There is an abundance of information circulating currently in relation to borrowing via Self Managed Super Funds (SMSF). For the right advice to meet your circumstances contact the HPH Team.

Congratulations to Rob, who has for the second year running qualified for the Top 50 Australian Financial Review Smart Investor Masterclass 2008.

HPH would like to welcome the appointment of Lisa Botha in an administrative support capacity and Greg McMeekin who will join HPH on the first of April as our Practice Manager.

For further information on any of the above or newsletter content, please contact our office.

Cheers Rob, Adam and the HPH Team.

## To fix or not to fix – that is the question

**In an environment of concerns about continued rises in inflation and interest rates, more Australians are opting for fixed-rate home loans.**

Australian Bureau of Statistics figures show the number of people with fixed-rate loans increased to 24 per cent, or nearly one in four, in November 2007, compared to 21 per cent in the previous month<sup>1</sup>.

Fixed-rate loans have an interest rate that stays the same for a set period, usually one to five years, compared to variable-rate loans where the interest rate rises or falls in line with market conditions.

When interest rates are rising, a fixed rate can give you the security of

knowing your ability to meet mortgage repayments won't be affected by interest rate increases.

Quite often though, fixed-rate loans don't have the flexibility of variable-rate ones. And switching from a variable to a fixed rate may attract fees. If market rates fall below your fixed rate, you will continue to be locked into your higher, fixed rate.

One option to capture benefits from both strategies is to choose a 'split-rate' loan, where the interest rate is fixed for part of the loan and variable for the rest.

Contact us to work out the best option for your circumstances.

1 ABS 5609.0 – Housing Finance, Australia, Nov 2007



### The HPH Hotline Newsletter

Rob Pyne & Adam Smith

Partners, HPH Solutions

Level 1, 35 Outram Street

West Perth

WA 6005

**Rob Pyne** BSc. F.Fin CFP Retirement Specialist

**Adam Smith** Dip FP CFP Protection Specialist

**Authorised Representatives of Charter FP**

Po Box 1798

West Perth

WA 6872

Phone: 08 9213 0444

Fax: 08 9226 4933

Email: [rpyne@hphsolutions.com.au](mailto:rpyne@hphsolutions.com.au)

Email: [asmith@hphsolutions.com.au](mailto:asmith@hphsolutions.com.au)

Web: [www.hphsolutions.com.au](http://www.hphsolutions.com.au)



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## History shows share markets can recover from present turbulence

In the midst of worldwide share market instability sparked by the sub-prime mortgage crisis and fears of a recession in the US, the key questions for investors are how markets will be impacted and for how long.

It's impossible to say with certainty when a sustained recovery will occur. And while it can be dangerous to attempt to pick the precise turning point, history shows that markets can and have recovered from dramatic downturns such as the one we have been experiencing.

The chart illustrates the performance of international share markets since 1987. It shows that a range of events including the Asian currency crisis, the Russian bond market default and September 11 all had a sharp impact on markets, but did not halt their long-term rise.

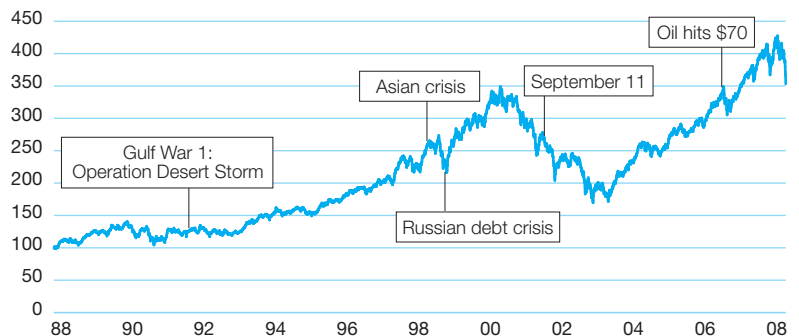
### Global economic fundamentals still sound

Commentators have noted that despite market volatility all over the world, global economic 'fundamentals' are sound or largely unchanged. In support of this, consider the following:

- The world economy, while slowing, is still projected to grow at a solid rate of between 3 and 3.5 per cent in 2008.



Impact of key market events on global shares



Source: MSCI International Share Index as of 22 January 2008, ipac newsnote, 23 January 2008.

- Forecasts already assume slower growth in the US, Europe and Japan, but stronger growth in China and emerging markets such as India.
- There is some risk of the US economy slowing sharply, although we have recently seen significant policy responses to reduce this risk.
- The global corporate sector is in good shape with profit margins at a 30-year high, gearing at low levels and strong internal cash flows to fund growth.
- Developing economies are strong, with strong surpluses and high capital reserves, government budgets in good shape, and financial institutions well regulated and managed.

Overall, the world economy appears to be on a strong footing and a recession in the US is not a certainty. However, share markets are very sensitive to short-term news flow, and volatility is expected to remain elevated over the coming months.

### Outlook for Australian investors

Within Australia, share markets have performed strongly, with the ASX/S&P 300 Index returning 16.2 per cent in the five years to 31 December 2007. Australia's strong economic ties with China and emerging markets in Asia will provide some protection against the direct impact of any continuing weakness in the US economy.

Investors in typical balanced funds with around 70 per cent of growth assets can expect to see lower unit prices, at least in the short term. Periods of market turmoil are dangerous times to make changes to long term investment strategies without first seeking expert advice.

The most prudent strategies continue to be based around quality, diversified portfolios representing a range of asset classes.

To discuss your investment portfolio and strategy, please contact our office.

## Have you planned your transition from work to retirement?

If you are close to retiring you've probably already spent some time thinking about how you will manage the important transition from worker to retiree.

Everyone is different and perhaps you would prefer to retire early, at 55. Or maybe you'd like to keep working until you are 70 or even older, if that is a possibility for you. You may wish to go straight from full-time employment to complete retirement, travelling the world or pottering about in the garden. Or you could be thinking of moving into part-time work for a while before leaving your paid employment for good.

Whatever your objectives, it's likely that in the years before you retire you will want to do everything you can to maximise your retirement savings. And you might be wondering if there are strategies you can use to reduce your tax and grow more super.

Perhaps you've heard that you can start accessing your super from the age of 55 while continuing to work, via a 'transition to retirement' income stream, and would like to know more about the potential tax savings and other advantages.

These income streams, commonly known as non-commutable allocated pensions or NCAPs, can have a number of benefits for people aged 55 and over who aren't yet ready to retire completely.

### How an NCAP works

If you're 55 or over but less than 65, you are eligible to commence an NCAP arrangement to access your preserved superannuation benefits without having to retire.

An NCAP can allow you to salary sacrifice a significant proportion of your income into your super, while supplementing your take-home pay with a regular income stream from your pension account.

This can help you to:

- reduce your work hours, ease into retirement and retain the same income, or
- work the same hours, boost your retirement savings through salary sacrifice and retain the same income.

You will pay less tax on income and super earnings, and gain a tax offset on your pension payments if you're less than 60, or receive tax-free pension payments if you're 60 or over.

### NCAP tax advantages

The tax advantages of an NCAP come about because of the differing tax rates applied to ordinary income, super and pension accounts such as NCAPs.

Ordinary assessable income is taxed at your marginal tax rate. Super is taxed at a concessional rate of up to 15 per cent on entry and 15 per cent on any investment earnings, with withdrawals tax free if you're 60 or over. Payments from NCAPs are also tax free if you're 60 or over. If you're aged from 55 to 59, all or part of the NCAP income may be taxable, but a tax offset of 15 per cent of taxable pension income will apply. In addition, there is no tax on any investment earnings in an NCAP.

### Case studies

The following case studies show just how effective an NCAP can be in transitioning to retirement and boosting your super:

#### Transitioning to retirement

David is 56 and works full-time as a pharmacist, earning \$120,000 a year. He enjoys his job but wants to gradually transition into retirement, initially reducing his workload to three days a week, but is concerned about the reduction in pay.

By commencing an NCAP he can work part time yet still receive the same take-home income as he did when working full time.

To date, David has accumulated \$550,000 in super. Naturally, drawing down on his retirement savings via an NCAP may result in less super for David when he does finally retire.

But this may be offset by the ongoing super contributions made as a result of his part-time work and the fact that his NCAP investment earnings will now be tax free. Also, the taxable portion of the NCAP payment is eligible for a 15 per cent tax offset, and will be tax free after he turns 60.

#### A super boost and tax savings

Sarah, aged 55, is a senior administration officer. She enjoys her work and no intention of retiring until she reaches 65. Sarah currently earns \$70,000 a year and has \$450,000 in super.

To boost the amount of super she'll have at retirement, Sarah begins salary sacrificing a significant portion of her regular pay into super, and commences an NCAP to

maintain her take-home income at the same level as before.

As the table below illustrates, she keeps the same income, pays less tax and contributes more to her super via salary sacrifice than she's withdrawing as a pension payment. Better still, it's projected that by age 65, she will have an additional \$118,284 in super.\*

	Current position	With NCAP and salary sacrifice
Gross salary	70,000	70,000
Salary sacrifice super contribution	0	(55,584)
Cash salary	70,000	14,416
Allocated pension	0	45,000
Taxable income	70,000	59,416
Gross PAYG tax	(15,600)	(12,425)
Mature age worker tax offset	0	500
15% pension tax offset	0	6,750
Medicare levy	(1,050)	(891)
Net tax and Medicare levy	(16,650)	(6,066)
Net cash after tax	53,350	53,350

\* The assumptions made in the projection are:

- salary is constant for each year of the projection
- all contributions and pension payments are made monthly
- no other income is received
- shading-in rules for Medicare levy for low income earners are not taken into account
- Medicare levy surcharge does not apply
- Super Guarantee contributions are based on 9 per cent of gross salary in both scenarios
- nominal rate of return (net of management fees for growth portfolio) is 6.4 per cent per annum (super), 7.3 per cent per annum (pension)
- 2007/08 tax rates apply in the first year and 2008/09 tax rates apply in each subsequent year
- Contribution caps are indexed by Average Weekly Ordinary Time Earnings of 4 per cent per annum.

To find out how an NCAP could work for you, speak to us today.

## A little sacrifice for a big return

**Contributing some of your salary into your superannuation fund can provide great financial rewards for when you eventually retire. And it's not just that the money put into super will be invested for your retirement: you'll also receive a nice tax benefit.**

Essentially, salary sacrifice is simple. The income you 'sacrifice' into superannuation is known as a deductible or concessional contribution. This means, because the contribution is made pre-tax (ie before you pay income tax on the money), it will have 15 per cent superannuation tax deducted from it.

### A double bonus

The double benefit of salary sacrifice comes from paying less tax and investing your money rather than spending it:

- concessional contributions are taxed at 15 per cent rather than being taxed at your marginal tax rate, and
- once contributed to superannuation, money you might have otherwise have spent is invested to grow as part of your long-term savings plan.

### How to salary sacrifice

Salary sacrifice is a simple three-step process:

1. Decide how much of your current income you can afford to sacrifice.
2. Check that your employer allows salary sacrifice.
3. Make a written agreement with your employer for them to pay this amount in addition to the regular 9 per cent superannuation contribution they already

contribute on your behalf. (Make sure you check the 9 per cent contribution they already pay continues to be calculated based on your total salary.)

4. Reassess your superannuation investment plan to ensure it fits with your retirement goals.

### Susan sacrifices for the long term

Susan is about to start a new job and has negotiated a salary of \$90,000 per annum. But she believes that she can comfortably fund her current lifestyle on the gross income level she previously had, which was \$70,000.

She negotiates an arrangement with her new employer to sacrifice \$20,000 on top of her 9 per cent employer contribution. The result can be seen in the table below.

#### Susan's salary sacrifice saves tax and invests for her future

	No salary sacrifice	Salary sacrifice
Salary	\$90,000	\$90,000
Salary sacrifice amount	\$0	\$20,000
Taxable income	\$90,000	\$70,000
Income tax payable	\$24,450	\$16,650
Net take-home income	\$65,550	\$53,350
Gross amount contributed into super	\$0	\$20,000
Superannuation contributions tax	\$0	\$3,000
Net benefit to superannuation	\$0	\$17,000
Net benefit (superannuation and after-tax income)	\$65,550	\$70,350
<b>Total benefit</b>		<b>\$4,800</b>

Note that this case study:

- does not consider the effects of lump sum tax upon withdrawal from superannuation
- assumes all contributions are within the concessional contributions cap of \$50,000 per person for 2007/08, and
- Superannuation Guarantee (SG) contributions are not included in the above calculations as it is assumed that SG is paid on the pre-salary sacrifice salary (ie \$90,000) for each option.

The salary sacrifice arrangement provides a personal tax saving of \$7,800 (ie \$24,450 – \$16,650). However the employer contribution of \$20,000 is subject to 15 per cent contributions tax, resulting in an immediate net benefit of \$4,800.

For more information on how you can salary sacrifice to boost your retirement savings and pay less tax, contact us today.

