Impact of the new tax rules on financial planning

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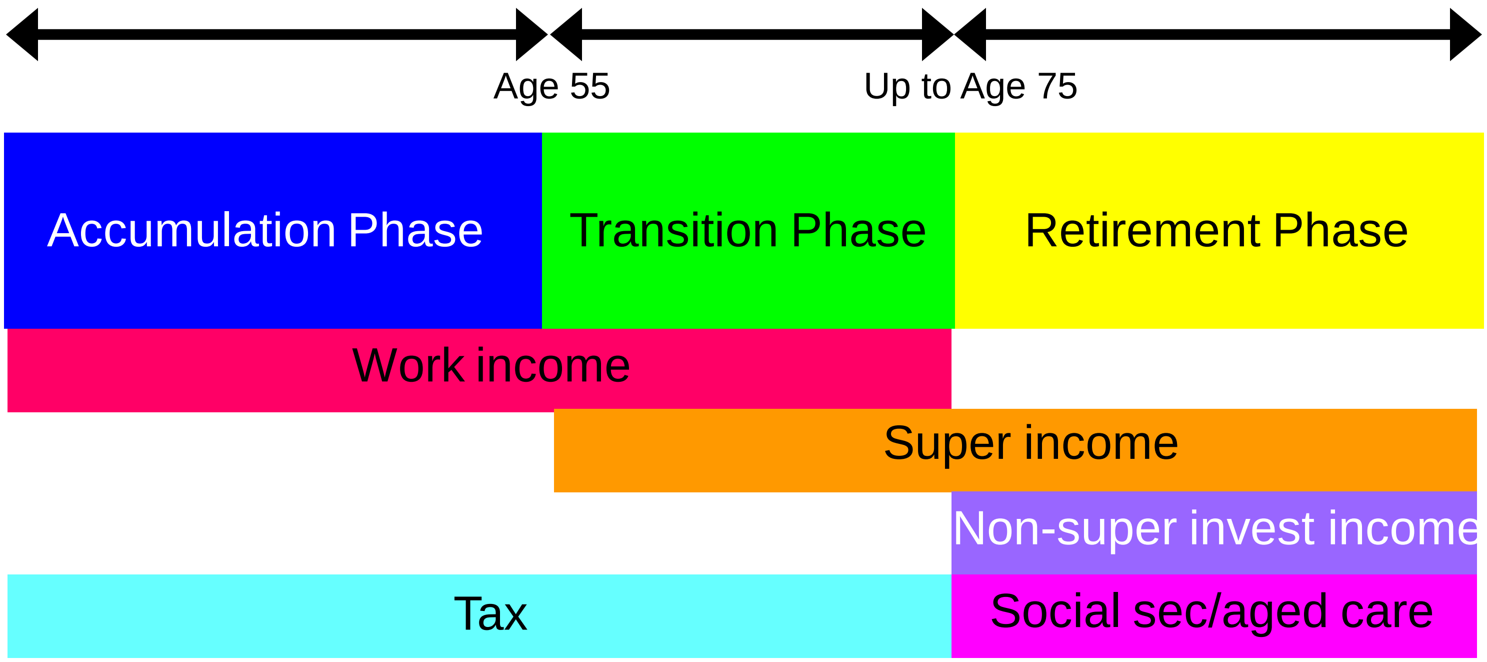
Agenda

- Wealth accumulation strategies
- Estate planning issues
- Impacts of Transition to Retirement

- Super Reform's impact on:
  3. Retirement phase
  2. Transition phase
  1. Accumulation phase

Introduction

- Possible new view of the superannuation life-cycle:



Phase 3 - Retirement

Phase 3 - Retirement

Consider impact on pension types individually:

1. Allocated pensions (APs)
2. Term allocated pensions (TAPs)
3. SMSF complying defined benefit pensions

Phase 3 – Retirement

APs

Example: Dwight & Dee Wong (nee Wright)
- Dwight started $600k AP on 1 Jul 06 at age 55

Options from 1 July 2007 include:
- Continue existing AP indefinitely
- Commute AP to new pension &/or accumulation phase

Assumptions:
- Full commutation, although partial commutation may be relevant
- Post 83 tax threshold all used up

Phase 3 – Retirement

APs

Issues to consider:

1. Pension payment levels
2. Tax deductible / exempt amts
3. Death benefit options
4. Social Security deduction amount
5. Removal of RBL implications (not relevant for Dwight)

Phase 3 – Retirement

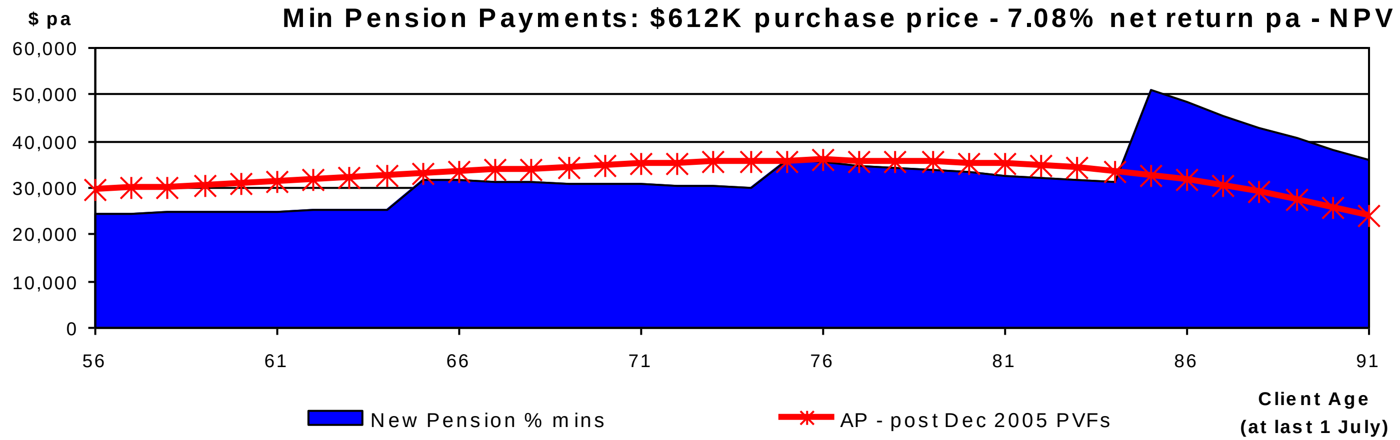
APs

(1) Pension payment levels:

- Fund may use new min factors for existing APs fr 1 July 2007
- No maximum to apply

i.e. typically neutral re decision to continue AP or commute to new pension

Dwight example:



Phase 3 – Retirement

APs

(2) AP tax free amounts:

- If continue, no change to existing ***deductible amount (DA)***
- If start new pension, ***tax free component (TFC)*** bigger?

Significance For Dwight:

- Tax payable when less than age 60

Phase 3 – Retirement

APs

(2) AP tax free amounts:

- ***1 July 2006: existing AP***
  - » purchased with $612k, age 55:
  - » UDC $156K
  - » ***DA*** = $156K / 25.92 ***= $6,019***

- ***1 July 2007: new pension***
  - » started with existing AP balance $612K:
  - » UDC $150K, Pre $204K
  - » ***TFC %*** = [($150K + $204K) / $612K]

    = 57.8% of pension payment

  - » TFC % constant for subsequent pension payments?

Phase 3 – Retirement

APs

Dwight example:

	Alloc Pen	New Pension	Alloc Pen	New Pension
Gross Income	29,500	29,500	40,000	40,000
Tax DA	6,019		6,019	
TFC (57.8%)		17,064		23,137
Assessable Income	23,481	12,436	33,981	16,863

Tax Savings:	$29,500 pa		$40,000 pa	
	Year 1:	By age 60:	Year 1:	By age 60:
MTR - 31.5%	1,822	7,290	2,825	11,298
- 41.5%	2,927	11,708	4,536	18,146
- 46.5%	3,479	13,917	5,392	21,570

Phase 3 – Retirement

APs

(2) AP tax free amounts - further considerations

Before 1 July 2007:

1. Advantages in amalgamating super - pre 83 service, admin?
2. Advantages in keeping separate benefits?
3. Re-contribution, fresh contributions within limits?
4. Spouse splitting?

On or after 1 July 2007:

1. Start new pension or separate benefits – TFC effect?
2. Re-contribution, fresh contributions within limits – TFC effect?
3. Partial commutation – effect on remaining AP?

Phase 3 – Retirement

APs

(3) AP Estate planning issues:

- If Dwight starts new pension from 1 July 2007:
  - Cannot pay pension to Dwight's non-dependent adult child
- If Dwight keeps existing AP
  - Current law: can pay Dwight's non-dependent adult child
  - Law change to prevent this?
    - If not, this is a relevant factor in pension choice

Phase 3 – Retirement

APs

(4) AP Social Security income test:

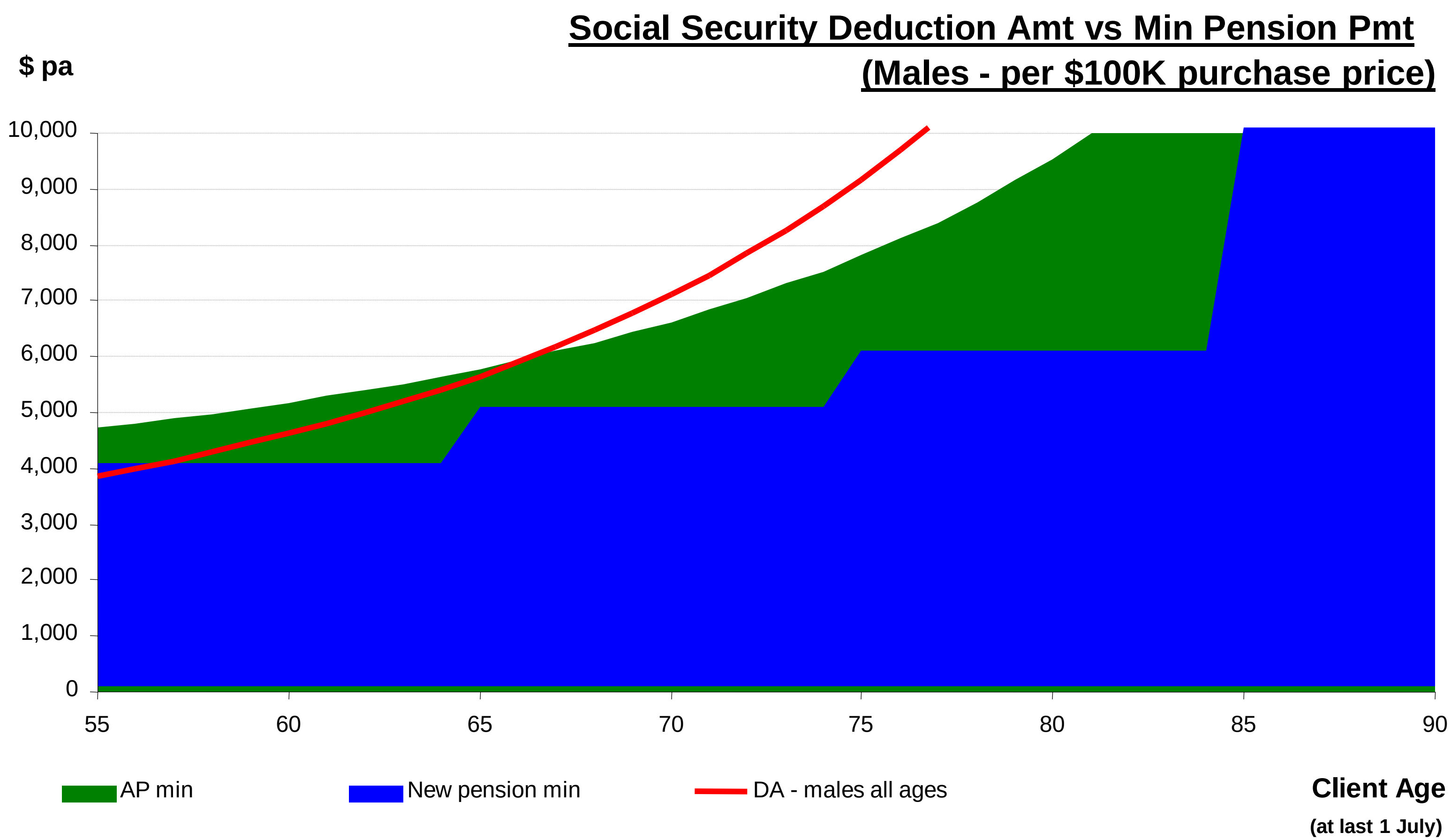
- 5 Sep 06 announcement:
  - Current treatment to apply to new pensions i.e. DA = PP / LE

Issues to consider:

1. New PP & LE if new pension
2. New min payments possible – compare with DA

Phase 3 – Retirement

APs



Phase 3 – Retirement

APs

(4) AP Social Security income test (looking ahead for Dwight):

- Conclusions:
  - New pensions also favourably treated
  - Typically neutral re decision to continue or commute
  - Assets test more often the relevant test if substantial super

Phase 3 – Retirement

APs

(5) AP excess benefits (not relevant for Dwight):

- Partially or non-rebatable APs - windfall from 1 Jul 07:
  - Age 55-59 fully rebatable
  - Age 60+ tax free
- Conclusion:
  - Typically neutral re decision to continue or commute
- How much impact on 2xAP excess benefit strategy?

Phase 3 – Retirement

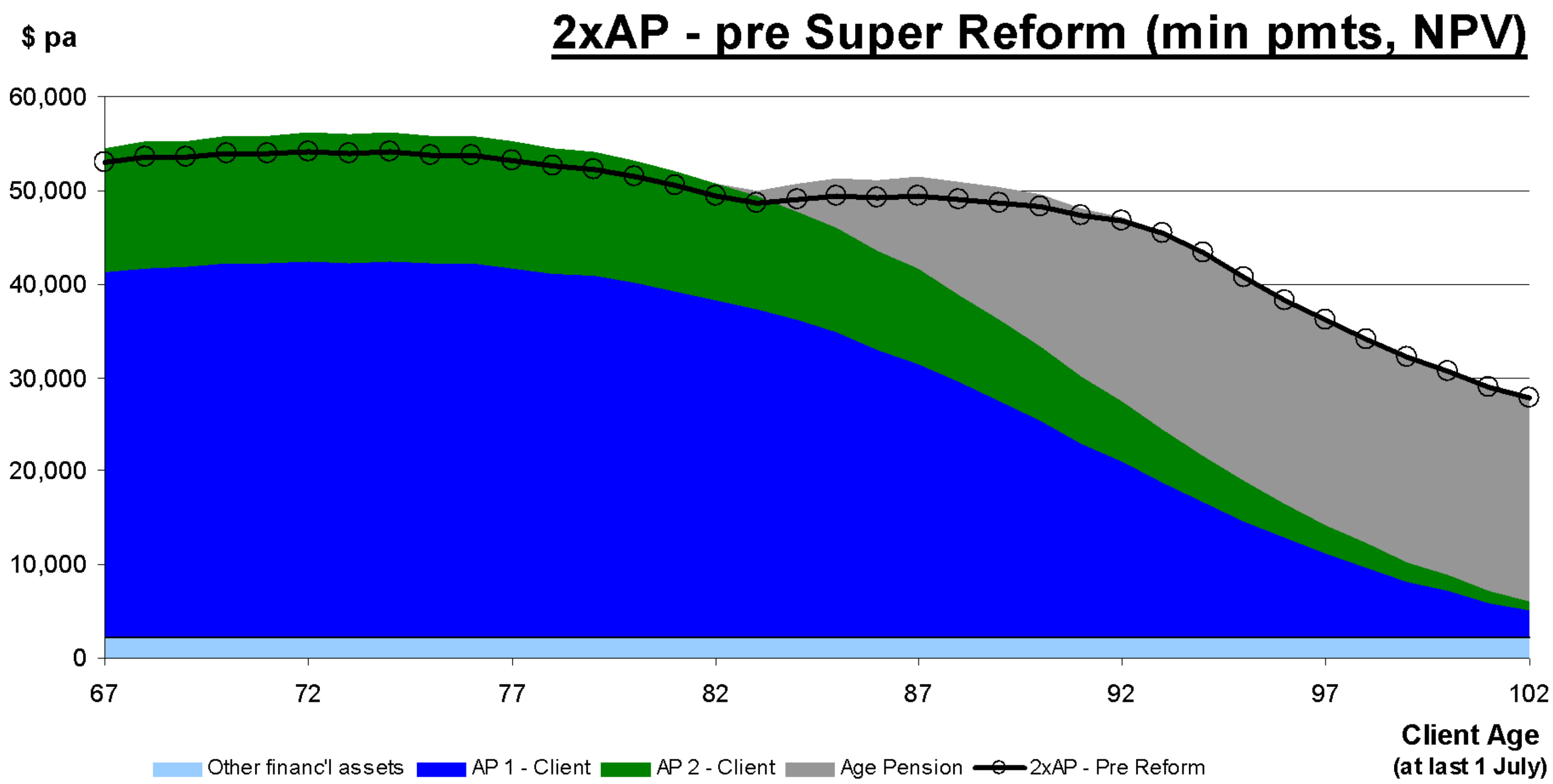
APs

Example: Lorraine & Dwayne Dwyer

- retired Sep 2003 age 65 & age 63, Dwayne started:
  - AP non-excessive: $580K ($170K UDC, no pre-Jul 83)
  - AP excessive: $200K (no pre-Jul 83)
- Homeowners, $50K cash, $80K other assets
  - Total Social Security assessable assets $910K
- Generating $50K net income
  - only need $35K – hence cash build up
- How will super reform affect?

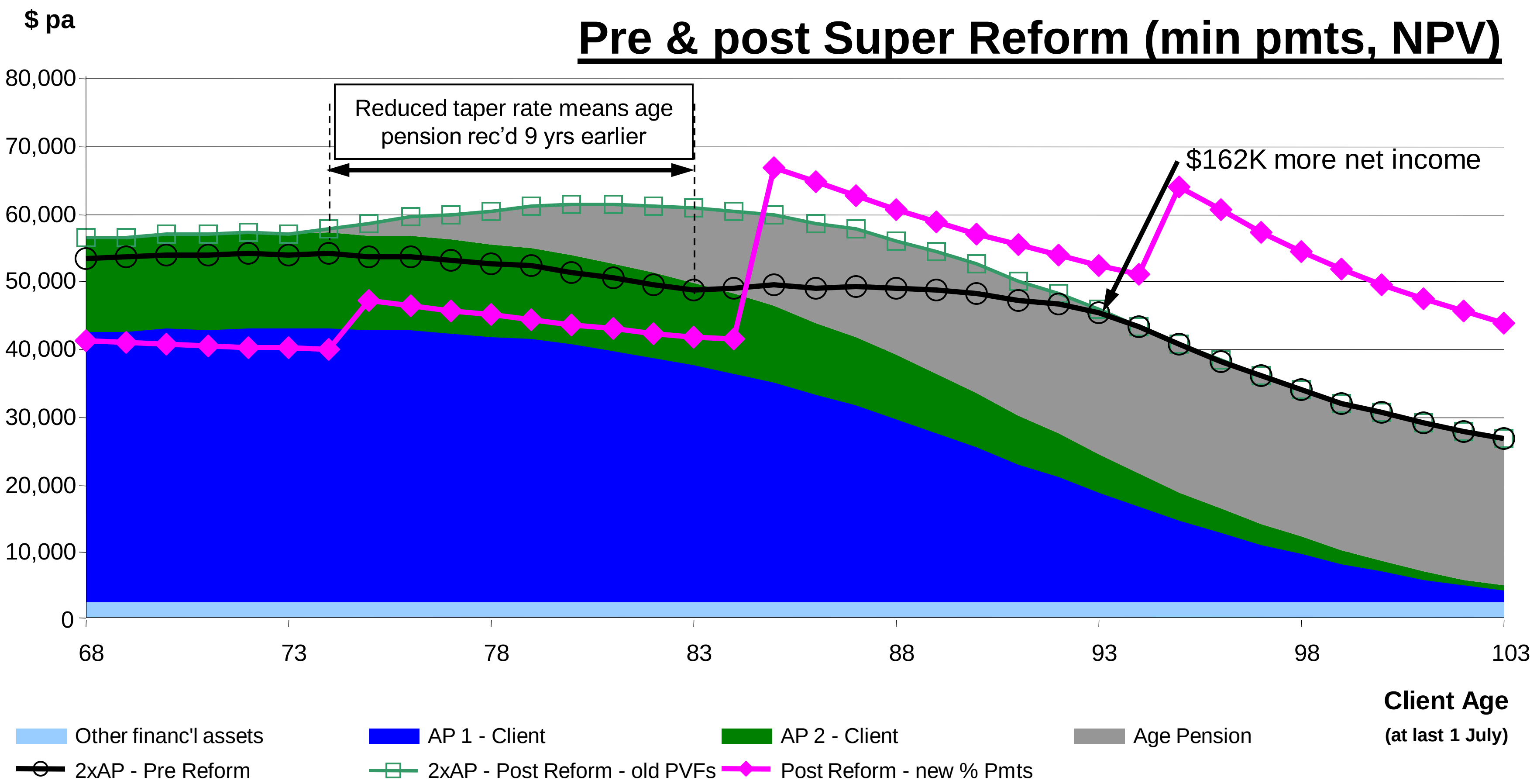
Phase 3 – Retirement

APs



Phase 3 – Retirement

APs



Phase 3 – Retirement

TAPs

Issues to consider:

1. RBL advantage irrelevant from 1 July 07
2. Social Security
   - Diluted but ongoing assets test advantage
   - Appeal to broader range of retirees
3. Income level, term
   - Assume new min, max & term relaxations will not apply?
   - If not, 90%-110% payment variation, fixed term

Phase 3 – Retirement

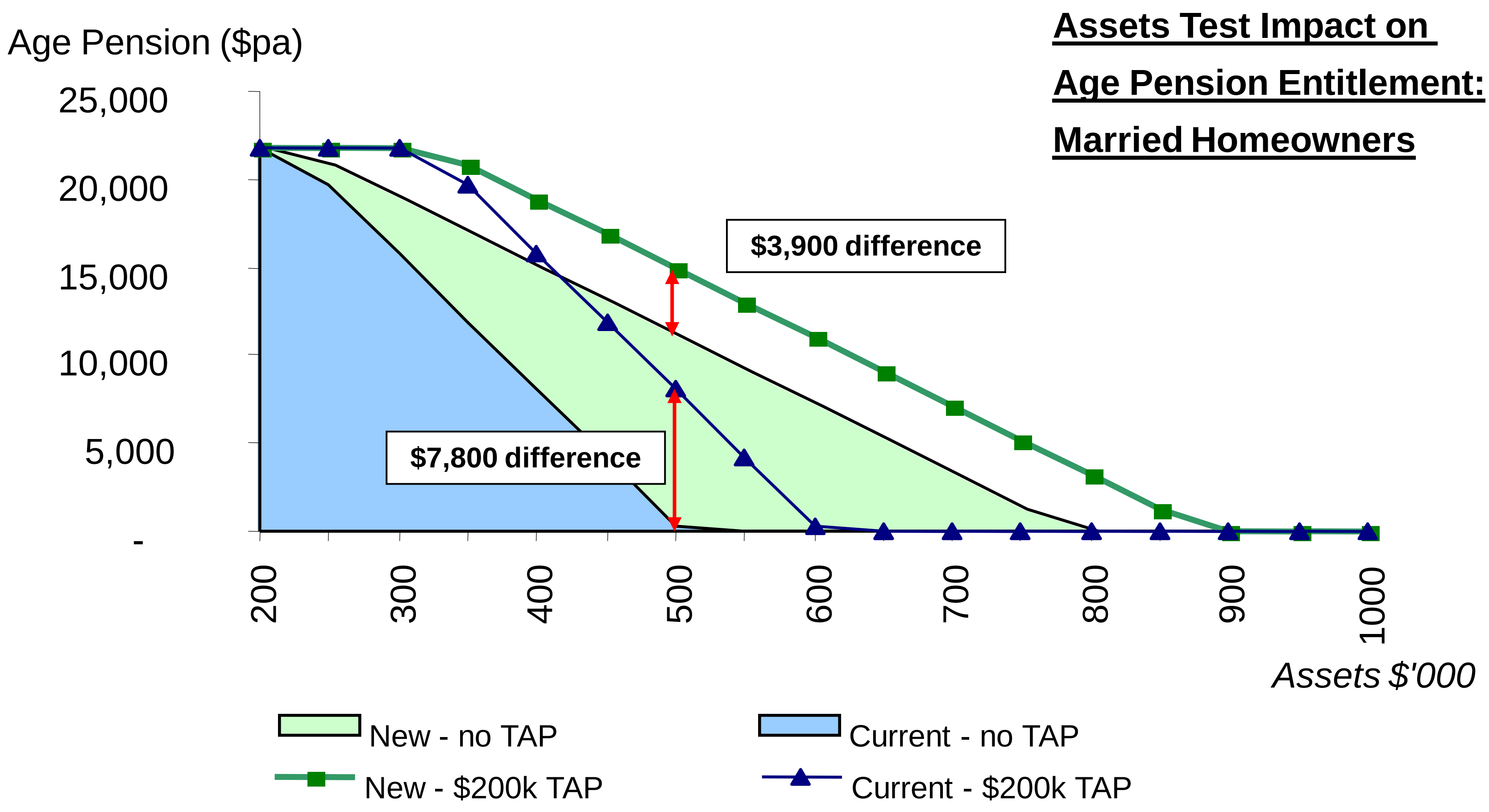
TAPs

Options:

1. No commutability to new standard pension?
   - Except if 6 month window
   - But continued ability to change underlying assets
2. Commute to another complying pension, incl another TAP
   - But only before 1 Jul 07 …or is it 20 Sep 07 deadline?
   - Change term for existing TAP holders?
3. Start new TAP for social security before deadline?

Phase 3 – Retirement

TAPs



Phase 3 – Retirement

TAPs

Married homeowners Assets test result

Assets $ ’000	Age pension $ pa Current	New	New with $200K TAP
500	1,253	11,822	15,722
600	-	7,922	11,822
700	-	4,022	7,922
800	-	122	4,022

Aged Care Treatment

- 100% exemption for TAPs & other CPs started before 20 Sep 07
  - long term view?

Phase 3 – Retirement

smsf defined pensions

Key Issue:

- **RBL compression irrelevance, can only commute to another CP**

Options incl:

1. Continue current pension:
   - arrangements settled
   - potentially low level of income may appeal
   - reserves have estate planning benefits?
   - 100% Assets Test exempt?
2. Move to TAP pre 1 Jul 07, surplus reserves to accum?
   - avoid actuarial & admin expense & complexity
   - more manageable estate planning mechanism?
   - release of surplus reserves? tax improvement?
   - TAP payments more flexible year to year

Phase 3 - Retirement

Action plan for retiree clients:

1. All clients with super - consider:
   - Amalgamating or keeping separate benefits
   - Re-contribution, fresh contribution where possible
   - Future eligibility re social security, aged care rules
   - New TAP before deadline

2. Existing AP clients:
   - Commute to new pension post Jul 07?

3. Existing TAP & other complying pension clients:
   - Modify complying pension arrangements before deadline?

Phase 2 – Transition to Retirement

Phase 2 – Transition to Retirement

- Transition to Retirement (TTR) pensions intro'd 1 July 2005
- Significant change to retirement planning process
- TTR pension & salary sacrifice strategy:
  - 17 Nov 2005 Tax Office announcement:

    "For example, an eligible person may take out a pension under the transition to retirement rules. At the same time, that person may engage in an effective salary sacrifice arrangement and contribute to a complying superannuation fund for their own benefit."

    "We would only be concerned where accessing the pension or undertaking the salary sacrifice may be artificial or contrived.
- Concept also relevant for people age 65-74 & still working

Phase 2 - Transition

2006/7- Dwendell 59, $500k super:		Current Position: $75K		Fix Salary: $25K index 3% pa	
Salary Packaging:	Gross salary	75,000		25,000	
	Employer super cont	45,000		95,000	
	Total remuneration		120,000		120,000
Personal Income:	Gross salary	75,000		25,000	
	TTR pension payment	Nil		40,419	
	Net tax & Medicare	18,975		9,394	
	Less undeducted cont	Nil		Nil	
	Net cashflow		56,025		56,025

Phase 2 - Transition

2006/7 - Dwendell age 59:

Accum + Pension accts:

	Current Position: $75K		Fix Salary: $25K index 3% pa	
Opening balances (both)		500,000		500,000
Employer super cont	45,000		95,000	
Less contributions tax	6,750		14,250	
Add undeducted cont	Nil		Nil	
Less TTR pension pmt	Nil		40,419	
Net annual contribution		38,250		40,331
Gross earnings (both) *	44,515		44,604	
Less fees *	7,787		7,802	
Less tax on earnings *	3,105		241	
Net earnings		33,623		36,560
Closing balances (both)		571,873		576,891

* Refer to earnings assumptions in Appendix

Phase 2 - Transition

2007/8 - Dwendell age 60:		Current Position: $75K		Fix Salary: $25K index 3% pa	
Salary Packaging:	Gross salary	78,000		25,750	
	Employer super cont	46,800		99,050	
	Total remuneration		124,800		124,800
Personal Income:	Gross salary	78,000		25,750	
	TTR pension payment	Nil		34,421	
	Net tax & Medicare	20,220		2,391	
	Less undeducted cont	Nil		Nil	
	Net cashflow		57,780		57,780

Phase 2 - Transition

2007/8 - Dwendell age 60:

Accum + Pension accts:

	Current Position: $75K		Fix Salary: $25K index 3% pa	
Opening balances (both)		571,873		576,891
Employer super cont	46,800		99,050	
Less contributions tax	7,020		14,858	
Add undeducted cont	Nil		Nil	
Less TTR pension pmt	Nil		34,421	
Net annual contribution		39,780		49,771
Gross earnings (both) *	50,744		51,602	
Less fees *	8,876		9,027	
Less tax on earnings *	3,962		783	
Net earnings		37,905		41,792
Closing balances (both)		649,558		668,455

* Refer to earnings assumptions in Appendix

Phase 2 - Transition

Year 11 - Dwendell 69, still works:		Current Position: $75K		Fix Salary: $25K index 3% pa		
Salary Packaging:	Gross salary	111,018		107,629		
	Employer super cont	66,611		70,000	**	
	Total remuneration		177,629			177,629
Personal Income:	Gross salary	111,018		107,629		
	TTR pension payment	Nil		27,290	#	
	Net tax & Medicare	33,923		32,516		
	Less undeducted cont	Nil		25,307		
	Net cashflow		77,096			77,096

** Concessional Deductible Contribution (CDC) restraint

Minimum pension restraint

Phase 2 - Transition

Year 11 - Dwendell 69, still works:		Current Position: $75K		Fix Salary: $25K index 3% pa	
Accum +	Opening balances (both)		1,545,023		1,678,536
Pension accts:	Employer super cont	66,611		70,000	
	Less contributions tax	9,992		10,500	
	Add undeducted cont	Nil		25,307	
	Less TTR pension pmt	Nil		27,290	
	Net annual contribution		56,619		57,617
	Gross earnings (both) *	134,913		147,486	
	Less fees *	23,600		25,799	
	Less tax on earnings *	12,532		9,072	
	Net earnings		98,781		112,614
	Closing balances (both)		1,700,423		1,848,667

* Refer to earnings assumptions in Appendix

Phase 2 - Transition

TTR / salary sacrifice general principles:

- Primary goal: maximise capital in pension phase
- Targeting 30% MTR threshold ($25K) appears to be effective
- Significant benefit age 55-59, added benefit age 60+

Action plan for clients aged 55-74 & working:

- Consider pension combined with deductible cont strategy, especially:
  - Before July 2012
  - From age 60
- Consider UDCs for some clients?

Phase 1 – Wealth Accumulation

Phase 1 - Accumulation

Action plan for clients aged 45 or more:

- Consider optimising super by preservation age (55-60)
- Need critical fund mass for TTR pension / sal sacrifice strategy

Phase 1 - Accumulation

Action plan for wealthy clients generally before 1 July 2007:

Make use of contribution limits:

- Each spouse? Children?
- UDCs
  - Limit $1m from 10 May 2006
- Other non-deductible amounts include:
  - Govt co-conts, permanent disability
  - Small business realised gains
  - Employer ETPs rollovers generally?
    - » APRA circular suggests must be eligible to contribute!

Phase 1 - Accumulation

Action plan for wealthy clients generally before 1 July 2007:

Make use of contribution limits:

- Deductible contributions
  - Essentially unchanged?
  - Age-based limits
    - Multiple non-associated employers?
    - Employer & personal deductible conts?
  - Employer contributing in excess of MDC?
  - Employer ETPs don’t count towards limit

Phase 1 - Accumulation

Moving assets to smsfs from related parties – before/after 1 July 2007

Considerations:

- SIS related party & investment rules, incl:
  - Acquisition prohibition (e.g. residential investment properties)
    - exceptions include listed securities, bus real property
- Bus real property issues?
  - CGT – concessions?
  - Cont cap issue: combine cont, employer ETP & fund purchase?
  - Transfer by instalments?
  - Stamp duty etc.
- Employer in-specie contributions
  - FBT removal date? Any use?

Phase 1 - Accumulation

From 1 July 2007

Concessional Deductible Contribution issues:

- Age limit raised to age 75 re non-personal non-mandated conts
- Unsupported personal conts fully deductible
- Exceptions to limits:
  - Taxable portion of overseas pension fund transfer
  - Certain employer ETP rollovers within limits

- Beware exceeding limit

Phase 1 - Accumulation

From 1 July 2007

Undeducted Contribution issues

- Treatment of excess severe!
- Timing of conts under age 65:
  - 3 year clumps vs year by year….

UDC 3 yr clumps vs annual indexed cap

Year	Contributions ($'000s)	
	Averaging	Annual
1	450	150
2	0	150
3	0	150
4	495	165
5	0	165
6	0	180
7	540	180
8	0	195
9	0	195
Total	1,485	1,530

Assumed AWOTE:
4.0% pa

Phase 1 - Accumulation

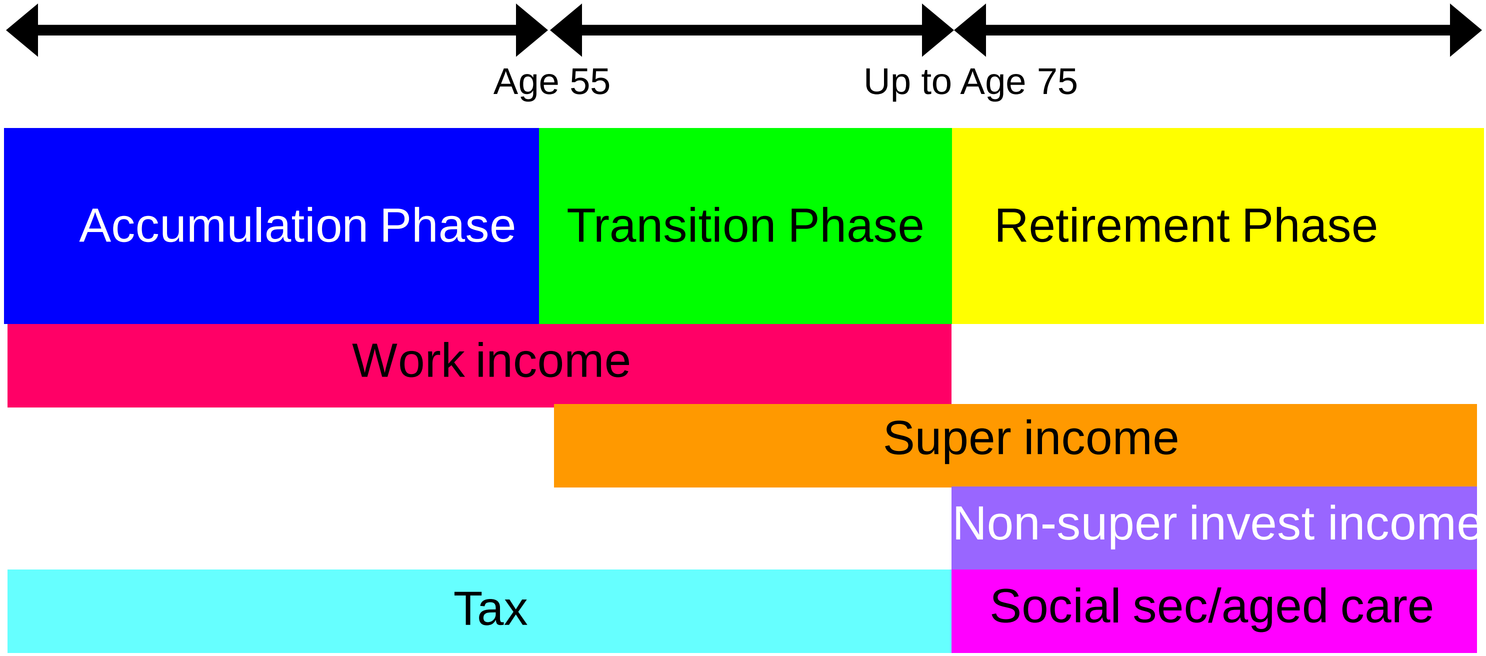
From 1 July 2007

Employer ETPs

- If pay before 1 July 2012 under 10 May 2006 agreement:
  - taxable component concessional cap is $1m
  - may be rolled over
    - cont caps don’t apply unless rollover exceeds $1m
    - cont eligibility rules apply? APRA view?
- Otherwise:
  - taxable component concessional cap is $140k
  - not able to be rolled over, so subject to cont limits

Conclusions

Conclusions



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