

# Change is all around

If you read the money pages of the papers you would be forgiven for thinking that superannuation is the only thing changing this year. Certainly the changes are far-reaching and will take some time to understand in full as the legislation and regulations are released.

However, it would be foolish to ignore other aspects of your finances and in this edition of Premium News we look at changes in disability insurance, family support from the Government and the opportunities provided by testamentary trusts.

The golden rule of planning for the future is that "nothing stays the same". We encourage you to see your Premium adviser to ensure your plans are still on track.

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A NEWSLETTER FOR CLIENTS AND FRIENDS OF PREMIUM WEALTH MANAGEMENT

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# Investing money in superannuation

The new superannuation rules place restrictions on the amount of contributions that can be made tax-effectively into super. The rules will get tighter from 1 July 2007 and investors are being encouraged to make extra contributions to super before the opportunity closes.

One question to ask about these contributions is "how should they be invested?" The answer will depend on your stage in life and your attitude to investment risk.

## If you are under 40

If you are age 40 (or younger) you have 20 or 30 years until you can touch your superannuation. You should have a high proportion of your super invested in shares and property. These growth assets can be expected to produce the highest returns although there will be some ups and downs along the way.

Depending on your attitude to investing you may choose not just blue-chip shares but putting some money into smaller companies, emerging markets or global property trusts. It would still be wise to have a diversified portfolio and not commit all your money to a select few large assets.

## If you are 50

If you are planning to retire and take a lump sum at age 55, you want to minimise the risk that your assets will lose value just before you access the money. Investing in more conservative investments like fixed interest and cash could be appropriate.

On the other hand, if you plan to keep working and take a pension at retirement, you are still a long-term investor.

## If you plan to use a pension

Rather than taking lump sums many retirees convert their super into an allocated pension. The temptation is often to switch their super into more conservative investments like fixed interest and cash.

You don't want to take the risk that your nest egg will fall in value because of fluctuating markets.



This logic may not be quite right. Certainly you need a proportion of your money in cash because the fund will be paying you an income. But if you have only just retired you may have 20 or 30 years of retirement ahead of you. It would make sense to invest at least some of your money as if you were a 40 year old. Higher returns will make your allocated pension last longer.

## If you plan to leave your super to your family

The super rules now allow you to leave your super to grow after age 65. You are no longer forced to take it out of super or use it as a pension. If you have other sources of income you could leave it to pass onto the next generation. From an investment point of view, this would be for a long-term and you would invest like a 40 year old.

Of course, these guidelines are the theory. In practice, an adviser will take your personal views into account. Whilst you may accept that investing in riskier assets is the right thing to do, you need to make investments that leave you feeling comfortable. In the end it's your choice.



# Money matters for 60-70 year olds

This age has traditionally been a time for planning and entering retirement. Nowadays many people don't suddenly stop work and retire - casual and part-time work often lead to a less stressful lifestyle before stopping work for good. Perhaps more than at any other time, you may seek the assistance of a financial adviser to help you prepare for a 20 year holiday.

## **Certainty, security and simplicity**

These issues are a common theme amongst retirees. It may be time to rationalise your assets and simplify your affairs. Are those life policies still needed? Should you sell your shares and put the money into super? Is it time to sell your investment property? Most importantly, how will you ensure a regular flow of cash into your bank account so you can pay bills on time?

## **Superannuation opportunities**

Age 65 is a significant age for superannuation. You can access your super even if you are still working. Whilst you are no longer forced to use your superannuation from age 65, you will be prevented from putting more money into superannuation unless you are working.

## **Accessing Government benefits**

For many Australians, the age pension provides one of the secure income streams underpinning their lifestyle. There are significant changes on the horizon in the way assets are assessed for the age pension. From 20 September 2007, private pensions and annuities will become 100% assessable but at the same time the assets test will be relaxed. Certain retirees and pre-retirees can significantly improve their age pension after September by taking action now.

The Government provides many concessions to age pensioners and self funded retirees through the pensioner concession card and the Commonwealth Seniors Health Care Card. State Governments provide further concessions through a Seniors Card.

## **Being sure of medical attention**

As you get older your health will be a greater concern. Rather than waiting for public hospital attention, health insurance can provide immediate access to medical treatment to ensure you can live the lifestyle you want. If you don't have health insurance now the premiums will be loaded by 2% for every year after age 30 – for example if the standard premium is \$2,000, it will be \$3,200 for a 60 year old. On the other hand, a 65 year old who now decides to take out private health insurance qualifies for a 35% rebate paid by the Government bringing the cost down to \$2,080. The rebate increases to 40% at age 70.

## **Preparing for the inevitable**

We accept that one day we will die and a will is important to ensure our assets pass smoothly and tax-effectively to those we love. Another important estate planning document is an enduring power of attorney – this enables someone else to act for you on financial matters if you are unable to do so yourself. Many people appoint their spouse or a close family member to act for them.

The last thing you want is for your finances to limit the lifestyle decisions you can make. You should discuss these important issues with your Premium adviser.

# New rules for golden handshakes

From 1 July 2007, payments from employers on termination of employment will be taxed at higher rates and cannot be rolled over to superannuation.

## **What payments are affected?**

### **Retrenchment and early retirement payments**

If you are retrenched or take an early retirement package, you will be entitled to a tax-free payment based on your years of service with the employer. The formula for calculating the tax-free portion is not changing. However the balance of the payment (if any) will be a 'golden handshake'.

### **Termination payments**

If you leave a job and the employer makes you an ex-gratia or contractual payment this is a 'golden handshake'.

## **How are they taxed now?**

You have a choice with a golden handshake to roll it over or take it in cash. In most cases, a rollover will be taxed at 15% in the super fund. If it is cashed out it will be taxed at 16.5% (including Medicare) if you are age 55 or over and 31.5% if you are under age 55.

## **How will they be taxed?**

From 1 July 2007 there will be limits on the amounts that can be contributed tax-effectively into superannuation. To prevent people getting around the new rules through the use of termination payments, they will not be able to be rolled over to superannuation. They will be taxed at the same rates as now up to \$140,000 and then at 46.5% over that amount.

## **Example**

Ben and Debbie each receive a golden handshake of \$200,000. Ben is age 56 and up to 30 June 2007 can choose to rollover into super or take the payment in cash. He will lose \$30,000 in tax if he rolls over and will pay \$33,000 in tax if he takes it in cash. From 1 July 2007, he must take it in cash and will pay tax of \$51,000.

Debbie is age 54. Up to 30 June 2007 she can choose to rollover into super or take the payment in cash. She will lose \$30,000 in tax if she rolls over and will pay \$63,000 in tax if she takes it in cash. From 1 July 2007, she must take it in cash and will pay tax of \$72,000.

This is a simplified description of the new rules. Talk to your Premium adviser if you are likely to receive a termination payment for guidance on how the new rules may apply to you.

## **Transitional measures**

To avoid a rush of employees taking termination packages before 1 July 2007, the Government has allowed a transitional period for employees who had termination clauses in employment contracts at 9 May 2006 (Budget night). Golden handshakes up to \$1 million can still be tax effectively rolled over to superannuation and the tax payable is lower. To qualify for the concession the payment must be taken before 30 June 2012.



*Life never presents itself with anything that may not be looked upon as a fresh starting point.*

*Andre Gide*

# The *Italian* experience

Italy has been described as a demographic, economic and social “laboratory” on ageing. It has one of the oldest populations on the planet with the over 65s already comprising 30% of the population. By contrast, about 12% of Australians are over 65. It is predicted that by 2050 almost two thirds of Italians will be over age 65 whereas the Australian figure will be about 25%.

The reasons for the ageing population are the same as in Australia – falling fertility rates and longer life expectancies. And Government responses have been similar too, such as incentives to encourage older workers to defer retirement and to retire gradually over a number of years. The state pension is currently available from age 57 but the Government is trying to increase the retirement age and reduce the amount of pension paid if you ‘retire early’ – a big challenge for politicians.

There are obvious concerns about too few workers to support retirees and strained social security and health systems – already about 15% of GDP is spent on state pensions and that is just not sustainable if 65% of the population receives a pension. But there are other interesting indicators of what the future may look like. For instance, 27% of old people live alone and the vast majority of these are women. Is this the sort of society we want or can afford? Seventy eight percent of women over age 75 provide personal care for a family member. Who will provide this service when they die?

There is no doubt there will continue to be significant changes in our society and Italy may help show a way forward.



## Is this a sign of the future?

A retired Italian man got onto an overcrowded bus and was forced to stand. He stood next to a young man in dirty clothes sprawled in his seat. “Aren’t you going to let me sit down”, he asked. “No,” said the young man, “I’ve worked 14 hours today and I’m exhausted. You’ve done nothing but sit round.”

## Keeping control after you’ve gone

Death means your assets pass to someone else – you hope they will use the money wisely. You’d like to ensure it’s not wasted or that the taxman takes too big a slice.

The solution may be a testamentary trust - a form of discretionary trust defined in your ‘last will and testament’.

The trust only becomes active when you die and you define the terms and conditions of the trust in your will. You can create a trust for each beneficiary or have one ‘family’ trust.

Your assets are held in trust and administered by a trustee appointed in your will – so you can describe how you want the capital and income to be used. The trustee may be a lawyer, a trustee company or other person.

Testamentary trusts can be used in many ways:

- To prevent money being spent unwisely, for instance if the beneficiary has a drug or gambling addiction or little sense of money management.
- To allow income paid to children to be taxed at adult’s tax rates rather than the penalty rates applying to children’s unearned income.
- To ensure money goes to specific beneficiaries and not to their spouses or the spouses’ family.
- To prevent the beneficiaries’ creditors getting hold of your money.
- To cater for the needs of beneficiaries with special needs (such as disabled relatives).

You can’t actually ‘rule from the grave’ but a testamentary trust can be the next best thing.

# TPD gets fairer

Total and Permanent Disablement (TPD) cover is a common addition to life insurance policies. After all, losing your ability to ever work again is financially not that much different to dying. You would still have debts to pay, a family to support plus medical and rehabilitation costs.

In the past TPD cover was criticised as being too hard to qualify for. You paid the premiums but when it was time to make a claim, you got knocked back. Although no statistics are published, it is believed about 70% of TPD claims do get paid but, of course, you are more likely to hear about the rejected claims than the paid ones. The criticism may also be unfair because the policies have been substantially upgraded in recent years.

The concept of TPD cover is simple. If you are ill or injured and are unlikely to be able to work again you get paid. The difficulty has always been to define what is meant by “unlikely to be able to work again”. Advances in medical science have meant that patients can soon return to work when once their condition would have left them permanently disabled. For instance, by-pass surgery once ended a working career nowadays normal life can soon be resumed.

Different policies have different definitions and it is an area where life offices are developing new features. Typical definitions that may be used are as follows.

## The any occupation definition

One definition of TPD is based on your ability to do your own job (or a similar one where you are qualified through education, training and experience).

### Examples

A painter who suffers a back injury and cannot climb ladders or stand for long periods may be TPD if he has no other employment skills. A teacher who suffers stress related illnesses when faced by a classroom of children may not be TPD if she can work outside the classroom as a tutor, examiner or writer of educational material.

## The own occupation definition

A second definition is based on your ability to do just your own job. The premiums for this type of cover will be more expensive.

### Example

A surgeon who damages his hands may be TPD because he cannot perform surgical operations but he will still be able to work as a doctor or lecturer though on lower earnings.

## Homemakers definition

The definitions above are only suitable for employed people but a new definition is based on the ability to live independently. You would be TPD if you could not dress, eat, bathe, maintain personal hygiene or move around your home unaided. This means that a spouse who works in the home and raises children could also be insured – what would it cost to provide the shopping, child minding, transport and other services if your spouse could not do it?

## How does TPD fit into a risk management plan?

Constructing a plan to protect yourself and your family against disaster can use a number of different types of policies. Income protection will provide up to 75% of your income if you cannot do your own work due to illness or injury – but can you service your debts on this income? Trauma cover will pay a lump sum if you are diagnosed with a defined illness – but the premiums are relatively expensive.

Your Premium adviser can help you mix and match the right policies to create an effective and affordable solution.



# Getting money into super

The focus in retirement planning has changed from minimising tax on benefits to finding ways to maximise contributions into super. Here are some examples of effective strategies.

## To jump or not to jump?

William has a dilemma. He is age 55 and has a share portfolio worth \$250,000. He would like to pay it into super before 1 July 2007 but he has an unrealised capital gain of \$50,000 and because he is on the highest marginal tax rate it will cost him \$11,625 in tax to make the transfer. Should he bite the bullet and do it?

His adviser makes some calculations based on the following assumptions: he retires at age 60; the shares grow at 7% pa and pay dividends at 3% pa with 65% franking; he will pay tax each year and will reinvest the dividends. At the end of five years William will have \$385,576 but he still has a CGT liability. Taking this into account his portfolio will be worth \$349,576.

If William takes the CGT hit now he will have \$238,375 to contribute to super. Using the same assumptions, his portfolio will be worth \$378,230 at age 60. The difference is because the super fund only pays up to 15% tax along the way. Once he is age 60, he pays no tax on withdrawal. In this example, William is \$28,654 in front.

## Another way to make large contributions

Jenny and Frank have retired and are planning to sell their suburban house to move into a new retirement resort. The river views from their house means it is expected to fetch a good price and they will have about \$1 million to invest. Frank is worried the house won't settle before 1 July 2007 and they will miss the opportunity to put \$1 million into super. Their adviser explains that even after 1 July they will have no problems.

Jenny is 63 and Frank is 64 and they are eligible to put money into super until they get to 65. The limit for after-tax contributions will be \$150,000 per year for each of them. However, to accommodate large contributions close to retirement, they can each make a contribution of up to \$450,000 in one year provided they make no contributions in the next two years. Their strategy will be for Frank to contribute \$450,000 in 2007-08 before he gets to age 65. Jenny will contribute \$150,000 in 2007-08 and \$450,000 in 2008-09 before she is age 65.

## Taking the plunge

Janine has avoided salary sacrificing money into super because it would only compound her reasonable benefit limit (RBL) problems when she retired. Now RBLs are to be abolished and super is tax free after age 60, she has changed her mind.

Janine is confident she can live the lifestyle she wants on a lower income and salary sacrifices \$20,000 to super. Rather than pay tax of \$9,300, the super fund will only deduct tax of \$3,000 so she has an extra \$6,300 a year in super working for her.

Your Premium adviser can help you navigate the contribution maze.





# Help for families

Falling birth rates are one of the contributors to an ageing population. Immigration may help to keep a society young but our Government has policies to encourage bigger families – as Peter Costello put it, “have one for Mum, one for Dad and one for the country”.

## **Maternity Allowance**

This is a one-off lump sum paid for each new born child. It is currently \$4,100 and is indexed twice a year.

## **Family Tax Benefits**

There are two possible benefits - one to assist all families and one for families where there is only one income earner. The benefits can be paid fortnightly, as a lump sum at the end of the year or through the tax system (as reduced PAYG tax or as a tax refund).

## **Family Tax Benefit A**

FTBA is paid for each dependent child up to age 18 (or age 24 if in full-time education). The maximum rate depends on the age of the child. For example, from 1 January 2007, the maximum annual payment was \$4,317.95 for a child under 13 and \$5,332.65 for a child aged 13 to 15. FTBA is income tested based on the combined family income. Once your income is over \$40,000 the rate of payment is reduced.

## **Family Tax Benefit B**

FTBB is paid to sole parent families or where there is a single major income earner. The payment is based on the age of the youngest child and the maximum annual rate at 1 January 2007 was \$3,467.50. The income of the major income earner is not taken into account and the secondary income earner can earn up to \$4,234 a year before payments are affected.

There is also a payment of \$227.90 to encourage immunisation of children and there are child care benefits up to \$148 a week. Families receiving FTBA may also qualify for a health care card to lower the costs of prescription medicines for their children

## **Getting your own back**

No one likes paying income tax and the family tax benefits effectively give you back some of your tax. Take Andrew and Beth as an example. Andrew earns \$65,000 and pays tax of \$15,825. Beth has a part-time job earning \$5,000 and pays no tax. They receive FTBA of \$3,651 and FTBB of \$3,314 meaning their tax is effectively reduced by \$6,965.

They choose to receive the payment at the end of the year and are saving the money to help launch their children on their lives when they become independent. Your Premium adviser can help you make the most of your family payments.

## **The family.**

*We were a strange little band of characters trudging through life sharing diseases and toothpaste, coveting one another's desserts, hiding shampoo, borrowing money, locking each other out of our rooms, inflicting pain and kissing to heal it in the same instant, loving, laughing, defending, and trying to work out the common thread that bound us all together.*

Erma Bombeck