



Personal Wealth



Winter 2010

A Quarterly Newsletter for

Lifespan Clients

Getting Your House in Order

The end of the financial year is fast approaching and it is never too early to start preparing. No one wants to pay more tax than they have to, but in many cases they do. Taking some time out to talk to your accountant or financial planner about managing your affairs can make a difference as to the amount of tax you may be able to save.

Salary & personal expenses

From 1 July 2010, modest tax cuts will kick in. The 30% tax threshold will start \$2,000 higher at \$37,000 and the 38% rate will fall to 37%. With marginal tax rates set to fall, bringing forward deductions or deferring income will make a difference.

Try to delay any bonuses or eligible termination payments to July 1. This will take full advantage of the lower tax rates which will kick in next financial year. Also, if you're taking leave in June/July, don't ask for payment in advance as it will be taxed at this year's rate, you will be better off trying to defer it to next financial year.

Superannuation is a great way to minimize your tax bill, but remember there have been some changes to super since last year, and more to come in the future.

If you have not been contributing the maximum deductible amounts into super you may want to consider this option. The maximum deductible contribution is \$25,000 for individuals under 50 years and \$50,000 for those over 50. However be aware that stiff penalties apply if 'over' contributions are made.

If you are between the ages of 55 and 65, and you have a reasonable amount in super you may want to consider commencing a Transition to Retirement strategy, whereby you commence a pension from your super savings. Depending on your age, this income can be tax free or partially tax free. In order to keep building your superannuation savings, you can salary sacrifice an equivalent amount in pre tax dollars into a separate

Before July 1 2010		After July 1 2010	
Taxable Income	Tax Payable	Taxable Income	Tax Payable
Up to \$6,000	Nil	Up to \$6,000	Nil
\$6,001 - \$35,000	Nil + 15%	\$6,001 - \$37,000	Nil + 15%
\$35,001 - \$80,000	\$4,350 + 30%	\$37,001 - \$80,000	\$4,650 + 30%
\$80,001 - \$180,000	\$17,850 + 38%	\$80,001 - \$180,000	\$17,550 + 37%
Over \$180,000	\$55,850 + 45%	Over \$180,000	\$54,550 + 45%

superannuation account. This means that the income you take home is much more tax effective and you pay less tax.

The impact of salary sacrificing more into super means that your taxable income drops and hence you pay less tax. Keep in mind that all deductible contributions into super will attract a 15% contributions tax.

Claiming deductible expenses

Individuals should consider if there are any deductible expenses that they can claim, and look to prepaying the next 12 months interest on margin loans or other investment loans. Prepaying this interest prior to June 30, will mean that you can claim the interest paid as an upfront deduction.

Other deductible expenses include:

- The premium paid on Income Protection Insurance
- Subscription to trade journals
- Subscription to investment journals or newsletters

- Subscription to professional associations
- Making after tax contributions to your spouses super can make you eligible for a spouse contribution tax rebate
- Keep a record of work related expenses, especially if you are thinking of claiming for a home office
- Donations to registered charity

Converting Non deductible debt to deductible debt

Making debts tax deductible is always a good strategy to consider. For someone with a home mortgage and a share portfolio, consideration may want to be given to selling down the share portfolio (remembering that Capital Gains may be incurred) and use the proceeds to pay down the existing home mortgage. Borrowing again and reinstating a new share portfolio, will mean that the new debt will become tax deductible.

Remember that restructuring your tax affairs to be more tax efficient is different to tax



washing. The tax office takes a dim view of tax washing.

Whilst considering making non deductible debt deductible, you may also want to make the new investments in the name of the partner who is in the lower tax bracket, so that future capital gains tax can potentially be minimised. However, the downside of this strategy is that having the investments in the name of the higher tax paying partner will mean you will get more benefit from the deductions. One alternative to consider is making the new investments in joint names.

Health Insurance

Many tax payers are not fully aware of the 1% Medicare surcharge which is on top of the 1.5% Medicare levy. If you are likely to breach the \$73,000 limit for singles

or \$146,000 for families and you do not have private medical insurance, you need to consider taking out private insurance. Having private medical insurance will mean that you have the premium cost to pay but you save the 1% Medicare surcharge.

Find out more

As you can see, planning for the year end can be complex. However the major benefit is that you will end up paying less tax now and also potentially in future years. If you are unsure which of the above strategies apply to you or how to implement them, you need to make an appointment with your accountant sooner rather than later, so that you can make the changes now rather than in a rushed manner at the end of the financial year.

This article is not intended to be taken as personal taxation advice. Lifespan strongly recommends that you speak to your accountant as some of these strategies may not be relevant to your personal circumstances.



Markets Hoping PIGS Can Fly

The Australian equity market briefly traded above the 5,000 (S&P/ASX 200) level in April before slumping to below 4,400. While company earnings and economic data have been positive for the market, a number of negative factors have held it back. The negative influences include:

- The Greek debt crises
- China attempting to slow its economy from an annualised rate of 11.9% in first quarter
- The US government suing Goldman Sachs, and the spectre of financial regulation.
- The Australian government's proposal to increase taxes on resource companies.

Most of the worry has been about the situation in Greece after Greek government bonds were downgraded to junk status. In response, Euro-region ministers agreed to a 110 billion Euro rescue package in order to prevent a default, and stop the crisis from spreading through the rest of the European bloc. However concerns still persist about the finances of Portugal and Spain which are under pressure to tackle their own budget deficits. Moody's Investors Service has said Portugal could be next to have its debt downgraded. As we write this, European leaders have approved a 720 billion Euro support package for debt-swamped governments (the so called PIGS: Portugal, Ireland, Greece, Spain) and this lead to a brief rally on global stock markets.

To give some perspective, the cost of insuring against a default by a country on its debt is measured by the value of credit

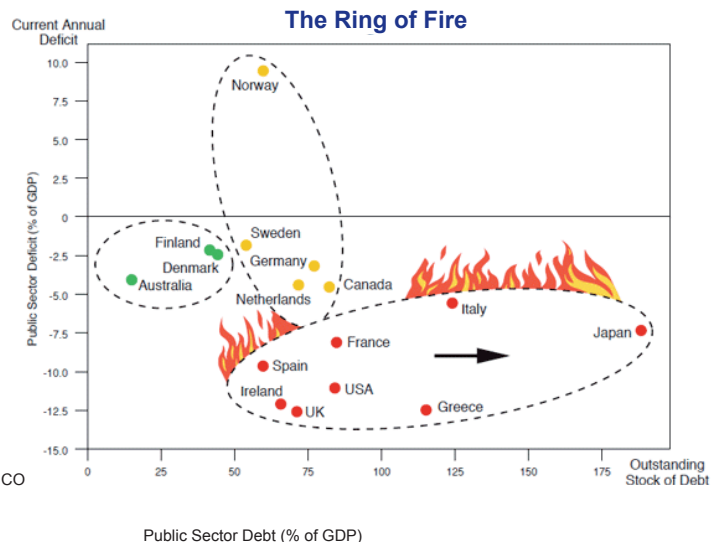
default swaps (a lower number is better). The cost of this protection at the peak of the crises in early May was 9.41% (annually) for Greece, 4.61% for Portugal, and 2.75% for Spain (Bloomberg). Post the support package, credit default swaps on Greece fell to 5.86% while contracts on Portugal fell to 2.55% and 1.73% for Spain.

Before the emergency measures were approved, the viability of the Euro zone was openly questioned. However the hardest part is yet to come as austerity measures will be imposed on Greece and any other country that needs to be bailed out. This will result in lower growth in Europe as balance sheets are repaired. Chart 1 shows government debt as percentage of GDP for various countries as well as their annual deficit. Countries with debt to GDP approaching 100% and with large deficits are most at risk, i.e. bottom right.

Cash and Fixed Interest

The Reserve Bank raised interest rates for the sixth time since October and the cash rate now stands at 4.5%. Before the Greek turmoil the market was factoring in a cash rate of about 5.25% over the next year after a run of strong economic numbers. One example is housing prices which have risen about 20% in a year.

However rate increases may be tempered by the situation in Europe. We remain cautious on fixed interest for the same reasons we gave in our last note, namely high levels of government debt. We believe that diversified fixed interest managers that have the flexibility to allocate between a wide range of sectors will do best in this environment.



Source: PIMCO



Equities and Property

The market is now lower than it was 3 months ago and volatility has increased dramatically. However Australian equity valuations are attractive at the moment. With the ASX200 at **4,400** the Australian equity market is trading at about (UBS, using consensus earnings):

- 14.2 times (PE) forecast June 2010 earnings
- 1 year forward PE of 12.3 times
- Fiscal Year 2011 PE of 11.7 times

According to UBS, the one year forward PE averages over 14 times earnings. While valuations seem attractive, the market could obviously fall further on concerns

over the Euro debt crisis. Note that these numbers are only estimates and may be off the mark. For example some of the recent Bank results were average and may not be fully factored in yet and we still expect slow growth in Europe.

We remain neutral on listed property as the yields on offer are not sufficiently far above 10 year government bond yields.

Chart 2. Investment Returns to April 30, 2010 (%)

Asset Class	1 month	3 month	1 year	3 years	5 years
Australian Shares	-1.4	6.5	32.4	-3.8	8.4
Global Shares	-1.4	-2.7	7.3	-10.4	-0.5
Listed Property	3.7	5.2	37.4	-22.8	-6.3
Fixed Interest	0.5	0.5	3.3	6.5	5.8

Source: van Eyk

In our previous note we said that conservative investors should probably wait for some more clarity on the Euro debt crises as markets tend to over shoot on the downside. We think this will be a protracted event and it is likely that the markets will struggle to sustain any meaningful rally. However valuations are reasonable and long term investors should look to accumulate equities during this pullback. So while we advise caution, we think long term investors should look to dollar cost average into the market over a period of time.

FEDERAL BUDGET HIGHLIGHTS

Labor's third budget contained few surprises, most of the changes were announced when the Henry Tax Review was released at the beginning of May. Below are some of the changes that will impact taxation, superannuation and social security.

Taxation

- > 50% tax discount on the first \$1,000 of interest income earned by individuals from July 2011.
- > Standard deduction for work related expenses of \$500 for the 2012/13 financial year and \$1,000 for 2013/14 onwards.
- > The Medicare levy low income threshold lifted to \$18,488 for individuals and \$31,196 for families from July 2009. The additional amount for each dependent child will also increase to \$2,865.
- > The Medicare levy for pensioners under the age pension age will increase to \$27,697 from July 2009.

Superannuation

- > The Co-contribution matching rate of 100% is to remain permanently in place for a maximum co-contribution of \$1,000 if the tax payer income does not exceed \$31,920 over the 2010/11 and 2011/12 financial years. Income over \$31,920 will reduce the co-contribution by \$0.3333 for every dollar above this amount until it reaches or exceeds \$61,920.
- > The First Home Savers Account (FHSA) can be paid into an approved mortgage after the end of the qualifying period of 4 years. The ability to reduce mortgage debt will be available to those buying a house after assent of the legislation.

Social Security

- > The Family Tax Benefit will cover children aged 16 to 20 who do not have year 12 or equivalent qualifications and who are participating in full-time education or training.



SUPERANNUATION KEY RATES FOR 2010 / 11

The Australian Taxation Office (ATO) has released some indexed caps and thresholds for the 2010/11 financial year which are displayed below. Other caps and thresholds were not available at the time of writing and will be published in June. Some of these thresholds are updated every year to reflect the movement in the in full time Average Weekly Ordinary Time Earnings (AWOTE).

Concessional Contribution Caps

The concessional contribution caps remain unchanged at \$25,000 for people under the age of 50 and at \$50,000 for those aged 50 and over. The non-concessional contribution cap also remains unchanged at \$150,000 or \$450,000 for the bring forward rule.

Low Rate Cap

This cap will increase to \$160,000 from 1 July 2010 from the existing \$150,000.



Superannuation Guarantee Contribution (SGC)

The SGC will remain at 9% for the 2010 / 11 financial year.

	2010	2011
Concessionnal Contribution Cap - Under age 50	\$25,000	\$25,000
Concessionnal Contribution Cap - age 50 +	\$50,000	\$50,000
Non-concessionnal Cap	\$150,000	\$150,000
Non-concessionnal Cap (three year bring forward rule)	\$450,000	\$450,000
Lump Sum Low Rate Cap (after preservation age before 60)	\$150,000	\$160,000
Superannuation Guarantee Contribution (SGC)	9%	9%
Maximum annual salary requiring 9% SGC	\$160,680	Expected June 2010
Co-contribution Lower Income Threshold	\$31,920	Expected June 2010
Co-contribution Higher Income Threshold	\$61,920	Expected June 2010

EMPLOYMENT

Employer Termination Payment Cap

This cap will increase to \$160,000 from the existing \$150,000.

	2010	2011
Employer Termination Payment (ETP) Cap	\$150,000	\$160,000
Tax free amount of a bona fide redundancy payment – All cases	\$7,732	Expected June 2010
Tax free amount of a bona fide redundancy payment – Extra amount for each year of service	\$3,867	Expected June 2010

Spreading the Wealth – Resources and the Australian Equity Market

The federal government has proposed that a Resource Super Profits Tax will be introduced on 1 July 2012 at a rate of 40%. Essentially this is a tax on mining companies which is projected to raise \$12 billion in the first 2 years. Also, the company tax rate will be cut to 28%.

Goldman Sachs (GSJBW) has done an initial analysis of the likely impact on ASX listed companies. As you would expect resources in general are the losers. Their conclusions are as follows.

> Resources: A decrease in earnings per share (EPS) of approximately 10% in 2014-15 although there are significant variations. Resource company valuations as measured by their net present value (NPV) are projected to decline by about 8%.

> Industrial Stocks (excluding banks): An approximate 1.5% EPS upgrade in 2014-15.

> Banks: An increase in EPS of approximately 3-4% in 2014-15 and a small rise in their projected return on equity.

> The impact on the ASX200 is a decrease in EPS of about 1.5% in 2014-15.

> While the impact on the market as a whole is modest, the two biggest miners, BHP and RIO are expected to cough up around 80% of the total tax.

However there are obvious risks in raising taxes on arguably Australia's most important industry. While it only represents

about 7% of GDP, it accounts for 50-60% of export value. BHP has stated that the tax rates will be the highest in the world and will make Australia uncompetitive. The tax is unfair in its present form as it kicks in at about a 6% return when the cost of funds for mining companies is in excess of 10%. Some of the unintended consequences may be lower investment and potential hits to the Australian dollar. It also introduces a level of sovereign risk that could impact our entire market. UBS estimate the tax could cut the economy's growth rate by 0.25% to 0.5% a year.

We think this tax is counter-productive as history has shown that high levels of taxation actually lead to lower wealth creation and ultimately lower taxation revenues.



ABN 23 065 921 735 Australian Financial Services Licence Number 229892

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