FM FINANCIAL

Helping you make the right financial decisions for both now & the future
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June 2016

May & June have been big months on the local economic front, beginning with the pre-election federal budget on May 3 and a surprise rate cut the same day.

The Australian dollar fell from above US77c before the rate cut, despite depreciating 35 per cent against the greenback over the past five years, economists are predicting further falls. The ANZ Bank is forecasting the dollar will fall to US50c next year, due to rising debt, falling exports and the possible loss of Australia's AAA credit rating. The market is now expecting two further rate cuts in the current cycle.

The local sharemarket hit a nine-month high after solid local earnings reports and lifting sentiment. The Australian Bureau of Statistics quarterly capital expenditure survey showed the economy is rebalancing away from the mining boom to other sectors.

In May FM Financial undertook a Client survey - sent to a sample of our clients - we received a 31% response rate and want to say THANK YOU to everyone who participated. We learnt that overall our clients are very happy with FM Financial - and that certainly makes us happy. One area of positive feedback was our communication and we are also working on creating a webpage on fmfinancial.com.au for those that want more detailed information about topics. Stay Tuned!

You also told us 70% of you would refer family & friends to FM - We would be thrilled to help your loved ones, so please let us know who we can help and we can contact them for an introductory discussion.

We will share some results with you over the coming months and hope to continue to improve the service and advice we offer all our clients.

As always, please contact FM with any questions you have about your financial plan and goals for the future.

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End of Financial Year *Checklist*

Planning for the end of the financial year is a little harder this year, with a federal election just days later which could result in sweeping changes to superannuation, negative gearing and business taxation. All the more reason to get on the front foot to make the most of the current tax arrangements while you can.

Now is the time to make any last minute adjustments to reduce your tax bill and maximise your long-term savings.

Pay expenses, delay income

Start by looking for ways to bring forward tax-deductible expenses to the current financial year and delay income until July. This is especially the case if your taxable income is likely to be higher this year than next.

You may be able to pre-pay 12 months' interest on a margin loan, or pre-pay 12 months' premiums on income protection insurance held outside super, and claim the full deduction in this year's return. You might consider pre-paying membership fees for professional organisations and subscriptions for work-related publications.

Instant asset write-off

If you are a small business owner with turnover below $2 million and you have been tossing up whether to invest in new equipment, get cracking. Businesses with turnover below $2 million can claim an immediate deduction for the cost of assets up to $20,000.

And if the May 2016 federal budget is passed, from July 1 the income tax rate for small business will reduce to 27.5 per cent so it makes even more sense this year to delay income where possible.

Top up your super

Despite the uncertainty surrounding superannuation, it is still the most tax effective investment vehicle for retirement savings. So if you have any spare cash, consider making a personal contribution to super but do seek advice if you have any concerns about the best way forward in light of the changes announced in the May budget.

If the budget measures are passed, then the annual concessional (pre-tax) contribution limit will be reduced to $25,000 for everyone from 1 July 2017. Currently the limit is $30,000 or $35,000 for people aged 49 or more. For those over 49 in particular, it makes sense to take full advantage of the higher limits this year and next, while you can.

However, if you are thinking of making a non-concessional (after-tax) contribution to super, be mindful of the lifetime cap of $500,000 that came into effect on budget night. Sweeping changes are also proposed for transition to retirement pensions, but you can still enjoy the current arrangements until 1 July 2017.

Take advantage of government contributions

If you earn less than $35,454 this financial year and make an after-tax contribution to super, then you are entitled to a government co-contribution of up to $500. The co-contribution tapers out once you earn $50,454.

Review your investment portfolio

After another volatile year on financial markets, you may be sitting on some paper losses from shares or other investments. This could be a good time to sell some of your poor performers to offset against capital gains made on the sale of other investments over the past 12 months.

Where possible, it makes sense to sell investments held for at least 12 months to qualify for the 50 per cent capital gains tax discount.

Claim rental property deductions

Residential property has enjoyed another boom year in parts of the country, despite tighter lending requirements for investors and uncertainty about the future of negative gearing. Whether you are a new landlord or an old hand, make sure to claim all allowable rental property deductions.

You can claim an immediate deduction for interest on your investment loan, repair and maintenance and tenancy costs such as the preparation of a lease or eviction.

You can also claim some expenses over a number of years, such as the cost of depreciating assets, structural improvements and borrowing costs such as stamp duty and loan fees.

With so much change in the air, it is more important than ever to seek professional guidance from your tax accountant and your financial adviser, so give us a call.

Retirement planning just became more complex after the government gave superannuation a surprisingly extensive shake-up in the May budget. Subject to legislation being passed, some of the proposed changes won't come into force until 2017, but others may require immediate attention.

If you are planning to put after-tax money into super before June 30 you now need to work out whether you will be in breach of the new $500,000 lifetime cap on non-concessional contributions. This cap is calculated from 1 July 2007.

There is no need to worry if you were already over the limit on budget night, but any excess contributions made after that date could attract a tax penalty.[i]

Assuming the budget is passed into law, two further caps will come into force on 1 July 2017 that could force many people to rethink their retirement income strategy. The annual concessional (pre-tax) contributions cap will be reduced to $25,000 for everyone. Currently the cap is $30,000, or $35,000 if you are 49 or older.

Pension clampdown

Then there is a new lifetime pension transfer cap of $1.6 million, restricting the amount that can be transferred from an accumulation account into pension phase where earnings and withdrawals are tax free. Any super savings above $1.6 million will need to be held in an accumulation account where earnings will be taxed at 15 per cent.

On the plus side, retirees will not be taxed on withdrawals from an accumulation account and they can pull their money out at any time.

Transition to retirement

One change that could adversely affect more people than the wealthy fund members targeted by the government is the removal of the earnings tax exemption for transition to retirement (TTR) pensions from 1 July 2017. There is no change to the way pension payments will be taxed; they will remain tax free if paid after age 60 and taxable but with a 15 per cent tax offset if paid before age 60.

When you retire or turn 65, your TTR pension balance will be assessed under the new pension transfer cap of $1.6 million.

This change may impact the ability of many middle-income earners to catch up on retirement savings in the final years of their working lives.

Good news for couples

But that's enough of the bad news. From 1 July 2017 the income threshold for the low-income Spouse Contribution Tax Offset will increase from the current $10,000 to $37,000. This will give more scope for higher earning spouses, or those who have reached their individual contribution limits, to boost their partner's super balance.

This should take some of the sting out of the new contribution limits and lifetime pension cap. Instead of an individual $1.6 million tax-free pension, couples can shoot for a combined $3.2 million.

...and older workers

The praise was unanimous for the decision to allow people to add to their super up to age 75. At present people aged 65 to 74 need to satisfy a work test before they can make a contribution.

From 1 July 2017 anyone can continue contributing to their super up until they turn 75, whether or not they are working. This applies to concessional and non-concessional contributions as well as spouse contributions and will give women and others with low super balances extra time to play catch up.

Also good news is the long overdue move to allow all individuals to make personal, concessional contributions to super, up to the new $25,000 annual cap, and claim a tax deduction.

Seek advice

With such sweeping changes in prospect, many people will need to revisit their retirement income planning. Wealthier Australians may also need to find alternative homes for their retirement savings once they reach their individual caps.

Yet despite the headache the proposed changes will cause, super is still the most tax effective retirement savings vehicle in the land, albeit less generous than it was. We are here to help you minimise any adverse impacts and maximise the opportunities, so give us a call.

i For all the details on the super changes covered in this article go to www.budget.gov.au and search under 'tax and super'

INTEREST RATES FEEL THE BIG CHILL

Things are getting decidedly chilly in the world of global finance. First it was low interest rates and zero interest rates. Now it's sub-zero, or negative interest rates. What on earth is going on?

Negative interest rates are a new phenomenon introduced by central banks in major economies across Europe and in Japan to stimulate growth. Or so the theory goes. Never before have rates moved into negative territory so the effects are not fully known.

So what are negative interest rates and what do they mean, if anything, for Australia?

What is a negative rate?

Negative interest rates are where you in effect pay for somebody else to hold your money. Rather than earn interest on your money, you are paying interest.

In reality, individuals taking out term deposits or holding money at the bank are not paying for the privilege, although it does mean that rates are very low. So far at least, negative interest rates only apply to large companies in Europe and Japan who are paying to park their cash.

This is how it works. Central banks charge private and commercial banks interest to hold their cash overnight. The intention is to discourage banks from holding excess reserves and motivate the private sector to increase spending. For instance, as at April 2016 the European Central Bank was charging banks 0.4 per cent to hold their money overnight.

Positives and negatives

All this should encourage the private sector to spend. In theory it makes sense, but in practice there are fears that negative interest rates could also have some negative consequences.

Discouraging banks from holding on to money could lead to their having insufficient funds to lend to borrowers which would put a brake on economic activity.

In addition, if the banks do not pass on the cost of holding their funds with the central bank to their customers, this will put a squeeze on their profit margins which might also reduce their willingness to lend.

Corporations – and indeed private investors – could even decide that holding their money in the bank is not the best bet and so choose to withdraw cash from the banking system. Again this could stymie economic growth and distort financial markets.

Individual borrowers unaffected

Sadly, for personal borrowers negative interest rates are not coming to a bank near you any time soon.

For instance, in Australia the base rate is at an all-time low of 2 per cent but the average mortgage is closer to the 5 per cent mark. Similarly overseas, where negative rates exist, homebuyers pay interest on their loans.

In fact, Australia's positive interest rates are having some negative consequence for the Aussie dollar as overseas investors look to our shores for better returns. While it looked at one point to be tumbling towards the US60c mark, it has since recovered to levels above US76c.

Implications for Australia

A stronger Aussie dollar is good news if you are travelling overseas, but it will also constrain the move to an economy no longer dependent on resources. The higher the dollar, the more expensive our exports and that makes it difficult to compete on the world market.

Low interest rates are not helping investors either. Term deposits attracting rates of around 2.5 per cent[i] will only just keep pace with inflation at the current rate of 1.3 per cent.[ii]

While holding your cash in the bank may seem increasingly less attractive, bonds may offer an alternative source of returns. With bonds, at least you stand the chance of the capital value of the bond increasing should interest rates fall further.

Despite the current downward pressure on local interest rates, it seems unlikely that we will move into negative territory. Even so, as investors we all benefit from understanding the 'Big Chill' in global interest rates and the flow-on effect to our economy.

i http://www.ratecity.com.au/term-deposits

ii http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/1345.0?opendocument