Your Wealth Bulletin

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Hi,

This month we take a brief look at last week's Federal Budget and what it means for you.

Federal Budget Summary

A sign of things to come

The first budget by Kevin Rudd's Labor Government has resulted in no 'significant' changes that are likely to impact the average investor.

Of particular importance is that superannuation has, by and large, been left untouched. The last 18 months have seen radical changes to the superannuation environment and at least the dust can settle for a little while.

On the positive side, the use of investment pools for infrastructure purposes has a good intent.

Much has been written and broadcast about the changes to the child care rebate, luxury car tax increase, education rebates and the introduction of means testing for family tax rebates and benefits.

There has also been a broadening of FBT benefit items that will result in less attractive salary packaging structures.

One point that has raised some ire within the financial planning community has been the 'add-back' of income for government benefits.

To explain further, if a person is on a salary of say $70,000 per year, and they salary sacrifice $20,000 into superannuation, then in past years, this would have made them eligible for the Government co-

contribution towards super.

The budget has indicated that while it's fine to continue sacrificing that amount into super, the net $50,000 salary will have the sacrificed amount of $20,000 added back onto it for calculating entitlements. In this example, it would void the super co-contribution completely.

It's important to note that there is no impact on the major benefits of salary sacrificing towards superannuation. The above add-back of income doesn't start until July 2009 thus giving a year of grace.

Other items of note:-

- Personal income tax cuts - as previously muted during election
- First home owners saving account - good idea, but not likely to get rich using them
- Super Fund Clearing House - allows employers to send 1 cheque for all staff funds
- Fringe Benefits Tax - tightening of rules
- Reduced Foreign Investor Withholding Tax - to encourage foreign investment (and boost Aussie share prices!)

A final change that has received limited publicity has been the alteration of tax deductibility for the interest on capital protected loans.

The interest rate that is deductible each year has fallen for income tax purposes. The investor is still able to offset the cost of interest by using that differential at the time of investment maturity as it will offset any capital gains tax liability. More on this later.

In summary, while there has not been 'massive' alterations, it would be fair to say that these changes will probably represent the direction that this government will take with it's future fiscal policy.

100% Protected Portfolio Loans

Tax effective & Highly leveraged

This time last year we witnessed a huge change to superannuation. On budget night, the government instantly limited how much a person could deposit into their super fund.

This year's budget night, we've seen a change for investors, but on a structure that's not anywhere near as widespread in it's use as superannuation.

In brief, a 100% protected portfolio loan is where a bank will lend you 100% of the money to invest into a selection of shares or managed funds. The investor chooses a timeframe for maturity, usually between 1 to 5 years.

The underlying security is simply the shares, no mortgage over property or other assets is needed.

The bank buys put options, (think of it as insurance protecting the price of the share), which protects the bank (and you) from having a portfolio that is worth less at the time of maturity. Of course, this comes at a price, for which the investor pays for.

As the investor, you receive all the dividends, voting rights etc as would any shareholder. Plus, you receive tax deductions on some of the interest paid.

The significant benefit of this structure is that you can borrow money to invest that ordinarily you may not be able to raise elsewhere.

The other benefit is that because each share is insured, at the end of the term, you hand back to the bank all of the shares that are worth less than what you paid for them, while you keep the profits on all the winners.

This means that there is no 'net' effect of winner minus loser as per a typical portfolio, with the insurance under each stock, you just keep the winner's profits.

The 'turn off' for investors considering this investment has been the headline interest rate of about 15% p.a. However, upon closer examination, it's not quite as clear cut.

Dividends in say the banking sector is approximately 6%. Last month, the tax deductibility of this structure was about 90% plus, meaning that with the dividends, franking credits and tax deductions, the break-even point of a high yield portfolio could be as low as 3%

per annum.

For a fully protected portfolio, that obviously offers a lot of comfort to investors in this volatile market, whilst also enabling aggressive investors the ability to leverage a substantial sum into the market.

The unfortunate news is that last week the government has altered the interest rate in which the tax deductilbility is measured. It has effectively been reduced from 14.55% down to 9.45% as of 7.30pm last Tuesday.

However, keep in mind that the difference in the interest rate will still be considered as a cost of investing and thus will be claimed as a capital expense. This means that the interest not claimed in that year can be used to offset future capital gains tax liability.

The lesson from the last two year's budget really has been that Tax Planning no longer has a 30th June deadline. The time for implementing tax minimisation strategies should now be completed pre-Budget night May of each year.

If you have any queries about this month's newsletter or would like to discuss your financial situation in more detail, please feel free to email or call our office on (02) 9525-0777. If you would like to forward this email to a friend, click on the forward email link below.

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