The Retirement Advice Centre

May 2015

In economic news the past month, there has been speculation that the Reserve Bank of Australia may decide to cut the official cash rate at its May board meeting. We will wait and see very shortly.

Inflation rose by a relatively benign 0. 3 per cent in the March quarter, for a seasonally adjusted annual rate of 1.3 per cent. This is well below the Reserve Bank's 2-3 per cent target band, leaving room for another rate cut.

But as April wore on, the case for another rate cut weakened. Unemployment was down slightly in March to 6.1 per cent, from 6.3 per cent in February, while the house price boom in Sydney and Melbourne shows no sign of abating.

The big turnaround in April was in the iron ore price.

After falling to a low of US$47.08 a tonne on April 2, the commodity's price jumped 23 per cent in the space of three weeks to US$57.81. This is welcome news for the Australian economy and the task of reducing the budget deficit. It also helped boost the Australian dollar from its six-year low of US$75.34 at the start of the month to more than US$78.

This month sees the Federal Budget released. As indicated, we will be issuing a summary of that budget to you via email. We will be monitoring closely the outcomes on the evening.

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Taxing issues for SMSFs

The re-think of Australia's taxation system has superannuation firmly in its sights. That's making investors nervous, especially those with their own self-managed super fund.

The recent white paper on tax, which was prepared for the government and designed to start a conversation, has sparked debate about what some see as the disproportionate benefits of super to wealthier investors.

While SMSFs are not being directly targeted, they tend to be more active contributors to super. Consequently, they stand to be more adversely affected by any winding back of current tax arrangements.

So what is the current tax regime and what areas might be subject to change?

Super contributions tax

Individuals can make voluntary contributions to super, in addition to their employer's super guarantee payments, on a concessional or non-concessional basis.

Concessional contributions are paid from pre-tax income and taxed at the special rate of 15 per cent rather than your marginal tax rate. As a result, if you are an employee making salary sacrifice contributions or a self-employed person making personal contributions you can reduce your tax bill.

If you are on the top tax rate of 49 per cent (including the Medicare levy and deficit levy), then you will receive a 34 per cent benefit by making concessional contributions.

However, if you earn more than $300,000 a year then you pay 30 per cent including an additional 15 per cent tax on your contributions.

If your income is at the other end of the scale then the benefit is minimal or even negative as it is likely you are not paying any tax at all. Until 2016-17, if you earn less than $37,000 a year and you or your employer make concessional contributions, you may be eligible for a refund of contributions tax of up to $500 paid directly by the federal government. This is called the low income super contribution.

Concessional contributions for the year ending June 30, 2015 are capped at $30,000 a year if you were aged 48 or under on June 30, 2014 and $35,000 for if you were 49 or over.

Non-concessional contributions are made from post-tax income so there is no contribution tax, but there are still limits. You can contribute $180,000 a year or, if you were aged 64 and under at July 1, 2014, $540,000 over a three-year rolling period.

Super earnings tax

In the accumulation phase, earnings on investments inside complying super funds are taxed at a maximum of 15 per cent. Tax credits from dividend imputation can reduce this tax liability further, while capital gains from the sale of assets held for more than 12 months are discounted to an effective tax rate of 10 per cent.

But super is most generous in the pension phase. Once you hit 60 both income on investments and withdrawals are tax free no matter how much money you have in super.

What's on the table?

The public discussion around super tax concessions has aired a number of possible reforms.

There is talk of lifting the tax rate on concessional contributions for more Australians. Since the tax is taken from your super account, it won't hit your current hip pocket but it will impact on your balance when you retire.

Lifetime concessional contributions could also be capped. Once your super balance was sufficient to give you a comfortable lifestyle in retirement, then you would revert to your normal marginal tax rate for contributions.

Another option is to tax the withdrawals of people with balances above a certain figure.

Dividend imputation has also come under scrutiny as the return of cash to those on low (or no) tax rates has a negative impact on government coffers.

Time to prepare

Of course all these options are just up for discussion. Depending on what changes, if any, are introduced, there is the possibility that existing arrangements may be grandfathered.

If you would like to discuss your retirement income strategy both inside and outside super, give us a call.

PUTTING ANNUITIES *under the* SPOTLIGHT

Annuities have been enjoying an upsurge in popularity since the global financial crisis, but they are about to become even more attractive to new retirees thanks to changes in the deeming rules.

That's because annuities are exempt from the new deeming rules which will impact any account- based superannuation pensions that are started after January 1.[i]

As a result, holding an annuity may help your chances of receiving a part age pension or the highly- prized Commonwealth Seniors Health Card.

What is an annuity?

An annuity works like a regular pay cheque in retirement. Basically, you buy a guaranteed income stream with a lump sum, using either your superannuation money or funds outside super.

You can buy the annuity for life, which is the more popular choice, or for a fixed term ranging from one year to a maximum of 50 years.

The advantage of buying an annuity within super is that your annuity payments are tax-free once you turn 60. The downside is that you will then be subject to the minimum annual withdrawal amounts which range from 4 per cent for those under 65 to 14 per cent for those aged 95 or more.[ii]

You can choose whether the income is paid monthly, quarterly, half-yearly or annually. The amount you will receive is determined at the time of taking out the annuity although you can choose to have the sum indexed so it keeps pace with inflation.

Currently there are only three providers of annuities – Challenger, CommInsure and BT - but many submissions to the Murray Financial System Inquiry called for annuities to play a greater role in the retirement sphere.

What do they pay?

The rate of payment will depend on the features you select at the outset. On a fixed-term annuity the longer the investment period, the higher the rate, similar to a term deposit. Rates are also higher if the principal is paid back progressively, rather than in a lump sum on maturity.

Progressive repayment of principal is popular among people who know they have insufficient capital to live on the investment income alone.

Payment rates for lifetime annuities depend on your gender and the age you start the pension.

You may also trade off higher payments against features such as a reversionary income stream where your beneficiary receives the remaining income payments if you die before them.

The benefits

It's not just the exemption from the new deeming rules that makes annuities attractive to retirees. Or the fact that there are no management or other fees.

Annuities came into their own after the financial crisis highlighted the risks associated with account- based pensions where you are vulnerable to movements in financial markets. In contrast, annuities offer a regular, certain income regardless of the performance of the underlying investments.

Another reason for the renewed interest in annuities is that Australians are living longer and many of us run the risk of outliving our retirement savings. Today's average 65- year-old male can expect to live to 88 while 10 per cent can expect to live to 98![iii] Women can expect to live a little longer.

One way to make your money last is to take out a lifetime annuity that will pay you until death. An even better solution might be a deferred lifetime annuity. Despite being available overseas, these are not yet available in Australia but pressure is mounting for their introduction.

With a deferred lifetime annuity you invest a sum of money on retirement but defer withdrawing income until you reach a certain age, say 80. This can be timed to kick in when your account-based pension is due to run out.

Some drawbacks

While annuities provide security, there are some negatives. For instance, you may not be able to withdraw your money as a lump sum and you get no choice in the underlying investments.

In addition, returns from annuities are generally lower than returns from account-based pensions as the money is mostly invested in fixed income products. This is particularly the case in the current low interest rate environment where you lock in the rate for the term of the annuity at the outset.

To enjoy the best of both worlds, many retirees choose to purchase an annuity in combination with an account-based pension and investments outside super.

In a world of uncertain markets and greater longevity, having an annuity as part of your retirement plan is worth considering.

Call us if you would like to discuss whether an annuity could be part of your retirement solution.

i https://www.dss.gov.au/sites/default/files/documents/09_2014/dss1430_a4_fact_sheet_-_deeming_v4.pdf

ii http://supergroup.com.au/resources/pension-minimums-and-maximums-2014-2015/

iii http://www.challenger.com.au/retire/lifeexpectancy.asp

Foiling the digital pickpockets

Just a few years ago the notion that you could pay for things by waving a card in the air – let alone your mobile phone or watch – would have seemed ridiculous. But fast forward to the present and carting around currency is rapidly becoming as archaic as mailing a letter.

There are a number of digital payments systems in operation. By far the most widely used at present are 'tap and go' systems such as Mastercard PayPass or Visa payWave. Both allow people to make sub-$100 purchases by placing their card on or near a device that captures their payment details.

These tap and go systems are based on 'near field communication' (NFC) technology that allows the contactless communication of payment details from a chip in your credit card to a business's cash register.

Though it's something only early adopters – be they consumers or retailers – are currently making use of, the same technology can and is being imbedded in mobile phones and other smart devices such as the recently released Apple watch.

Convenience at a cost

Unfortunately, increased ease of use comes at the cost of increased chance of being defrauded.

As of October 2014, there were 15.6 million credit cards making $20.5 billion worth of transactions each year in Australia. ABS research shows that between 2009 and 2014 – even before tap and go digital payments went mainstream – 10 per cent of Australians reported being a victim of credit card fraud at least once.

A lack of timely data makes it difficult to estimate just how widely the new digital payment systems are being breached.

Even so, the Victorian Police Commissioner[i] is on record saying that increasing amounts of police resources are being devoted to crimes involving the theft and misuse of tap and go cards. That's despite credit card companies insisting that contactless payment technology is reasonably secure. They also point out that customers are fully compensated for any fraudulent use of their cards.

21st century thieving

Fortunately, there are simple precautions you can take to avoid becoming a victim of contactless payment fraud.

The biggest risk at present is also the most unsophisticated – a thief getting hold of your tap and go card, possibly after breaking into your home or car, and making a series of transactions totalling $99.99 or less.

Ian Selbie, Banking Solutions Director, Unisys Asia Pacific, advises: "Cards which use pay wave – be they credit, gift or transit cards – should be treated like cash and safeguarded similarly. You should also put a maximum transaction cap on them to minimise the damage if they are stolen."

Future-proofing your finances

- Keep your devices safe
- Secure them with a password, PIN or biometric such a thumbprint
- Opt for banks that require multifactor authentication to confirm your identity
- Only download apps onto your devices from credible sources

– Ian Selbie, Unisys Asia Pacific

It's all about contacts

While it's not common yet, what has cyber security experts such as Ty Miller, Director of IT security firm Threat Intelligence, concerned is the potential for criminals to sidle up to people in crowded public places and deduct money from their card.

"It's not something that's difficult," he says. "You can buy the necessary technology for around $130 from a Dick Smith shop and watch tutorials on YouTube about how to capture people's payment details while standing next to them in a lift."

Fortunately, there are easy ways to avoid being digitally pickpocketed. Wrapping your cards in aluminum foil is a cheap but fiddly way of blocking the signal. Miller advises investing "in a RFID [Radio Frequency IDentification] blocking wallet or purse with a shield that reduces the distance cards can be read from. You can get them for as little as $20."

It's likely that payments with smart devices will take off soon, so you might as well mitigate your risks from the get-go.

i 'Tap and go credit cards contributing to increase in crime statistics, Victoria police says', by Stephanie Ferrier, ABC News, 25 July 2014