NEWSLETTER

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NEWSLETTER

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THE CURRENT LIBERAL AND LABOR PROPOSED CHANGES

This newsletter is written to assist in recognising issues and developing strategies so as to maximise profits and minimise and / or defer taxes payable in the current and future years. Estate planning must be an integral part of that strategy, so wills should be reviewed concurrently and as family dynamics change.

Taxes, superannuation, dividends, equities and properties all need to be considered, because they are all (including taxes) an integral part of your Family's wealth creation and can be designed to provide substantial tax savings if correctly structured and managed.

If a strategy is to work, all the elements must be considered and kept in balance. It does not have to be in writing, but the elements should be clear and understood. You need to have wealth and tax strategy that deals with*:*

- ***increasing your return on investment;***
- *paying off your home with pre-tax dollars;*
- *lowering tax rates across the family's income spectrum; and*
- ***freeing up cash to invest and by such means increasing your wealth****.*

The strategy should be understood by the owners, operators and their advisers. For additional copies of this newsletter please refer to ***www.goodco.com.au***.

This newsletter is all based on public statements and press reports and NOTHING is Law nor confirmed to occur.

It is interdependent on many situations occurring and the issues being legislated, passed by both houses and then passing the final legislation and becoming Law.

Also, importantly there is no indication as to when these proposals will take effect. Some of it could be in the May 2019 budget, or in the response by the Labor Party or immediately after the election (presumed to be the third of fourth week of May).

It is more than likely that any of the proposed changes including those in the April 2019 budget will have an effective date of 1 July 2019.

Certain issues will affect certain taxpayers, but the big issues need to be dealt with. These should definitely be dealt with before 30 June 2019 and preferably now as the budget will be brought down on 2 April 2019.

These issues are covered in paragraphs 9 and 10 and possibly 11 (depending on what structure you have). Being prepared is better than being full of regret. The big issue is franking credits and how you deal with them now and definitely before 1 July 2019.

It is well known from previous Newsletters that that we are not fans of superannuation because of:

- the continual changes made by both Liberal and Labor Governments;
- the additional taxes being levied, and the benefits withdrawn as time moves forward;
- the benefits lost over time which in certain circumstances have been substantial; and
- the move to lock funds up in such a way that retirees and others are deprived access to part or all of their retirement funds as they get older.

These issues and changes have occurred regularly since compulsory superannuation was first introduced. Just because superannuation pensions are tax free today does not mean that when you get to retirement they will still be tax free. The Party (both Liberal and Labor) keep on changing the ground rules.

If you are cashed up as part of your assets outside superannuation there are some benefits that arise from these proposals that are alluded to in this newsletter. You should seek separate financial advice now and preferably before the budget on these issues.

Strategy and implementation of plans to minimise the impact of some of these issues requires the adviser to hold a financial services licence, so they can give you specific advice as it may apply to you and your family’s circumstances.

1. Concessional superannuation contributions

There seems to be no changes being proposed as to how much superannuation can be contributed per taxpayer in a year.

For the year ended 30 June 2019, the concessional contributions cap is $25,000 for all age groups:

- Compulsory contributions that an employer has to pay on top of wages and salaries are limited to a maximum of $20,531 per year; and

- The Superannuation Guarantee rate remains at 9.5% up to 30 June 2020.

Note: If your employer pays up to $20,531 you can still salary sacrifice a further $4,469 tax effectively.

Taxpayers can contribute up to $25,000 in pre-tax income to their fund, so long as it is in the hands of the fund by the close of trading on 30 June each year. These contributions are tax deductible to the employer making the contribution.

2. Non-concessional contributions (after tax contributions by Member of a Fund) used and unused

You can currently make a non-concessional contribution of up to $300,000 in any three-year period. These are contributions from your capital to your superannuation fund on which tax was paid in prior years or which you received previously tax-free. On receipt they are accumulated, and no tax is payable on the receipt by your superannuation fund.

3. Unused concessional cap being carried forward

From 1 July 2018 if you have a total superannuation balance of less than $500,000 on 30 June of the previous financial year, you may be entitled to contribute more than the general concessional contributions cap and make additional concessional contributions for any unused amounts.

The first year you will be entitled to carry forward unused amounts is the 2019–20 financial year. Unused amounts are available for a maximum of five years, and after this period will expire.

It is being suggested that the Labor Party are considering lowering the non-concessional limit from $100,000 to $75,000. If you are considering making non-concessional contributions in the next three years it may be worth considering contributing $300,000 before the election.

If what is proposed does occur and the accumulation is allowed for the three years, the $300,000 will reduce to $225,000.

4. Superannuation balances above $1,600,000

If your super fund balance is more than $1,600,000 then your unused concessional cap is $0.

If you want to convert your super balance from accumulation to pension mode, you can do this, but only the first $1,600,000 will be tax free and the balance of the pension fund will be subject to tax.

5. Division 293 amendments

If you earn more than $250,000 a year, your annual superannuation contribution will be taxed at 30%. 15% of that will be paid by your superannuation fund and, following your income tax assessment, a further 15% will be charged to you as a separate assessment under Division 293.

If you received a Division 293 assessment, you can either elect to pay that amount yourself or you can elect to have it paid by the superannuation fund.

Prior to 2017 this threshold was $300,000. The Labor Party have suggested that the $250,000 would be further reduced to $200,000.

6. First home buyers' super scheme

From 1 July 2017, you can make voluntary concessional (before-tax) and non-concessional (after-tax) contributions into your super fund to save for your first home.

From 1 July 2018, you can then apply to release your voluntary contributions, along with associated earnings, to help you purchase your first home. You must meet the eligibility requirements to apply for the release of these amounts.

You can use this scheme if you are a first home buyer and both of the following apply:

- You either live in the premises you are buying or intend to as soon as practicable.
- You intend to live in the property for at least six months within the first 12 months you own it, after it is practical to move in.

You can apply to have a maximum of $15,000 of your voluntary contributions from any one financial year included in your eligible contributions to be released under the FHSS scheme, up to a total of $30,000 contributions across all years.

You should also receive an amount of earnings that relate to those contributions.

If your children do not own a home and have a taxable income from say sources other than salaries and wages, they could contribute to superannuation up to $25,000 in total and should notify their fund that the contributions are part of the first home buyer super scheme.

The Labor Party has suggested that this scheme would be removed.

7. Downsizing superannuation contributions

From 1 July 2018, if you are 65 years old or older and meet the eligibility requirements, you may be able to choose to make a downsizer contribution into your superannuation of up to $300,000 from the proceeds of selling your home.

Your downsizer contribution is not a non-concessional contribution and will not count towards your contributions caps.

The downsizer contribution can still be made even if you have a total super balance greater than $1.6 million.

Your downsizer contribution will not affect your total super balance until your total super balance is re-calculated to include all your contributions, including your downsizer contributions, on 30 June at the end of the financial year.

The downsizer contribution will count towards your transfer balance cap, currently set at $1.6 million.

This cap applies when you move your super savings into retirement phase.

You can only make downsizing contributions for the sale of one home. You can't access it again for the sale of a second home.

Downsizer contributions are not tax deductible and will be considered for determining eligibility for the age pension. If you sell your home, are eligible and choose to make a downsizer contribution, there is no requirement for you to purchase another home.

The Labor Party has suggested that this scheme would be removed.

8. Negative gearing

To keep this simple negative gearing is where the profit arising from an investment in property, shares or otherwise leads to a taxable loss but may not necessarily lead to a cash flow loss.

In this example capital works allowances are deducted on the basis that the investment was for the purchase of a new building. From 1 July 2018 purchases of old properties had capital allowances excluded.

By way of example:

Forecast for the acquisition of Unit 2 at 39 Black Street Blaxland
Based on a full year rented and that the borrowing is by the Unit Trust

	Profit $	Non cash $	Cash $
INCOME			
Rent received	**72,800**	**-**	**72,800**
Less **OUTGOINGS**			
Council rates	1,574		1,574
Depreciation - furniture and fittings	9,500	9,500	
Depreciation - capital works	10,000	10,000	
Electricity	750		750
Insurance	5,500		5,500
Interest on borrowing			-
Land tax	11,500		11,500
Letting fees	2,800		2,800
Management fees	3,640		3,640
Repairs and maintenance	3,000		3,000
Water rates	3,500		3,500
Total deductions	**51,764**	**19,500**	**32,264**
NET PROFIT TO BE DISTRIBUTED	**21,036**	**(19,500)**	**40,536**
	-		
Interest base on a borrowing of	**1,000,000**		
		Contract price	**Stamp duty and legals**
Cost	**2,098,990**	**2,000,000**	**98,990**
Borrowed from Bank	1,000,000	**at 5%**	
To be funded by the owner of the Unit Trust cash reserves	**1,098,990**		
Money on Term deposit	**1,000,000**	**at 2.5%**	
	Total	**Interest on the term deposit at 2.5%**	**Cash surplus from renting for a year**
Interest earned from term deposit and monies paid back to investor by unit trust	65,536	25,000	40,536
Interest paid on unit trust borrowing by investor	50,000		
Net cash surplus	**15,536**	**25,000**	**40,536**

In the example the borrowing on $1M at 5% by the investor creates an accounting profit and taxable profit of $21,036 while the actual cash is a surplus of $40,536. This is a not a negative gear. If you factor in the interest at 5% (by the owner of the asset) which totals $50,000 then the $21,036 profit before interest becomes a loss of $28,964.

It is proposed by the Labor Party that the gearing loss arising from borrowings will be denied and that amount can then be capitalised and added to the cost base of the asset in the entity that has the loss.

This will then become part of the capital gain calculation when the property is sold.

You will not be able to carry forward negatively geared losses to future years.

It is apparently not going to be drafted this simply as they have announced that any borrowing which occurs in one entity and is used in another entity will be looked at as a negative gear so putting properties in a Unit Trust and funding the Units (in which the loss will occur) will not work.

If you are planning to acquire assets against which you will be borrowing, and which will result in a loss it may be prudent to consider advancing the purchase or refinancing your total borrowings prior to the election.

9. Surplus franking credits received by taxpayers, superannuation funds

It appears that the Labor Party want to remove the benefits of over-franking received by investors from public and private company shares or possibly from over franked distributions by their family trusts.

The concept here is that you can reduce your tax by using imputed credits to the point that no tax is payable however, instead of getting the excess franking credits back as a refund, you will just lose them. This will affect retirees and superannuation funds the most.

Self-managed superannuation funds and investors and family trusts will be significantly affected. If changes to income streaming as dealt with in paragraph 11 are also introduced, this could be very costly to the community. It is being politically sold on the basis it affects only the wealthy and public superannuation funds.

Many retirees particularly rely on the surplus franking credits to provide them with a Christmas bonus which is usually derived from tax refunds received in November / December and spent on Christmas visiting families and providing Christmas gifts.

To deprive them of the franking credits which arise from their personal savings over many years is going to seriously affect retirees in self-managed superannuation funds and retirees in family trusts. This can potentially be fixed but is going to require special advice before the event, which is not something that most taxpayers will seek or understand.

It is well accepted that the Liberal Party (in the May 2019 budget) will reduce the tax rate for all companies to 25% under the guise that it is good for the economy and that it makes companies more competitive.

They are fully aware that by that move, any and all dividends paid will be paid say from 1 July 2019 at 25% and therefore shareholders will receive dividends with smaller franking credits and they will be obliged to make up the difference of 5% when they pay their personal tax, because personal tax rates are not changing. Individuals will not see the impact until about November / December 2020 and then it will be all too late.

The tax consequence of this is demonstrated as follows:

CHANGE OF TAX RATES ON DIVIDENDS RECEIVED BY INDIVIDUALS

	Franked at					
	30%	**27.5%**	**25%**	**30%**	**27.5%**	**25%**
	$	**$**	**$**	**$**	**$**	**$**
Dividend paid in cash	70,000	70,000	70,000	700,000	700,000	700,000
Imputed or franked credit applicable to dividend	30,000	26,552	23,333	300,000	265,517	233,333
Taxable income	**100,000**	**96,552**	**93,333**	**1,000,000**	**965,517**	**933,333**
Tax payable on taxable income	26,632	25,287	24,032	443,232	427,025	411,899
Less Imputed or franked credits from above	30,000	26,552	23,333	300,000	265,517	233,333
Tax payable / (refundable) by individual taxpayer	**(3,368)**	**(1,265)**	**699**	**143,232**	**161,508**	**178,566**
Additional tax arising in the hands of an individual from change in company tax rates		**2,103**	**1,964**		**18,276**	**17,058**
Additional tax that will arise in the hands of individuals if the tax rate is reduced to 25% on 2 April 2019			**4,067**			**35,334**
Percentage of additional tax payable on current individual tax rates		**2.18%**	**4.36%**		**1.89%**	**3.79%**

If your company is currently paying tax at the rate of 30% and you want to pay a dividend, your tax payments will go up under both Liberal and Labor Party proposals.

If you earn $70,000 just from franked dividends at 30%, then you currently get a refund of $3,368, however when the company tax rate is reduced, and a dividend is paid after the effective date for the same amount of cash, then your tax will go ***from a refund of $3,368 to tax payable of $699, a difference of some $4,067.***

This effectively means your tax rate goes up by 4.36%.

If you earned more than $180,000 and on top of that, amongst other income, you receive a $700,000 cash dividend then the tax payable would have been $143,232. When the company tax rate is reduced, and a dividend is paid after the effective date for the same amount of cash, then your tax will go from a payment of $143,232 to a payment of $178,566, ***an increase of some $35,334***.

This effectively means your tax rate increases by 3.79%.

In the second case (where the dividend is $700,000), should the Labor Party ***re-introduce the deficits franking tax on incomes over $180,000, then on $700,000 your tax will increase from $143,232 to $193,632, an increase of some $50,400***.

Effectively the tax rates reduce from 30% to 27.5% and then to 25% and you would expect the % of additional tax payable would show 2.5% and 5%.

The cash dividend remains the same on both dividends however the franking credits reduce in value and as a consequence the taxable income reduces and therefore the percentages in the table above will never be 2.5% and 5%.

10. Unused and surplus franking credits held by taxpayers' companies. Do I pay out my retained earnings?

Currently there are two tax rates being applied to companies. Small trading companies are paying tax at the rate of 27.5% and all other companies, including investing companies, public companies, etc are paying tax at the rate of 30%.

Arising from the payment of tax, an off-Balance Sheet account maintained for taxation purposes arises and all tax payments are added to that account and from that account (known as a franking account) is deducted the tax content of dividends paid. If you pay a $70,000 dividend fully franked, then attached to that is a franking credit of $30,000 and a $700,000 fully franked dividend comes with a $300,000 franking credit.

To pay a fully franked dividend, your franking account must be in credit to pay a franked dividend, so any shortfall is paid as an unfranked dividend.

To work out the maximum dividends that can be paid at the tax rate applicable to a company, you divide the franking account balance by the tax rate (either 30% or 27.5%) and multiply it by 100. If the tax rate applicable to a company moves from 30% to a lower rate, then a greater amount of franked dividends can be paid, however if the retained earnings in a company (being the profits not distributed as dividends) are not as great as the franking account balance then ***you end up with surplus franking credits that cannot be paid out to shareholders and are lost forever.***

As the tax rates reduce, the company's franking credits stay the same, as they are effectively a running balance of taxes paid less the tax effect of dividends paid. As the tax rate goes down, the amount of franked dividends that can be paid goes up.

We are seeing companies like BHP, Westfarmers etc paying out substantially high dividends or entering into share buy backs where the consideration has a high content of 30% franked dividends.

The benefit of this to the shareholders is that it gives the shareholders the ability of having dividends franked at the higher rate of 30% so that those franking credits are not lost to the shareholders.

If you are a shareholder in a private company and do not pay out most of your franking credits, then you will end up with surplus franking credits that you can never pay out to shareholders **i.e. tax paid lost forever**

The attached diagram reflects a company, public or private, that has retained earnings of $3,000,000 and a franking account balance of $1,300,000.

At the current tax rate of 30%, should that company pay out all its retained earnings, it will end up with excess franking credits (which it cannot use or give to shareholders) totalling $33,333.

When the tax rate for that same company reduces to 25%, if it pays the same dividend out, the amount of tax payable by a shareholder earning more than $180,000 from other sources will increase by $151,429 to $880,000.

This means the individual tax payable by the shareholder will go from 17% to 22%.

Effectively the tax reduction of 5% given to the company will now have to be funded by the shareholder.

If, that proposal goes through **and the Labor Party introduce the budget deficits tax, on that same transaction, the tax will increase from $814,286 to $960,000, a further increase of some 2% taking the tax rate on those dividends to 24%.**

To put this into perspective, if the same dividend as per the attached was paid today, the tax would be $728,571.

If paid in a year from today, with the reduction of tax rates by the Liberal Party in the May 2019 budget and a change of Party in May and the introduction of the budget deficits tax, **that same dividend will attract tax of $960,000. That is an increase of $231,429.**

You really need to urgently look at this issue if you are the shareholder in a proprietary company.

SURPLUS FRANKING CREDITS ARISING FROM REDUCTION IN TAX RATES AND ADDITIONAL TAX PAYABLE

	Liberal party current position			Proposed labour party reintroduction		
	30%	27.5%	25%	30%	27.5%	25%
	$	$	$	$	$	$
Franking credits currently available at 30 June 2018 after current year tax paid	**1,300,000**	**1,300,000**	**1,300,000**	**1,300,000**	**1,300,000**	**1,300,000**
Franked dividend payable based on franking account balance at 30 June 2018 of $1,300,000	3,033,333	3,427,273	3,900,000	3,033,333	3,427,273	3,900,000
Retained earnings at the end of the year ended 30 June 2018	**3,000,000**	**3,000,000**	**3,000,000**	**3,000,000**	**3,000,000**	**3,000,000**
Franking credits lost after retained earnings paid out	**14,286**	**162,069**	**300,000**	**14,286**	**162,069**	**300,000**
Franking credits used to pay out retained earnings of $3,000,000	**1,285,714**	**1,137,931**	**1,000,000**	**1,285,714**	**1,137,931**	**1,000,000**
Taxable income of individuals earning more than $180,000 from other sources						
Franked dividend paid prior to 30 June 2019	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
Franking credits that would apply to company tax rate pre / post 30 June 2019	1,285,714	1,137,931	1,000,000	1,285,714	1,137,931	1,000,000
Taxable income on dividend paid	**4,285,714**	**4,137,931**	**4,000,000**	**4,285,714**	**4,137,931**	**4,000,000**
Tax payable by taxpayers	**728,571**	**806,897**	**880,000**	**814,286**	**889,655**	**960,000**
Additional tax to be paid by the family if not paid at 30%		**78,325**	**151,429**			
Additional tax to be paid by the family if not paid at 30% plus budget deficits tax				**85,714**	**161,084**	**231,429**
Effective tax rate in the hands of shareholders	**17.0%**	**19.5%**	**22.0%**	**19.0%**	**21.5%**	**24.0%**

The factors that must be considered to derive the correct answer are:

- ***The amount of retained earnings and franking credits held by your company and at what franking rate;***
- ***The amount of cash reserves carried by you in your name, your company and / or your trust;***
- ***Whether you would be investing those cash reserves in the next 5 to 7 years at a rate greater than the cash rate; and***
- ***Whether you can earn a compounding 7% over the next 5 to 7 years.***

The answer and solution will be different for each client.

11. Trusts and income streaming

Software for tax agents is written so that the agents are driven to not use “income streaming” and because the software must be approved by the tax office, how the tax office want it distributed is the way it is written. That is not what the law says.

The software proportionally distributes the net income of the Trust Estate allowing the operator to put a percentage against each beneficiary who are then distributed a mixture of capital gains, foreign Income, interest income, franked and unfranked income etc.

This is terribly tax inefficient and expensive for the beneficiary but because it is written this way it excludes the ability of trusts to make distributions to tax effective entities and is very costly to the family. It can be overwritten to stream income, but most agents do not.

It is quite legal not to apply percentages to trust distributions but because it requires a sophisticated user in the accounting practice and pre-planning, most accountants opt out and do this as a percentage after the event. This is unfortunately a widely used practice in the accounting profession.

Specialty practices such as us and certain other practices who have high net wealth clients spend time prior to 30 June (or some after) and stream different types of income such as:

- realised capital gains;
- franked dividends;
- unfranked income;
- foreign income;
- interest;
- rent; and
- primary production income etc.

to different taxpayers thereby obtaining a far better outcome for the beneficiaries so that different outcomes can be achieved defending on the beneficiary’s taxable income prior to the distribution.

This gives the Trustees the ability to stream different incomes to different taxpayers and use certain structures to defer the payment of tax.

By way of example if a fully franked dividend received by a trust is paid to a company that has the same tax rate as the franking credit then the 17% tax that would be paid by an individual on a 30% franked divided is deferred until that company itself pays a dividend.

It seems that the Labor Party is seriously considering abolishing income streaming, which will affect the typical family business or retirees where income streaming saves and / or defers tax by using rates of tax applicable to different family members or parking franked dividends in companies.

Please do not underestimate the additional tax cost that will arise particularly in families and retirees earning through trusts incomes comprising a mixture of realised capital gains, franked dividends and other income that currently goes to different beneficiaries.

We know you all hate having more structures, but it may be very beneficial, prior to the May federal election, to invest a few dollars increasing the numbers or types of entities you own which may prove very financially beneficial in a Labor Party era.

12. Capital gains tax discounts

The Labor Party are as part of their platform suggesting that they will reduce the CGT discount from 50% to 25%.

Should you be considering purchasing an asset and / or borrowing money, it may be very prudent to do that before the budget and / or the election.

If you put in place action today, which is finalised prior to any announcements, then you could avail yourself of negative gearing and capital gains tax discounts of 50%, which may be excluded in the near future.