

focus

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Welcome to Financial Advisory Services' latest newsletter

Another financial year is over, and this is a good time to review strategies to improve your financial position. In this issue, we examine some of the changes that have been introduced this year, together with some insurance issues and superannuation ideas.

Investment markets have been volatile in recent weeks in the light of high oil prices, interest rate movements and economic activity. Although returns for the full financial year will be satisfactory, client reports for the 6 month period ending 30

June are unlikely to show much increase in valuations, and indeed some decreases are probable. However, there are positive indicators for investors, so it is a time to review expectations rather than significantly changing your investments.

As always, if you want to know more about any financial matter, or how you might be personally affected by the announced budget changes, please do not hesitate to call us on (08) 8232 3111.

Budget snapshot

The latest Federal Budget has proposed sweeping changes to the superannuation system.

Among the major proposals, the lump sum tax on superannuation will be abolished for all Australians who are 60 years of age or older.

In addition, existing Reasonable Benefit Limits (RBL) will be removed, enabling workers to accumulate an unlimited amount of retirement savings without paying tax on excessive benefits.

The RBL had restricted super benefits to \$648,946 for a lump sum and \$1,300,000 for those who took at least 50 per cent of their super as an income stream.

The self employed are also big winners, with their superannuation contributions to become fully tax deductible. At the moment, the self-employed can claim a tax deduction only for the first \$5000

of superannuation contributions and then 75 per cent of any contributions above that amount up to their age-based limit.

The age based limits will be dropped and all superannuation benefits made by the self-employed up to a universal limit of \$50,000 would now be tax deductible. From 1 July 2007, a transition period of five years will allow a \$100,000 limit for those 50 and over.

The change also allows the self-employed to be eligible for the Government's co contribution for their post tax contributions. Previously, this benefit was only available to employees.

People with assets outside of super will be able to make an additional \$150,000 contribution to super, allowing transfers of share portfolios or proceeds from a property.

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Words of Wisdom

'Success is more than a good idea. It is timing too.'

- Anita Roddick,
Body Shop Founder

Financial Advisory Services Pty Ltd
AFSL Number 227929
91 Halifax Street
Adelaide 5000
Ph: (08) 8232 3111



Singles suffer if out of action

For many single people, having insurance cover in place for their home and contents, their motor vehicle and their health are the three most important considerations when it comes to having adequate risk protection.

Unfortunately, while these insurances are all very important, considerably less thought is put into making sure that there is also insurance cover to pay for everyday living costs should they become totally and permanently disabled, or suffer a major critical illness.

Who will foot the bills?

Changes to your lifestyle, including home and mobility, can be costly to manage, and the need for long-term care is generally very expensive. So who will pay the bills if you're single?

Even if you get married, and there is more than one income earner in the household, the financial burden of

losing income can be enormous. But, increasingly, many people are choosing to live single lives. In this situation, there is generally no income back-up at all if you suddenly have to stop work. For example, if you are diagnosed with a critical illness such as breast cancer or suffer a stroke, you could be left in an entirely different situation than a person with a partner.

Without a joint income, single people are more reliant on their income for debt repayments and other living costs.

Critical illness is really critical for singles

In Australia, a 35 year old male has more than twice as much chance of suffering a critical illness compared with the risk of dying¹. If they are single, the financial effects could be substantial.

Some singles will currently find they are extremely under-insured against critical illness. Various surveys of individuals in

the Australian market have shown that a high percentage of people do not have sufficient insurance in place to cover their current income, leaving them with a huge funding gap should they be forced to stop work.

The cost of assistance can be substantial

Unfortunately other income streams, such as social security, sick leave, workers' compensation and superannuation provide only a limited level of financial support.

Whether caused by ill health or an accident, disabilities are almost always unforeseen and can seriously impair your ability to function in the same way you did before. While they don't necessarily have to affect your long term enjoyment of life, they can often have an enormous financial impact.

The cost of medical assistance can be substantial, and restrictions on work and education can severely affect your capacity to earn a living.

Recently, insurance company, Aviva, has added a number of new insurance features to its products, tailored for critical illness. These include improved critical illness definitions, an option to pay out the life insurance if the policyholder becomes critically ill, and another option to pay the funeral costs as a part advanced death payment.

Aviva, in a first for Australia, has also added International SOS to its critical illness policies. This gives critically ill policyholders, who have been paid out a lump sum, access to a global service with medical experts acknowledged worldwide for their ongoing contribution to medical research from some of the world's leading medical institutions – at no extra cost.

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Two single questions that could change your life

1. Have you insured yourself for disability?

The financial costs of disability can be high. One of the best ways to prepare for this cost is to transfer the risk to an insurance company.

Total and Permanent Disability (TPD) insurance covers you for disabilities that permanently prevent you from ever working again. TPD is normally paid as a lump sum. Note that many TPD insurance policies require up to six months of total and permanent disability before paying a benefit.

2. Have you insured yourself for critical illness?

Critical illness insurance can help you cope financially with the affect that a medical trauma, such as a stroke, can have on your life. Critical illness insurance is normally paid as a lump sum and can be used to pay for changes to your lifestyle or for care that you may require because of the trauma.

If you believe you may be under insured or would like to review your insurance cover, please contact your financial adviser.

¹ Pricing Dread Disease Insurance 1994. Report presented to Institute of Actuaries of Australia by Edward Fabrizio and Warren K Gratton.

Single Facts

The 2001 Census revealed about one fifth of all Australians are living alone, and the Australian Bureau of Statistics predicts that in 20 years the number of single-person households will increase by up to 105%.

What's more, 9% of households have single occupants, and the average household size will drop from 2.6 to 2.3 people during the same time.

(Source: The Age, October 2005).

Help your kids avoid the super tax sting

Adult children could find themselves facing an unexpected tax bill unless investors organise their superannuation death benefits allocation carefully.

We need greater clarity urgently from the government. They proposed that superannuation benefits paid to a 'dependant' would be tax-free regardless of their age, but they did not specify whether this referred to a dependant under tax or superannuation law.

Under superannuation law, an eligible child over 18 is classified as a dependant, but under tax law they will be a non-dependant unless they can be categorised as financially dependent on the deceased.

Any death benefits paid to the adult child could therefore be taxed at up to 15%.

Although it has always been the case that superannuation death benefits were taxable when paid to a non-dependant, it was often avoided by



paying the death benefit as an income stream.

As part of its proposals, the government has stated that superannuation death benefits cannot revert to an income stream for a non-dependant. Again, further clarity is needed.

However there is an out for those aged over 60.

Since superannuation benefits are tax free after 60, a person could withdraw their benefits tax-free and re-contribute them as undeducted contributions.

When paid as a death benefit, undeducted contributions would not be taxable regardless of who they are paid to. Earnings, however, would form part of the taxable component.

Reverse super-splitting: cash to last the distance

Married couples considering splitting their super contributions for tax-efficiency need not abandon these plans due to the proposed Budget changes.

The proposed changes are just that ...proposals. A husband and wife who split their super contributions wisely might still benefit from tax savings, particularly if they still intend to access their super before the age of 60.

And a large age difference between the partners opens up a whole new range of possibilities of reverse contribution splitting – which optimises tax-efficiency and even potentially social security benefits.

Reverse contribution splitting refers to the process of the younger spouse splitting their contributions to the elder spouse, who will be able to take advantage of the benefits of super earlier.

However, you might also decide to split to the younger spouse, particularly where the older spouse is reaching age pension age, because superannuation assets are only exempt from social security testing until this age.

Replacing the current age-based deductible contribution limits with an annual limit of \$50,000 regardless of age is a great savings tool for young investors keen to boost their savings future.

Couples can still super-split – to top-up the superannuation savings of the lesser-earning partner – to maximise their future investment.

The Budget changes mean that it is critical for people to consider their savings earlier in their working lives to maintain or improve their future lifestyles.

Some products offer considerable benefits during this accumulation phase. For example:

- contributions can be split between spouses from 1 July 2006, offering tax-advantaged savings of up to \$20,000 under the current environment;
- * for certain products, tax on contributions and earnings is remitted to the tax office after the end of the financial year, which means your money works harder, for longer;
- * certain products can later be shifted to pension phase without incurring fees, charges or taxes; and

- the convenience of a simplified system of tax-effective wealth protection.

Contribution splitting is not dead, otherwise the government would have proposed its removal as well. It just needs a little more thought and planning.

Contribution splitting can still help you get the most out of tax efficiency, life insurance, estate planning and social security.

* These are special features not available on all products.



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