

Forsythes Financial Planning Money Matters

“ Budget 2006 - The most significant change to Australia's superannuation in decades ”

Peter Costello - 2006 Budget proposals

WELCOME TO THE FORSYTHES FINANCIAL PLANNING - MONEY MATTERS - SECOND EDITION 2006

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News Update

John O'Connor - Partner

We have experienced a degree of volatility in the domestic and international equity markets over the last quarter. After nearly three years of solid share market performance we all understand that the corrections experienced were due. It is important that when dealing with growth asset investments such as shares and property, we recognise that unrealised capital gains cannot be banked and that long run average returns are often well short of those achieved in boom periods. All that aside, Forsythes continues to see future growth potential, particularly in the international share markets, hence no significant reduction in existing share or property exposure is warranted at this point.

Two exciting initiatives have been progressing at Forsythes over the last six months. Firstly, we have invested significantly in comprehensive new computer software which we believe will increase the accuracy and efficiency of our client reporting. We look forward to providing more details of this initiative in our next newsletter.

The second equally exciting initiative follows the successful completion of formal financial planning qualifications by three of our Business Services Partners. Our Partners recognise the importance of the whole-of-life financial planning process in delivering a complete service to our clients. On this basis Hugh McKensy, Bill Tonkin and Brad Nichols will assume advising responsibility for their accounting and taxation clients previously advised by myself or Bruce Killingly.

This will ensure that all aspects of our client's personal and financial well being are being comprehensively considered by a single skilled adviser. Review meetings have been scheduled in this format over the past few months and the response from the clients has been unanimously supportive.

I am also pleased to report that six more of our senior accounting staff and four of our financial planning team are currently undertaking further financial planning qualifications. This will further enhance our ability to provide high quality financial planning advice across our entire client base.

Staff Profiles



Lauren Mears

Congratulations to Lauren Mears on her successful completion of the Diploma of Financial Services! Lauren will soon become an Authorised Representative of Forsythes Financial Services, specialising in personal risk insurances.

After being with us for almost 6 six years, most of you will know Lauren and many of you will be familiar with her calling you to arrange your review appointments. To enable her to focus on her new role, Lauren will now be passing on this responsibility to a new member of our team – see below.



Rebecca McNally

Rebecca joined our team in July in the role of Personal Assistant and Administration Coordinator. As part of this role, Rebecca will be taking over responsibility for the scheduling of review appointments, so after 5 years there will be a new voice on the phone!

Rebecca has recently moved from Mudgee and is enjoying discovering all that Newcastle and the Hunter Valley has to offer.

Welcome Rebecca!

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Budget 2006

what will this mean for you?

On Tuesday 9 May Peter Costello announced his Budget proposals and boy, did they produce some surprised faces. As Mr Costello announced at the time – this is ‘the most significant change to Australia’s superannuation in decades’.

These proposals still need to be passed in Parliament and the Government is currently inviting feedback on the superannuation proposals, so it’s possible they may change. That said, you might want to take them into consideration when deciding what to do with your retirement savings and discuss your options with your financial adviser.

What are the main 2006 Budget proposals?

Personal income tax cuts from 1 July 2006

An increase in tax thresholds and a reduction in the top two income tax rates will be especially beneficial for high and middle income earners.

Current 2005/06	
Threshold	Tax rate*
\$0 – \$6,000	0%
\$6,001 – \$21,600	15%
\$21,601 – \$63,000	30%
\$63,001 – \$95,000	42%
\$95,001+	47%
Proposed 2006/07	
Threshold	Tax rate*
\$0 – \$6,000	0%
\$6,001 – \$25,000	15%
\$25,001 – \$75,000	30%
\$75,001 – \$150,000	40%
\$150,001+	45%

* Not including 1.5% Medicare Levy

Changes to tax rules for converting super into a retirement income from 1 July 2007

This is where the Budget gets even more interesting. The tax rules that deal with people aged 55-59 and 60+ are quite different. However, the age at which you can access your super (preservation age) has not changed.

Retiring age 60+

→ ALL benefits from super will be tax free from 1 July 2007. This will mean you pay no tax on your benefits*, whether paid as a lump sum or as a pension with regular income payments.

Retiring age 55-59

→ Benefits from super taken as a lump sum will continue to be taxed, but the tax rules will be simplified. There will be just two tax components (instead of eight):

- exempt component – tax free
- taxed component – tax free up to a low rate threshold (currently \$129,751 in 2005/06) and then taxed at a flat rate of 16.5%.

→ Super benefits taken as a pension will be taxed at your marginal tax rate, less a 15% pension tax offset. You may also be entitled to a tax exempt component, which could further reduce your tax.

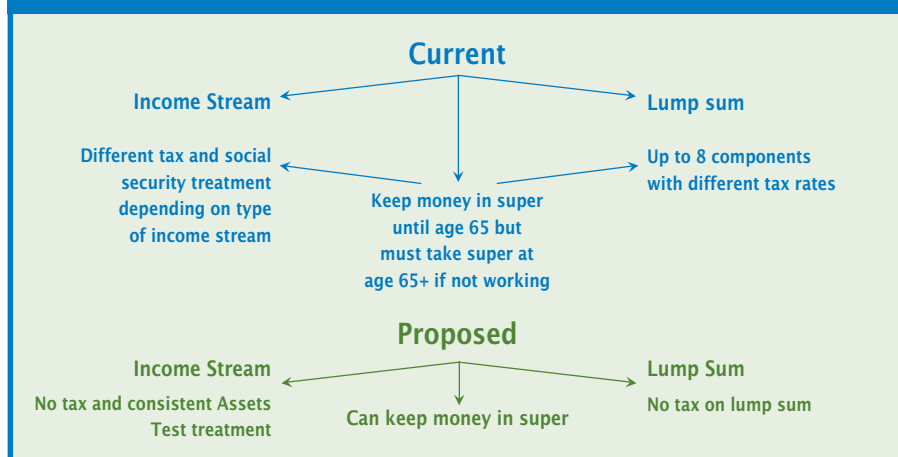
Additional announcements

- Reasonable Benefit Limits (RBLs) will be removed completely. RBLs are used to limit the amount of concessional tax super benefits you can receive. The changes mean that, however much you save within super, you will receive it tax free once you reach age 60+.
- The compulsory cashing rules will go. This means you can leave your money in super without being forced to cash it out or convert it into income payments once you have retired. (This became effective from 9 May 2006.)
- Currently, income payments received from products known as allocated pensions are set between a minimum and maximum amount. The new changes will remove the maximum amount, so you will not be restricted to how much income you receive each year (except for pre-retirement pensions).

Social security changes

- The main change is to the Assets Test Taper Rate, which will halve. As a result, people who receive the Centrelink Age Pension will only lose \$1.50 (not \$3.00) in benefits per fortnight for every \$1,000 of assets above the relevant Assets Test threshold. This means you can own more assets before you are no longer eligible for a Government pension.
- Any ‘complying’ income stream (pension) purchased after 20 September 2007 will no longer receive a 50% Assets Test exemption.
- Existing pensions will continue to receive their current Assets Test exemption.

Fewer decisions for retirees*



* Person aged 60 or over and benefits paid from a taxed fund. Source: Australian Government.

What does this mean

More money in your pocket or more to invest?

You could use the extra money you get from the tax cuts to salary sacrifice or top up your super. Especially since your super benefits will be tax free when you retire (age 60+).

Could your investments be more effective?

Once you reach 60, any money you take out of super will be tax free. But you may have to pay tax on any investments you have outside super. Now is a good time to look at your investments and think about whether you would be better off if you move them into super.

Super will be simpler from 1 July 2007

The proposed changes are quite radical and will mostly come into effect from 1 July 2007.

Not only do these proposals simplify super and retirement planning, but they arguably make superannuation the most tax-effective way to save for retirement.

The proposals also make superannuation rules for the employed and self-employed more alike.

The 15% tax on superannuation contributions and earnings will stay the same, but the age brackets used to limit the amount of tax deductible contributions you can make will be replaced with a simple set of rules.

(The information provided below does not apply to some super funds that are run for public service employees. You will need to speak with your Forsythes financial adviser about how the Budget affects such public service super.)

From Budget night, 9 May 2006, undeducted (after-tax) contributions are now limited to \$150,000 pa regardless of your age (or a total of \$450,000 averaged over three years).

If you're employed

- Any employer and salary sacrifice contributions will be taxed at two rates regardless of your age:
 - up to \$50,000 per year – 15% tax
 - in excess of \$50,000 per year – 45% tax (not including the Medicare levy).

If you are under 50 this represents an increase in the amount of concessional tax contributions that can be made each year. If you are over 50 a transitional period will apply (see box).

- Co-contributions (up to \$1,500 pa) will be available until age 75 (previously to age 70).

If you're self-employed

- Existing age-based deduction limits (ABDLs) will be removed. This means the amount you can claim as a deduction (where you are eligible) will no longer depend on your age. Your contributions will then be taxed at two different rates:
 - up to \$50,000 per year – 15% tax
 - in excess of \$50,000 per year – 45% tax (not including the Medicare levy).

If you are under 50 this represents an increase in the amount of concessional tax contributions that you can make each year. If you are over 50 a transitional period will apply (see box).

- You will be able to claim a tax deduction for 100% of all contributions up to age 75.
- You will be able to make both deducted and undeducted contributions to receive a co-contribution from the Government as well. To be eligible for a co-contribution, you must:
 - earn 10% or more of your income from carrying on a business or eligible employment or a combination of both,
 - make an undeducted contribution, and
 - receive a maximum total income which is within the existing co-contribution thresholds.

Transitional period

If you are age 50 or over in the 2007/08 financial year, a transitional period will apply. This will allow you to make contributions of up to \$100,000 each year for five years at the concessional tax rate of 15%.

Snapshot of key changes

- Personal income tax rates – the top two income tax rates will be lowered and income tax thresholds will be increased from 1 July 2006.
- The superannuation tax rules will be much simpler from 1 July 2007. This will potentially impact most people's retirement planning strategies. In particular:
 - you pay no tax when you withdraw your superannuation benefits if you are over age 60 (from a taxed super fund)
 - you could pay tax if you retire before age 60 but the current rebates and thresholds will reduce and even eliminate your tax
 - there is no limit to how much you can save in super through the removal of the Reasonable Benefit Limits
 - each year all working Australians will be able to contribute up to \$50,000 of before-tax money into super. A transitional period applies for those over 50.
 - annual after-tax contributions are limited to \$150,000 pa from 9 May 2006 (or \$450,000 averaged over three years).
- A range of social security changes, such as having more assets and still qualifying for social security benefits due to a significant reduction in the Asset Test Taper Rate from 1 July 2007.

“If you want to save, put money into superannuation – you will never find a better savings vehicle” Peter Costello, 2006 Budget proposals

What is best for you and are there any opportunities?

Do you need to put off accessing your super until after 1 July 2007?

If you're over 60 and thinking of accessing your super within the next year you might want to reconsider. The main reason being that your super would be completely tax free after this date. If you are aged 55-59 there may also be tax advantages to delaying starting a pension.

Do you need to delay retiring or semi-retiring until you're 60?

If you delay retirement and don't take out a pension until you turn age 60, you could save a lot of money in tax. This could mean you have more to retire on.

Could you be eligible for Centrelink benefits after 20 September 2007?

If you don't currently qualify for an age pension because you have too many assets, this may change after 20 September 2007. A proposed reduction in the Taper Rate means you could have more assets and still qualify for a part pension.

If you're self-employed do you want to increase your contributions?

The new proposals give you the same contribution limits as employed people, as well as access to co-contributions. Putting money into your super fund is now easier and more tax effective than ever.

Should I still consider splitting my super with my spouse?

The removal of Reasonable Benefit Limits and tax on the payment of super benefits after age 60 makes a super splitting strategy less relevant from a tax saving point of view. However, if you intend to retire and draw super benefits before age 60, then this strategy may still be worth considering.

What if I have already retired and started a pension?

If you are age 60 or over, your pension will be tax free from 1 July 2007. If you are age 55-59 your pension will continue to be taxed as it is now, until you turn 60 when it will become tax free. Also, from 1 July 2007 you may pay less tax if you were not receiving the full 15% pension tax offset.



Finger on the pulse

After strong growth in 2005 and early 2006, equity markets took a step backwards during May. Inflation fears and concerns over rising interest rates sat at the heart of the decline. Internationally, emerging markets bore the brunt of investor disquiet.

Australian shares

After a strong run in the early months of 2006, the Australian sharemarket took a backward step in May, falling 4.7%. Despite this, the market is up 27.3% over the past 12 months.

During May, the All Ordinaries index reached a record level of 5317 but then fell 6% to end the month below 5000. The decline was triggered by weak US markets and the fear of inflation in the US. With few changes to the outlook for earnings in Australia, profit taking tinged with fear appeared to be the primary motivator.

Sectors that had experienced strong growth during 2006 were among the hardest hit. The banking sector fell 6.6% while the resources sector fell 3.9%. The decline among the banks came despite reasonable profit results from St George and Westpac. The decline in the resource sector came despite contract iron prices rising 19% for 2006. In the month, copper slipped from its highs of early May but still ended the month up 13.7%; nickel prices rose 12.1% and zinc prices were up 17.3%.

Among the best performing larger companies so far in 2006 are BHP Billiton (+25.1%), Promina (+24.2%) and AMP (+21.1%). BHP continues to see commodity prices rise; Promina is expected to lift margins while AMP is benefiting from strong markets and the demand for superannuation.

At the other end of the scale Telecom Corporation of New Zealand (-29.6%), Qantas (-19.3%) and Newcrest (-17.1%) have all fallen over the course of 2006. Telecom faces increased competition following regulatory changes in New Zealand, Qantas faces high oil costs and possibly slower passenger growth while Newcrest initially rose but then fell with the price of gold.

The market looks set to remain skittish until there is more news on earnings or until speculation regarding US inflation and US interest rates subsides.

Global shares

Global sharemarkets felt the chill winds of inflation during May. Higher than expected inflation in the US led to speculation about higher interest rates and that precipitated a decline in equity markets. The MSCI World index fell 2.7% in AUD terms with several emerging markets down sharply.

Many investors were convinced that the US Federal had completed its cycle of lifting interest rates but new inflation numbers disturbed that view and the market ran for cover. The S&P 500 index fell 3.1% in May while the NASDAQ was down 6.2%. The S&P 500 is now up just 1.7% for the year to date – despite solid growth in US company earnings.

The story was the same in Europe and in the major markets of Asia. The UK's FTSE 100 index fell 5.0% in May to be up 1.9% in 2006. The French market fell 5.0% in May while the Nikkei was down 8.5%. While all these markets are up in 2006, the returns are not especially impressive.

The lower returns in 2006 come despite optimism regarding the outlook for growth around the globe. In its April update, the International Monetary Fund lifted its forecast for global economic growth in 2007 to 4.7%.

There were significant declines in several emerging markets during May. The Indian market fell 13.6%, Brazil fell 9.5% while the market in Saudi Arabia has fallen 45% in the past three months. The appetite for riskier investments evaporated when signs of inflation and higher interest rates emerged.

The MSCI Emerging Markets index fell 9.8% in May in AUD terms.

Fixed interest and cash

The Reserve Bank of Australia lifted its official cash rate from 5.50% to 5.75% in May with an eye to dampening demand in the economy. A few days later the Government announced large tax cuts that seem likely to stimulate demand. The cash rate had been unchanged at 5.50% since March 2005.

For around 12 months Australian 90 day bank bill yields hovered around 5.65%. With the cash rate now higher they have moved up to 5.90%. The UBS Australia Bank Bill index has returned 5.75% over 12 months.

Australian and global bond yields fell in mid May as investors moved out of equities and into bonds. However, over the course of 2006 yields have generally drifted higher as inflation has ticked up. Australian 10 year government bonds started 2006 at 5.20% and ended May at 5.73%.

With bond yields rising, returns from bonds have been subdued in the short term. The UBSA Composite bond index returned 3.84% over the 12 months to May, but higher bond yields will be reflected in returns over time.

Property securities

The Listed Property sector index has risen just 0.1% in 2006 having fallen in March, April and May. While the sector is well supported by the underlying economy, higher bond yields and less merger activity has taken its toll.

Despite the aggregate weakness of returns there have been some solid returns from individual trusts in 2006. Macquarie Goodman (+17.3%), Centro Retail (+7.3%) and Tishman Speyer (+7.3%) have all performed well. Westfield Group, the largest trust from the sector, is down 7.5% so far this year.

The yield generated by the sector is around 7.0%, however, it continues to trade on a premium to net tangible assets of close to 43%.

Source: Colonial First State
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