Prepositioning yourself for change

May 2019

As we enter the last week of the Federal Election campaign, there is still great uncertainty as to who will win. However, if the ALP win Government, the taxation environment for high net worth individuals could go through the most fundamental change in decades.

As a result, I am suggesting you need to *preposition yourself for change*.

What are the proposed taxation changes the ALP wants to introduce?

The proposed Shorten tax changes are fundamentally designed to increase the taxation burden for high net worth individuals who have created their own wealth utilising structures and strategies which have been designed to encourage the self-funding of one's retirement.

These structures include the use of Self-Managed Superannuation Funds and the negative gearing of investments.

These proposed changes relate to the following:

- Elimination of dividend imputation credit tax refunds;
- The taxing trust income distributed to individuals at a minimum 30% rate;
- Reducing the capital gains tax discount; and
- Eliminating negative gearing tax deductions on assets other than newly constructed property.

The ALP also proposes to limit the tax deductibility of fees taxpayers can claim on having a Tax Agent assist them in managing their taxation affairs.

There is of course a significant amount of water that needs to go under the bridge with respect to the above-mentioned proposed tax amendments before you start making fundamental changes to your personal financial management strategies. The ALP not only need to win a Federal Election but of course need to then deal with what could be a fractured and hostile Senate to implement its proposed taxation Agenda.

Revisiting the purposes of your wealth to help refine your strategies

It is important that you start reflecting on the purpose of your wealth.

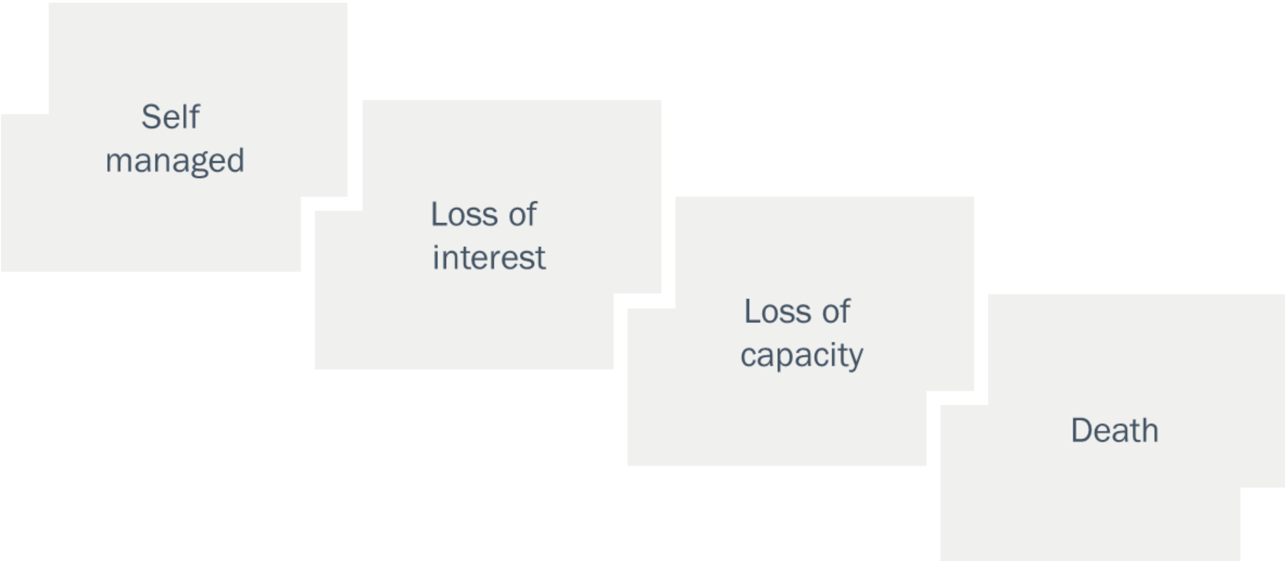
This will then provide you with your own internal guidelines on how to prepare your financial structure for potential change.

Generally speaking, your wealth will serve the following purposes:

- Ensure you have sufficient resources to meet the cost of your current day-to-day living;
- Ensure you can meet your future health and accommodation costs if you are unable to physically or mentally look after yourself;
- Provide for your immediate family or other beneficiaries of your Estate on your passing; and
- Share your resources and wealth with those less fortunate through philanthropic activities.

Designing your Personal Financial Structure to meet your needs

Your personal financial structure evolves through the different stages of your financial life.



It needs to reflect:

- Your current financial circumstances;
- Your current personal circumstances and lifestyle needs; and
- The regulatory environment that we are operating within.

It is the regulatory environment that is changing requiring you to now pro-actively adapt your strategies.

Are you Prepared for Turbulent Taxing Times?

Your personal circumstances will dictate:

- your financial structure for accessing cash to manage your day-to-day costs and current investments; and
- how you will structure your asset succession strategy and the documentation needed to implement that strategy.

Your strategy must now adapt for a change in a regulatory environment in which we live.

The Royal Commission into the Australian Banking and Finance Sector will clearly result in more red tape being imposed upon us in investment management and banking. You must have a good support crew who can help you with this red tape.

The fluidity of personal relationships is placing and increased strain on the Family Law System, increasing the cost of managing financial separation. Whilst this hopefully will not impact you personally, it may impact your children or grandchildren.

Finally, our taxation environment, (if we have a change in Federal Government), could go through the most fundamental changes in many years.

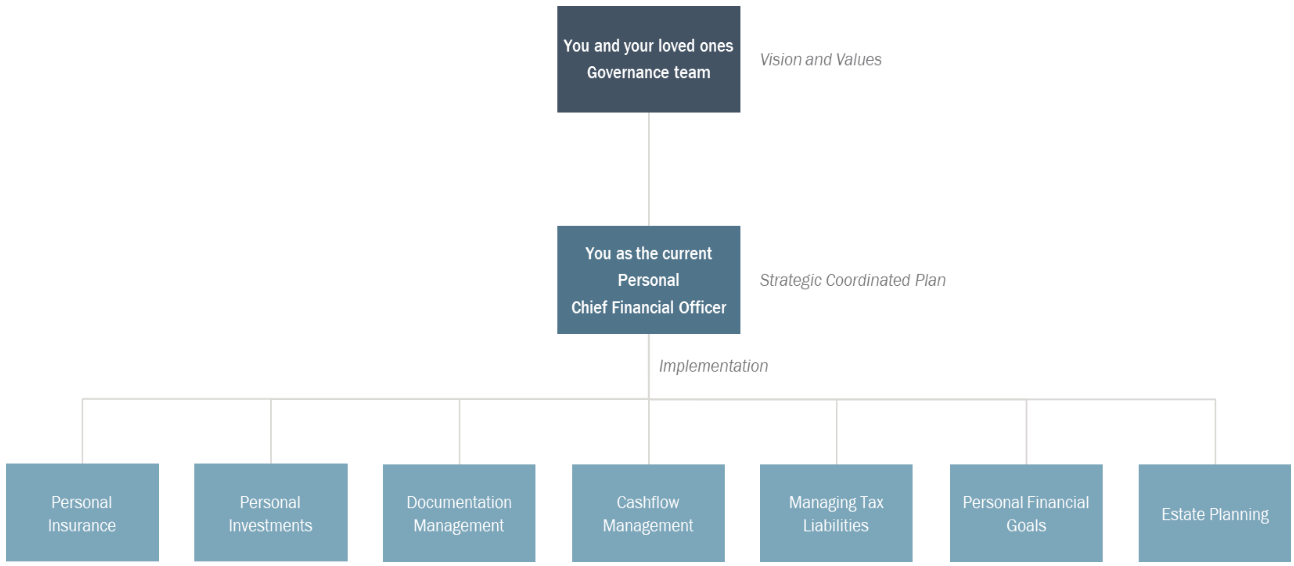
This is why you need to preposition yourself for change.

How do we prepare for a change in our taxation environment?

“If you don’t know where you are going any road will get you there” (Lewis Carroll).

The rise of micro political parties and their potential for obtaining seats in the Federal Senate means that there is no certainty that the Government of the day will be able to legislate its taxation agenda. However, there are many things that you can do currently to preposition yourself for any potential change.

Firstly, you must understand your current strategy and the team of Advisors you have that are helping you manage it.



There are also specific matters you can address in preparation for the possibility of the proposed ALP tax changes.

Impact of the Elimination of the Refund of Imputation Credits for Self-Managed Superannuation Funds

The action you can possible take to prepare for this measure depends upon;

1) the amount you have accrued in superannuation; and

2) whether you are currently in Pension mode within your self-managed superannuation fund.

Those with less than $1.6 million in Superannuation benefits and currently in Pension mode

For those with less than $1.6 million in accrued superannuation benefits and currently in Pension Mode this potential change in tax legislation is purely and simply an increase in your rate of tax payable by your SMSF. As you are not paying any tax on your accrued superannuation benefits whilst you are in pension mode the elimination of the refund of the Imputation Credits is just a straight tax hike.

Those with more than $1.6 million in Superannuation benefits and in Pension Mode

If you have more than $1.6 million in accrued superannuation entitlements, then part of your accrued superannuation must be in accumulation mode. A proportion of your Fund's annual income is therefore already subject to a minimum 15% tax on income and 10% tax on capital gains.

If you have unrealised capital gains inherent in your SMSF's investment portfolio, once this legislation is brought in and your SMSF is accumulating excess imputation credits which will otherwise be wasted, the obvious strategy is to trigger a capital gain that would otherwise be subject to tax but can have its tax eliminated by the use of the otherwise wasted Imputation Credits. The triggering of the gain absorbs the otherwise wasted Imputation Credits and increases the cost base of the asset for CGT purposes. This shelters part of the future capital gain from a potential CGT liability as you have increased the asset's cost base.

To prepare for this eventuality, you need to review your current Superannuation Fund Investment Portfolio now.

If you have currently realised capital losses within your Fund, you should look to realise capital gains in the current financial year to soak up those losses. This will increase the cost base of those assets sheltering any future capital gains from tax up to the revised cost base.

In the future then if there are possible excess Imputation Credits which would otherwise be wasted then prior to the end of each financial year, you can look at your investment portfolio with a view to triggering a prima facie taxable capital gain that can have that tax sheltered with the otherwise wasted franking credits.

If you do not absorb the carry forward capital losses now, then if the Imputation Credit refund denial is legislated, the future capital gain will first be offset against your Fund's carry forward capital losses. As such the excess Imputation Credits will be wasted.

Accordingly, the action prior to 30 June 2019 is to review your current portfolio to ensure that where possible you absorb any carried forward capital losses within your SMSF.

That is, you do look to absorb those losses with realised capital gains in the current year.

Please contact your SMSF Advisor to discuss the application of this strategy in your circumstances.

Taxation of Trust Income on Distribution to Individuals

The ALP policy is looking to tax any income from a Discretionary Trust distribution to an individual at a minimum 30% rate. The 30% tax rate cuts in at $37,000. If this tax change eventuates then a distribution of $37,000 to an individual that has no other income from a trust will result in a $7,528 increase in their income tax liability on that income per annum.

The strategy to consider if this change is legislated is to see if we can shift income from a Trust that would otherwise suffer a 30% tax on the distribution into another taxpayer who would suffer a lower rate of tax. This might involve moving investments to individual names as opposed to having them in a trust where the income is taxed directly in the names of the individuals.

Significant detail needs to be released on this policy if the ALP win Government before making any wholesale changes to the structure holding your investments if you currently have a Discretionary Trust.

There are asset succession and capital gains tax implications of moving assets and as such, I would hasten slowly.

However, if you have a Trust review the current taxation characteristics of its investment assets.

Reviewing your Investment Management Strategy

A global market place now sees greater volatility in investment markets. A change in our Government may influence investment markets.

As such:

- Have you positioned your investment strategy to meet a possible change in taxation laws?
- Is your current investment strategy suitable for your current financial and personal circumstances?
- Have you sufficient liquidity in your investment base to meet unexpected financial needs due to mental or physical incapacity?
- Will the possible changes in tax legislation referable to negative gearing or imputation credits influence the after-tax returns of your current investments requiring a change in your thinking in relation to your investment strategy?

These are matters that you need to contemplate and reflect upon with your Investment Advisor.

Conclusion

Let's wait and see the outcome of the Federal Election before making fundamental changes to strategies.

We also then need to wait and see the make up of a new Senate and how friendly it will be to the next Federal Government.

Accordingly, there is no need to necessarily make drastic changes currently.

However, the message is clear, preposition yourself for potential change.

Anthony Jackson