Like it or lump it: there are strategies to follow

TONY NEGLINE

The tax system is full of anomalies and intricacies that create confusion but occasionally some fascinating and useful strategies pop out of this ridiculous maze.

You will be fascinated to know that some people might save tax when they take a pension from their super fund by deeming income payments under the tax laws to be lump sums. To understand this, I need to first explain how the super laws work and then move on to the tax laws.

Those who were born before July 1960 have a "preservation age" of 55. Higher preservation ages apply for those born after.

Once you hit your preservation age you can elect to take your super benefits. If you satisfy the various definitions of retirement in the super laws you can elect to take your super money as lump sums or as pensions. If you aren't fully retired but under age 65 you can elect to receive a Transition to Retirement pension.

If you receive a pension, then each financial year you must receive a minimum income. For those under 65 the minimum pension payment is 4 per cent of the pension's account balance, determined using market values, on July 1 each year, for the assets backing the pension.

If you're receiving a TtR pension then you can't receive pension income greater than 10 per cent of the pension's account balance, again using market values for the pension's assets on July 1 each year.

A key issue is that under the super laws (and probably under general trust law) you're receiving pension income payments.

Now let's look at what happens under the tax laws. When your pension commences, your super fund works out what proportion of your pension, in percentage and dollar terms, falls into the tax-free and taxable components. The tax-free component primarily is any contributions you've made that aren't claimed as a tax deduction; the taxable component is the balance of your super account. Once the proportions are worked out they never change.

If you're aged at least 60 then all pension income paid to you won't be taxed.

If you're aged between your preservation age and under age 60 then the taxable component proportion of every pension payment is taxed at your marginal tax rate less a 15 per cent tax offset.

How are lump sum withdrawals taxed? Everyone has what's called a low-rate cap amount which is indexed each year and in 2015-16 is $195,000. Lump sum benefits taken from super over your lifetime up to this threshold are tax-free. Any lump sum benefits that exceed this amount are taxed at 15 per cent plus the Medicare levy.

It appears that under the tax laws you can deem your super law pension income payments to be lump sums. The potential tax savings for a person aged between their preservation age and under 60 who has their full $195,000 low rate cap available are obvious. Lump sums under the low rate cap are tax-free or pension income is taxed at marginal rates less a 15 per cent tax offset. Once you've decided if you're receiving income or lump sums under the tax laws your super fund can complete relevant paperwork and work out how much tax to deduct.

Where did this idea come from? Craig Day, FirstTech executive manager at Colonial FirstState, raised this concept at a SMSF Association Technical Conference.

He noted the following information on the Tax Office website from a webinar in December 2014: "the election (to receive a lump sum) is an income tax law provision, whereas the minimum pension payment requirement is a super law requirement ... an amount paid from a pension is still treated as a pension payment for super purposes, even though, for tax purposes, a member can make an election and take advantage of the low rate cap ..." Interestingly, this information no longer seems to be on the ATO website.

So can you use this strategy? I suggest you act cautiously. Information on the ATO website is helpful but not legally binding. Until we have a formal announcement, you may want to seek its advice via a Private Binding Ruling.

Tony Negline is author of The Essential SMSF Guide 2015/16 published by Thomson Reuters.

Discretion better part of value

GETTY IMAGES

Prime looks likely to have to pay more if it wants to show AFL after 2017

The sell-off offers opportunity, but you must look for value

DAVID WALKER

The Australian equity market's recent correction has thrown many stocks into value, creating some of the best conditions for value investors in years.

For so long stocks traded on excessive multiples as markets inflated on surging liquidity from central banks, but now there is more opportunity.

Our "in value today" filter search shows some 93 stocks are undervalued and in our model portfolio we have added to a number of existing positions.

But investors must discriminate, as returns will increasingly depend on stockpicking, now that central bank liquidity is no longer a tide lifting all boats.

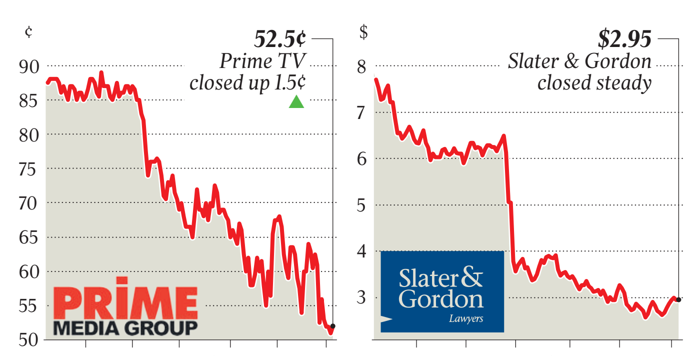
Value investing is not a mechanical trading rule where undervaluation of any size necessarily makes a stock a buy.

Instead, undervaluation is a prompt for further research and before investing conservative investors must:

- Be satisfied the stock's risk profile is consistent with their risk tolerance
- Approve of the assets, management and strategy
- Decide if the discount to value is sufficient for the risks the valuation will not be realised.

Two examples of stocks trading at less than our valuations but likely to continue to do so — so we would not buy them — are Slater & Gordon and Prime Media Group.

Slater has now released fully audited 2015 accounts with a substantial number of adjustments we would describe as innocuous. Some in the market feared the auditors would only express a qualified opinion of the accounts but this did not happen.



Source: Bloomberg

The stock has not rerated since the release of the new accounts, probably because the market remains unconvinced, especially as ASIC's review of Slater's accounting continues. A legion of short sellers continues to bet against the firm.

We are not as negative as some but we remain unconvinced, mainly because the company is difficult to value given high complexity and poor historical conversion of reported earnings into cashflow.

We would prefer to wait to see solid cash earnings from the recent PSD acquisition, and a broader improvement in cashflow conversion, before investing. The market is getting it right at the moment.

Prime Media Group is a case study in why traditional regional broadcasting will have a tough future without changes in media ownership laws. The well-managed regional TV broadcaster has grown audience size, lifted advertising revenue share and maintained margins despite subdued advertising conditions, but we are cautious on the industry.

Disruptive video-streaming services have already taken share from free-to-air broadcasting in the cities, but the same shift is coming to the bush as the NBN rolls out. This week's launch of the Sky Muster NBN satellite brings the effect forward.

Also Prime's share has probably peaked with audience momentum from its content supplier, Seven Network, while the AFL TV broadcast rights end in 2017 and Seven could share the costs of winning the new rights with Prime.

To make matters worse, the company last week warned of material falls in advertising revenue below already modest expectations early in the new financial year. Regional advertisers lack confidence due to poor consumer sentiment, especially in the mining regions of Western Australia.

David Walker is senior analyst at StocksInValue.com.au.

FLOAT WATCH

Baby goods firm eyes growth

Baby Bunting Group Ltd

ASX CODE: BBN
SHARES ON OFFER: 37.2 million
LISTING PRICE: $1.40
MARKET CAPITALISATION: $175.8m
LISTING DATE: October 14

TIM MORRIS

Up until the turn of the decade, Australia was one of only two Organisation for Economic Co-operation and Development countries without a national Paid Parental Leave scheme. The anomaly was addressed by the Gillard government in 2011, which introduced 18-week payment programs on a means-tested basis.

As the $1.7 billion program nears its fifth anniversary and attracts increasing fiscal scrutiny, what impact has it delivered for the economy?

Since its introduction, the ratio of female labour force participation has improved from about 83 females per 100 males to 85 females per 100 males. While the expansion suggests more than 100,000 additional women subsequently joined the workforce, attribution to the paid leave policy is challenged by a general uptrend in the female labour force participation rate.

Nonetheless, the extra disposable income made possible by paid parental leave has provided a positive environment for the coming listing of Baby Bunting Group.

Founded in 1979, the specialty retailer has grown to become one of the largest participants in the nation's $5bn baby goods industry. Its network of 33 stores is 50 per cent greater than the nearest competitor, and only two other companies hold more than three stores. Industry has remained fragmented after Mothercare Australia went into administration in 2013.

While Baby Bunting's initial public offer represents a partial sell-down by existing shareholders, there remains strong impetus for new investors. BBN is on course to post its third consecutive period of increasing sales, earnings, and profit margins. To sustain the trend, Baby Bunting has plans to double its store network, and enhance brand awareness in east coast markets.

The expansion may also drive online sales, which grew 59 per cent in FY15.

Primary operational risks surround its capacity to procure new store sites. Baby Bunting stores are typically between 1500 and 2000sq m. Other risks surround a significant unallocated free float, which could impact early trade. However, the overall outlook appears positive for investors seeking capital growth potential and income.

Tim Morris is an analyst at wise-own.com

SMSFs investing in property can offer tax breaks, but the rules must be obeyed

MONICA RULE

Many self-managed superannuation funds would like to invest in property, but are too busy to understand how the SMSF investment rules work.

Add in some property spruikers trying to tempt investors into dodgy investments, and it's little wonder SMSF trustees are wary.

This is where knowledge is power. For example, if you own your own business, perhaps there are property investment options closer to home that you haven't considered. If you own your business premises, having your SMSF acquire it may offer significant tax breaks.

Some of my clients operate their businesses from properties they own. Because these properties are wholly and exclusively used in their businesses they meet the definition of "business real property" under the superannuation law. This means their business property can be transferred as an in-specie contribution, or sold to their SMSF.

When transferring a BRP into an SMSF as an in-specie contribution, the contributions caps must be considered. If your business premises are worth more than your contributions cap, you may want to transfer a percentage of the property over two to three financial years so the contributions caps are not exceeded. Of course, if you sell the property to your SMSF, you do not need to consider the caps at all.

To transfer your business premises, you will need to ensure that your SMSF's trust deed allows for in-specie contributions to be made to your SMSF; your SMSF's investment strategy allows for property investment; the price paid on the property is at arm's length; and, the reason for the acquisition is to provide for your retirement. Now, if you are worried a property transfer or sale would result in capital gains tax, talk to your accountant.

It's possible you may qualify for small business CGT concessions and not have to pay CGT at all.

To qualify for the small business CGT concession, the small business must either have an aggregated annual turnover of less than $2 million or the net value of its assets does not exceed $6 million.

There are three main concessions available in relation to property investments. Under the "15 year asset exemption", you need to be at least 55 years old and selling your BRP because you are retiring or because you are permanently incapacitated. You will also need to own the BRP for at least 15 years. If you qualify under these grounds, you can disregard the entire capital gain made from the sale or transfer.

The beauty of this concession is you can contribute the entire sale proceeds into your SMSF, without it counting towards your non-concessional contributions cap, provided you elect for the money to be counted under the CGT cap by completing the ATO form NAT 71161.

The CGT cap for the current financial year is $1,395,000. Any amount in excess of the CGT cap counts towards your non-concessional contributions cap.

What if you don't want to retire? Then perhaps you may qualify for the "Retirement Exemption". Even though it is referred to as the "retirement exemption" you do not need to retire from your business. Really it should be renamed as "Non-retirement Exemption" to stop all the confusion that the name is causing!

If you are under the age of 55, to qualify for this exemption you will need to contribute the capital gains from the sale or transfer of the BRP into your SMSF. The CGT cap for this exemption is a lifetime limit of $500,000. In addition, you may also apply for the "50 per cent active asset reduction" by reducing your capital gains by a further 50 per cent discount. This means, not only can you claim the normal 50 per cent CGT discount on the sale of assets held for more than 12 months, you can also claim a further 50 per cent discount. You can then apply the balance towards the CGT cap of $500,000, which means you end up not having to pay any CGT if your remaining capital gain does not exceed $500,000.

Finally, if you are considering property investment for your SMSF, I always recommend getting professional advice first before taking the plunge.

Monica Rule is an SMSF Specialist and author of the book "SMSFs and Properties" www.monicarule.com.au