Here's the seven realities of new super system

It's time to come to grips with the big changes under way

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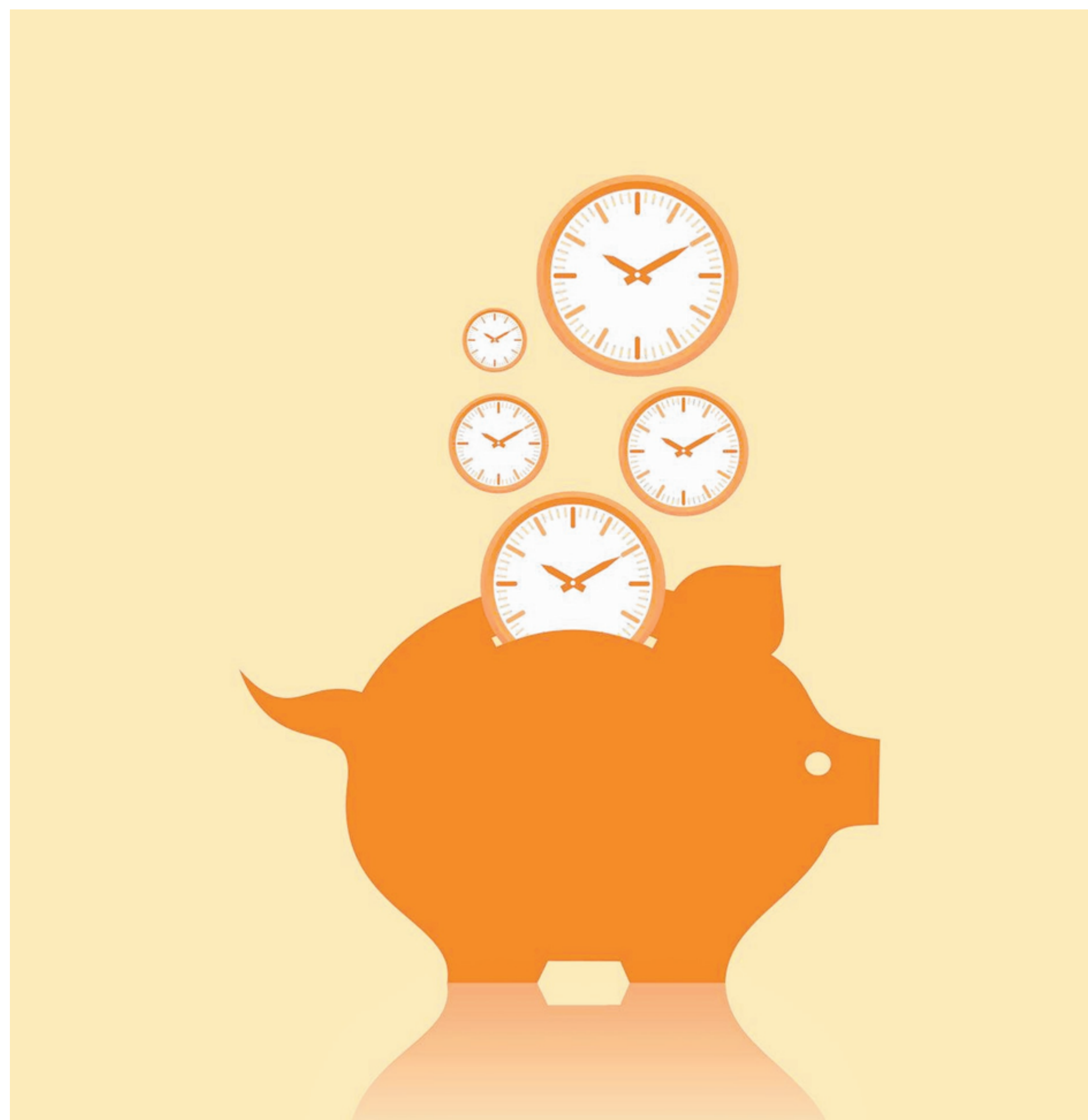

Faster than you can say the words "non-concessional contributions", the sweeping super changes that have been looming over investors for months are ready to launch.

The new system kicks off on July 1 but the misunderstanding around the new rules is still widespread.

Nonetheless, investors simply must grapple with the new superannuation regime and at least understand the key elements which are due to change.

Here are the seven most common misunderstandings and the realities around those issues.

1. The new pre-tax contribution "cap" is not really $25,000 because it includes your super guarantee contributions.

Under the present mandatory superannuation system, your employer must put 9.5 per cent of your annual salary package into superannuation for you. If you wish to make a voluntary superannuation contribution, that amount is included in the $25,000 pre-tax (concessional) cap.

It seems many readers of *The Australian* — and we can safely assume the wider public — do not realise this is how it works: it means the actual pre-tax cap has just got a lot smaller than might first be evident.

If you make $100,000 then your employer's compulsory contribution is $9500 — in turn that means the amount you can voluntarily put into super on a pre-tax basis through so-called salary sacrifice is $25,000 minus $9500, or $15,500.

2. You can still put a multi-year sum into super — but not as much as you could before.

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Inside our super system there is a procedure open to all, called the "three-year bring forward rule", which applies to post-tax (non-concessional) contributions. It is still in place, only it's just been sharply reduced.

Until now you could put in $180,000 each year and under the "three year bring forward" rule you could put in $180, 000 x 3 — that is $540,000.

From July 1 the post-tax annual limit is $100,000. The three-year bring forward rule is still in place so you can put in $100,000 x 3, that is $300,000.

3. The new super balance caps pertain to *individuals* — it's a $1.6 million limit per head.

Many people operate their super as a couple. Naturally, enough many of the investors in DIY funds have interpreted the new rules as meaning the $1.6m cap is per fund — it's not, it's per person (or member) so with a couple the effective cap is $1.6m x 2 — that is $3.2m.

4. You can have more than $1.6m in super, you just can't have more than that funding a tax-free pension.

This is very often misunderstood by investors — it's not a case of $1.6m is the most you can have in super from now on.

The most you can have funding a tax-free pension income is $1.6m — if you have more than that you can keep it in super, that is it can remain within the super system.

But the earnings on the money that is above $1.6m still in the super system will be taxed at the standard rate of tax for super (in accumulation) of 15 per cent.

5. There is a tax-free income alternative for retirees outside the super system.

Our personal tax system is not based on age — it is based on income and under the current system the first $18,200 that anyone makes is tax free.

So it is quite possible that people will take money out of the super system entirely and seek tax-free earnings rather than earnings which will be taxed at 15 per cent (see item 4 for more on this).

On top of this many seniors are entitled to various tax offsets that can bring their tax-free earnings threshold well above $18,000.

6. There are two caps and they are both $1.6m.

Yes, the boffins in Treasury thought it was not confusing enough with the multiplicity of rules in super so they introduced two new caps and they are the same dollar value, just to make sure everyone gets mixed up.

There is the $1.6m transfer balance cap — put simply, this is the maximum amount with which you can kick off your tax-free pension fund at the time you retire.

And there is the $1.6m total superannuation balance cap — this exists chiefly to police the issue of whether you can (at any age) put more into super.

How it works is, they add just about everything in here from retirement pension account and accumulation accounts and if that number is over $1.6m, then you cannot make any further post-tax contributions to super.

But you can make pre- tax contributions! Who knows why?

As you may have gathered by now, if you are looking for logic here, you are looking in the wrong place.

7. If you don't have $1.6m by the time of retirement, all is not lost ... you can add to it later.

If you did not make to the $1.6m ceiling and somehow came upon more money later, then all is not lost: you can add to the fund to bring it up to the maximum limit subject to you satisfying contribution rules.

Healthscope hurdles a symptom of wider pressures on healthcare stocks

ROGER MONTGOMERY

You'd think owning a private hospital would be a licence to print money.

There are certainly a number of favourable underlying drivers for private hospital operators in Australia — not least the ageing population — resulting in increasing service volumes per person.

Extended lifespans and improving medical treatments ensure more services are demanded by each person now and in the longer term.

And while much is made of the pressure on private health insurance and possible reforms to healthcare, the bottom line seems to be that fiscal constraints on governments limit their ability to meet increasing healthcare needs through the public system.

So despite the inevitable fits and starts, the long-term prospects for HSO and other private hospital operators such as Ramsay Healthcare and Sonic Healthcare offer organic growth rates above GDP.

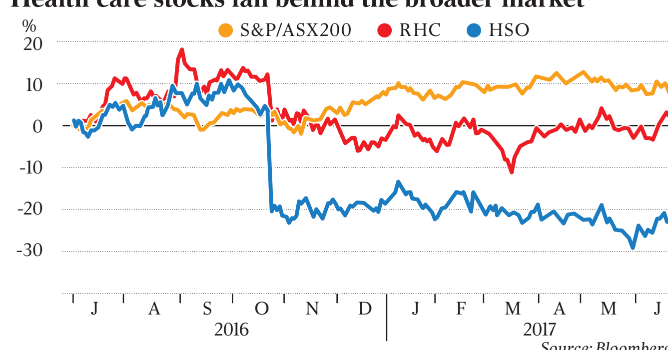
Of course, those fits and starts can have significant implications for share prices in the interim.

Witness the near 30 per cent share price decline in Healthscope, in just a few days last September, when the company announced a soft September quarter of volumes, forcing investors to reappraise previous estimates of 10 per cent annual EBITA growth.

What's more, slowing volume growth in hospitals, as illustrated in the quarterly APRA data and monthly Medical Benefits Schedule statistics is the result of a number of factors.

- First, there has been a slowing in the growth of the number of people opting for private health insurance thanks to premium increases of 5-8 per cent a year. Private health insurance is the primary base of people from which private hospitals services (separations) are demanded.
- Second, our private health insurance system is based on what is known as the Community Rating System, which seeks to provide affordable insurance for anyone, irrespective of age. But young people have worked out they aren't getting value for money when subsidising the premiums of older members and are opting out. This puts pressure on insurers through high claims growth rates.

Health care stocks fall behind the broader market



Source: Bloomberg

Private hospitals are also casualties in the trend that sees public hospitals being ordered by their respective state governments to put pressure on patients to claim on their private health insurance for services. State governments are in effect enhancing their federal government MBS revenues at the expense of private health insurers and directly competing with private hospitals for private hospital patients. This is despite private health insured patients receiving the same service as any other public patient.

This adds to the claims cost base of the private health insurance sector — such as Medibank Private and Australian Unity — which needs to be recouped as higher premiums, rendering private cover less affordable and resulting in higher churn.

On top of that, we have been told public hospitals — and doctors in public hospitals — are being directed to meet a targeted percentage of patients (we have heard as high as 25 per cent) admitted on a private basis. If this is true, it is taking patients out of private hospitals to enhance state government revenue. At its worst it's reminiscent of the favoured treatment of first-class passengers on the Titanic — the social cost is enormous, with public patients pushed further down waiting lists.

Recovery path

The question is how this all plays out for investors in healthcare stocks, which have been strong performers for a long time.

One stock I follow closely is Healthscope. Perhaps as a direct result of the above pressures, Healthscope's profit margins disappointed in the past couple of results. This was also due to softer volume growth overall and a slower than expected commissioning of two large facilities and the decommissioning of older facilities.

It will take a few years for demand to grow and fill the new facilities, particularly the Northern Beaches hospital, due to open in 2019, and for the right mix of services to be provided.

These are critical factors for Healthscope's outlook, but I'm optimistic about its prospects.

Still, the various government reviews of and inquiries into the nation's healthcare system create some risk around margins and revenue for all hospital operators. Of note is the potential for changes to prosthetics prices, and, in turn, the rebates hospitals receive from manufacturers.

The declining penetration of private health insurance must ultimately be resolved by the government, unless it wishes to wind up funding the ageing population's growing healthcare needs itself — something it can't afford. In the near term, I expect government to act on the state's double dipping on public hospital revenue.

Of course any increased risk — if only perceived — has an amplified impact on the share price of a high multiple stock such as Healthscope. But share price dives are often the result of the market treating what is temporary as permanent. As with many companies there are near-term headwinds, but long-term structural dynamics tend to win out.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund. www.montinvest.com

Q: When I engage my accountant to do my tax returns I'm able to claim a tax deduction for the work provided. I have been advised the same is not true for financial planning advice. Can you please explain what I can and can't claim as a tax deduction in relation to receiving financial planning advice?

A: What you can and can't claim for in relation to financial planning advice is dealt with under section 8.1 of the Income Tax assessment Act (ITAA 1997). There are strict guidelines surrounding the deductibility of financial planning advice and the Australian Taxation Office has previously issued a specific tax determination on this matter (TD95/60).

Generally speaking, costs associated with an initial financial plan that establishes new investments or strategies are not tax deductible. If the advice relates to establishing an investment that will generate taxable income, then the advice fees will be considered capital costs and be added to the cost base of the asset.

If you receive advice to alter an existing investment portfolio that generates taxable income and this is part of your ongoing portfolio management, then the costs may be tax deductible.

Once a plan has been established, ongoing advice fees or retainers, where the advice is in relation to generating income associated with the investment portfolio, are generally held to be deductible expenses.

The same principle applies to self-education expenses such as attending seminars. If you already own an investment property, then attending a property seminar is deductible provided the claim relates to gaining assessable income. If you didn't already own an investment property, then the expenditure would be considered a capital outlay. The same applies for sharemarket education courses, information services, journals or software.

If you receive and pay for advice in relation to an investment loan and the purpose of the loan was to generate taxable income, the costs may be deducted over the lesser of five years or the life of the loan, whichever is shorter.

Where the financial planning advice does not relate to assets or investments that generate taxable income, then generally the expense in not tax deductible. For instance, if you receive advice on your personal superannuation, the fees generally will not be tax deductible as the super fund does not generate taxable income to you personally. In the example of a self-managed super fund, the initial advice would be considered capital in nature. Ongoing advice in relation to generating taxable income to the fund should be deductible to the SMSF.

The Financial Planning Association supports simplifying the rules by making financial planning fees deductible, regardless of whether the advice was initial or ongoing. The FPA believes the present inability to claim a tax deduction for the fees associated with an initial financial plan acts as a disincentive for consumers to take the first step towards organising their finances on a strategic basis.

In summary, under the present rules, if the financial planning advice is to establish a plan, or the advice does not relate to assets or investments that now generate taxable income, then the advice fees are not tax deductible.

If the advice expense is in relation to ongoing advice for an existing portfolio, then the expenses may be deductible.

Before making any claim for financial planning advice, please contact your accountant and seek their tax advice.

Visit the Wealth section at www.theaustralian.com.au to send your questions to Andrew Heaven, an AMP financial planner at WealthPartners Financial Solutions.

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