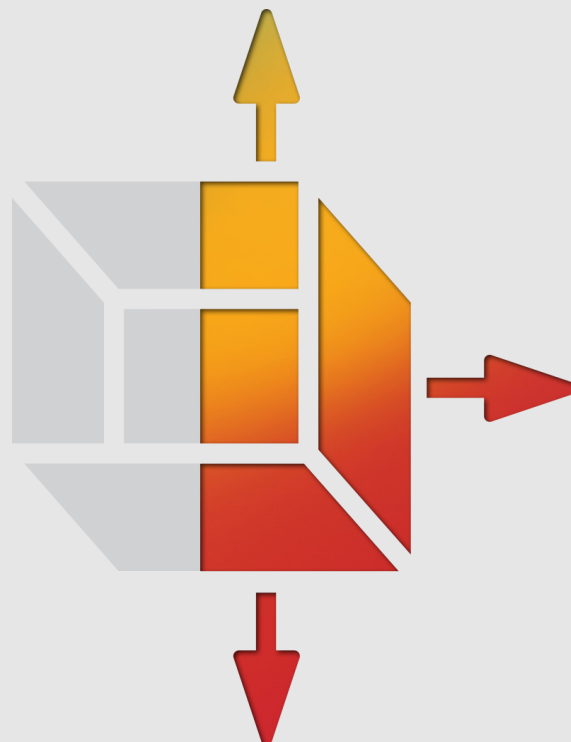


Outside the super square

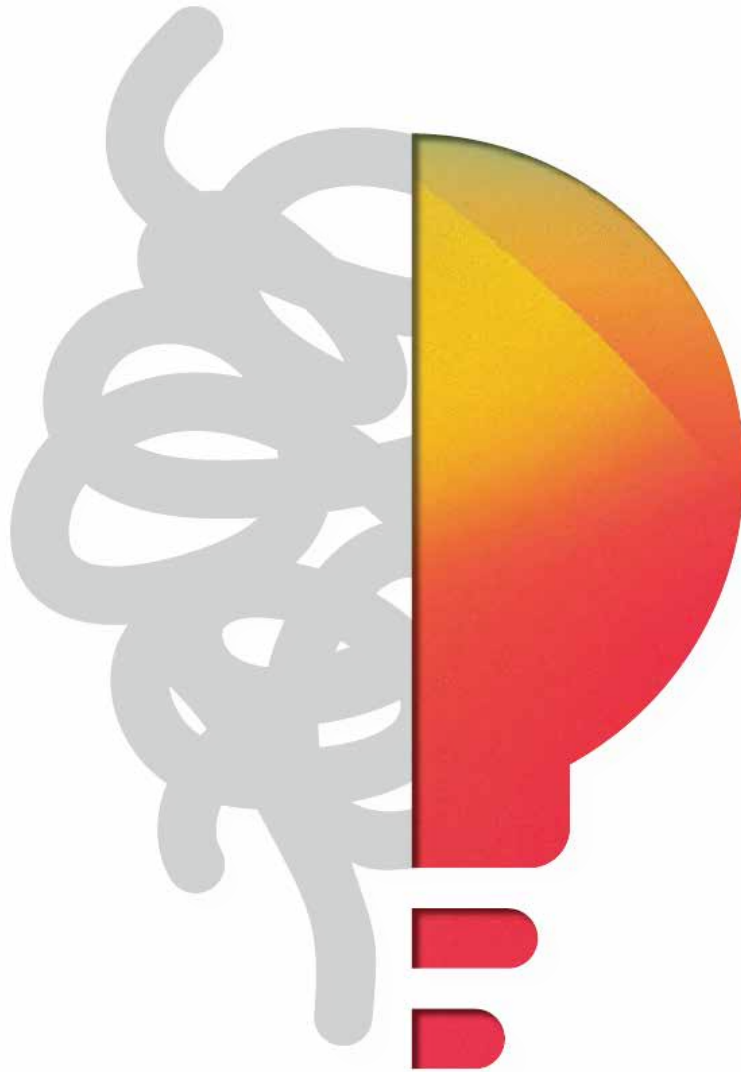
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March 2019



With change
comes your chance to
deliver better client outcomes

First Home Saver Saver Scheme	Small business CGT concessions	Untaxed elements	Labor's proposed franking credit policy
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Introduction

This guide explores four alternative super strategies, that look outside the super square, to remind the industry that there is a lot more to super than just implementing the recent changes.

We hope that this guide will set off a chain reaction, prompting financial advisers to come up with more ideas and strategies that are tailored to their clients' needs.

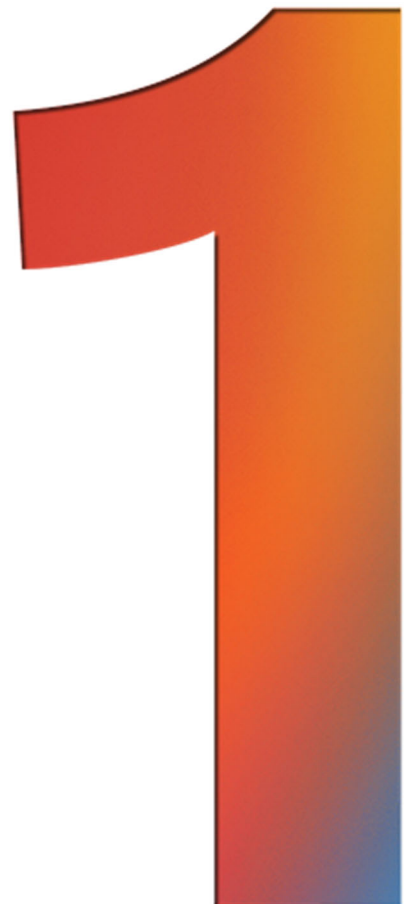
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First Home Super Saver Scheme: Super savvy savings for the first home



First Home Super Saver Scheme: Super savvy savings for the first home

The First Home Super Saver scheme (FHSSS) was introduced by the Australian Government in the 2017–18 Federal Budget to reduce pressure on housing affordability. It allows individuals to make voluntary superannuation contributions, up to prescribed amounts, with the ability to withdraw them plus associated earnings, for the purchase of their first home at a later date.

This will help first home buyers save faster and accumulate more with the aid of concessional tax treatment of super at all stages of the cycle - contribution, earnings and upon withdrawal of their money.

There are, of course, tight eligibility criteria to participate and limitations on how much can be contributed. There are also “escape” options should arrangements change after the actual withdrawal.

Still, we believe, this is a vast improvement to the previous first home saver account which failed to take off primarily due to its inflexibility and complexities.

Advantages

- Tax efficient option which leads to a higher deposit towards the first home
- Simple, can just use existing super account for the scheme
- Voluntary concessional and non-concessional contributions can be used
- Earnings that accrue are taxed at a maximum of 15% in the fund which is generally significantly lower than an individual’s marginal tax rate
- Concessional contributions and associated earnings are withdrawn at a concessional tax rate while non-concessional contributions are withdrawn tax free
- Release process reasonably easy with a large part of it handled by the Australian Tax Office (ATO)

- Provides a high level of discipline as money is locked in super until withdrawn
- If not needed for a home deposit, can remain in super to build toward future retirement or withdrawn with a reasonable tax penalty
- There are financial hardship provisions that may allow access even if previously owned property in Australia.

Disadvantages

- Limited contributions – maximum of \$15,000 in any one year up to a maximum of \$30,000 over all years
- Withdrawal amount based on a “deemed earning rate” which could be lower than actual earning rate
- Tax is still payable, albeit at a reduced level
- Delays in getting the money once requested – up to 25 days – so timing can be an issue
- There may be penalty tax payable if not used as a deposit and fail to meet the conditions.

A closer look at the details

Who is eligible to participate and withdraw?

To be eligible to participate and withdraw, an individual must:

- Never have owned property in Australia including investment property, vacant land, commercial property, a lease of land or a company title interest in land; and
- Not have previously requested to release an amount from the FHSSS; and
- Be 18 years or over at the time the release request is made.

Eligibility is assessed on an individual basis, meaning that each member of a couple may be eligible or, where one

member of a couple fails to meet eligibility criteria (e.g. previously owned property in Australia), the other member of the couple is not precluded from qualifying.

Couples is defined very broadly and includes de-facto and married couples, siblings or friends.

While the rules require an individual to be 18 years of age or older in order to request release of amounts under the FHSSS, there is no age restriction on making the initial contributions. This is because the FHSSS release amounts simply consist of voluntary contributions to super made after 1 July 2017 under normal rules – there is no need for a special account or notify the superannuation fund trustee that it is a FHSSS contribution.

Finally, it is also worth noting that a withdrawal under the scheme may still be possible despite having previously owned a property in Australia, if the ATO determines that the individual has suffered a financial hardship that resulted in a loss of ownership of all property interests.

Financial hardship event may include:

- Bankruptcy
- Divorce, separation from a de-facto partner, or a relationship breakdown
- Loss of employment
- Illness
- Being affected by a natural disaster
- Being eligible for early access to superannuation.

Eligible contributions – what counts and what doesn't?

Contributions under this scheme can be made to any superannuation fund without the need to open a special account. However, only voluntary member contributions, being either concessional or non-concessional contributions, can be withdrawn under the FHSSS.

Voluntary concessional contributions can be made from pre-tax income, such as salary sacrifice, or personal contributions for which a deduction has been claimed.

Voluntary non-concessional contributions are made from after-tax income and no tax deduction is claimed.

Some contributions to superannuation are not eligible to be withdrawn under the FHSS scheme. These include:

- Compulsory employer contributions - Superannuation Guarantee
- Spouse or child contributions
- Government co-contribution
- Voluntary contributions to defined benefit funds or constitutionally protected funds.

The maximum eligible voluntary contributions that count towards the amount that can be withdrawn are:

- \$15,000 per financial year; and
- \$30,000 in total over the whole period. There is no prescribed time limit that the contributions must be left to accumulate or to exit the FHSSS.

The contributions made in a year must also be within the relevant contribution cap.

There are no special rules regarding whether the contributions, at the time they are made, should be concessional or non-concessional. However, there are rules around the "order" in which the various components are released when the time comes.

How much do contributions earn (associated earnings) over the period?

As stated above, eligible contributions - concessional and non-concessional - that are released have an amount of "associated earnings" released with them. This is a deemed amount based on the 90-day Bank Bill rate plus 3%. It is set on a quarterly basis and for the January - March 2019 period, is 4.94% (annual rate).

The associated earnings have no relationship to the actual rate earned within the fund and any "excess earning" above the deemed amount will remain in the fund for the member's eventual retirement. The ATO calculates the "associated earnings" for each contribution on a daily basis. For contributions made in the 2017-2018 financial

year, earnings are calculated from the first day of the year. However, for contributions made in later financial years, contributions are calculated from the first day of the month in which the contribution is made.

How are the contributions ordered when they are released?

Upon request for release, the 'ordering rules' are designed to maximise the amount available for release, without requiring the individual to make specific elections about which contributions should be eligible. They also have a flow-on effect on the calculation of associated earnings and the taxation of released amounts (as there is no tax on non-concessional contributions).

The ATO will apply ordering rules when calculating a FHSSS maximum release amount. The ATO performs this calculation, not the superannuation fund trustee or the individual requesting the release amount.

Contributions are counted towards the release amounts as follows:

- A 'first-in first-out' rule applies – this means that contributions made in an earlier financial year are counted before contributions in a later financial year. Contributions made within a financial year are counted in the order they are made.
- A simultaneous contributions rule applies – this means that if an eligible concessional contribution and an eligible non-concessional contribution are made at the same time (for example, in the same payroll process), the non-concessional contributions are taken to be made first.
- If contributions within a financial year are made and a deduction is claimed for some or all of the contributions is made, the resulting eligible non-concessional contributions (if any) are taken to be made before any eligible concessional contribution.

What is the maximum release amount?

The "maximum release amount" is the maximum amount, calculated by the ATO, that an individual can seek to have released from a nominated superannuation account under the FHSSS guidelines. It is the sum of:

- 100% of eligible non-concessional contributions
- 85% of eligible concessional contributions
- Associated earnings calculated as explained above.

The FHSSS maximum release amount takes into account the \$15,000 limit from any one year and \$30,000 total limit to the total contributions across all years when calculating the eligible contributions that can be released, before adding the associated earnings.

What is the release process to receive the FHSSS amount?

To withdraw the voluntary super contributions under the FHSSS, the individual must request a FHSSS determination and release authority from the ATO by applying online using their myGov account linked to the ATO (<https://www.ato.gov.au/General/Online-services/Individuals-and-sole-traders/>).

When the application for a FHSSS determination and release is made, the ATO will calculate and advise the "maximum FHSSS release amount". More than one request for a determination can be made, but only one FHSSS withdrawal is permitted.

Having received the FHSSS determination and release request, the member can decide to apply to release an amount up to the maximum FHSSS release amount, if they are ready to purchase a home. Be aware that the member:

- Can apply for a release only once
- Must confirm as part of the release application that they will not claim further tax deductions on the non-concessional contributions included in the determination
- The ATO must have released an FHSSS amount to an individual before they sign a contract to purchase or construct residential premises or there may be FHSSS tax to pay.

The request form is returned to the ATO who will issue the release authority to the nominated superannuation fund.

The nominated superannuation will send the amount requested in the release authority to the ATO.

What tax is payable and what is the tax offset?

Tax is payable on the “assessable FHSSS released amounts” which are defined as the concessional contributions plus associated earnings (including the associated earnings on eligible non-concessional contributions). The assessable FHSSS released amount is calculated by the ATO and advised on the ATO determination.

Assessable FHSSS released amounts are taxable at the individual's marginal tax rate less a 30% tax offset.

What is the ATO withholding tax on the released amount?

Because a release of the FHSSS amount is likely to occur part way through the financial year, the individual's actual final marginal tax rate is not known. The ATO will therefore withhold an amount based on the individual's expected marginal tax rate, less the 30% rebate, at the time of release. If the ATO is unable to make an estimate of the tax rate, they will withhold at 17%. An adjustment of tax, under or over will be made when the individual lodges the tax return for the year.

What happens after receipt of the FHSSS amount?

Once the savings have been released, individuals have up to 12 months from the time the amount is released, to sign a contract to purchase or construct a home. If the intention is to purchase a vacant block of land to build a home on, it is the contract to construct the home that must be entered into within the 12 months after the release of FHSSS amounts.

There must be a genuine intent to occupy the property as a home, demonstrated by:

- Occupying or intending to occupy the property as soon as practicable after purchase
- Occupying or intending to occupy the property for at least six of the first 12 months from when it is practicable to occupy it.

Individuals who have satisfied the conditions to purchase or construct their first home must notify the Commissioner in the approved form that they have satisfied those conditions within 28 days after they enter into the contract.

What happens if the contract to purchase or construct a home does not occur within 12 months?

If a contract to purchase or construct a home within 12 months is not signed from the time the first amount is released to you, one can either:

- Apply to the ATO for an extension of time for a maximum of a further 12 months
- Recontribute an amount into your super fund (or funds). This amount must be a non-concessional contribution and be at least equal to your assessable FHSS released amount, less any tax withheld. This amount is stated in your payment summary and may be less than the total amounts released to you.
- Keep the released amount and be subject to FHSSS tax. This is a flat tax equal to 20% of your assessable FHSSS released amounts, not the total amount released.

Conclusion

The FHSSS looks quite complex but in practice the complexities are dealt with by the ATO, which should leave a relatively simple process for the individual. The tax benefits of using superannuation as the investment vehicle are attractive, making it worthy of serious consideration for those saving for a first home deposit.

Small business CGT concessions: Save tax and save for super



Small business CGT concessions: save tax and save for super

The small business CGT framework

The small business CGT concessions are available to individuals, trusts, companies and partnerships that carry on a small business. These concessions can be used to disregard or defer some or all the capital gain resulting from the disposal of small business active assets. For this purpose, an active asset is one which is owned and used (or held ready for use) in carrying on a business. Active assets can include intangible assets such as goodwill, trademarks etc.

To meet the definition of a small business, an entity must satisfy one of two tests, the first being the turnover test, which requires the net total turnover of the business and connected entities to not exceed \$2m. Failing that, as an alternative, the sum of net value of CGT assets owned by the entity and other connected entities must not exceed \$6m. Certain assets such as personal used assets and superannuation are excluded in the calculation of the \$6m.

An important objective of the small business CGT concessions is to assist small business owners who sell their business to reduce or eliminate the CGT on the disposal. An equally important objective following on from the CGT tax benefit is the ability to utilise the concessions to contribute the sale proceeds to superannuation.

This is a great initiative for small business owners, as during their working lives many of them would be concentrating more on investing in their business rather than contributing for their retirement. This is a chance for them to catch up on their contributions with the additional liquid funds they now have coinciding with the sale of their business.

Accessing the concessions - basic and specific conditions

Assessing whether a business owner meets the small business and the active asset tests can get awfully complicated, particularly where different business structures and other connected entities are involved. Having considered and satisfied the general basic conditions for the concessions, gaining access to each of the individual exemption requires the specific conditions

under each of the exemptions to be met. These test conditions can be just as complicated and confusing to carry out.

It is only when both the basic conditions and the specific conditions are met that the exemptions are available for use. There are four exemptions and relief available and they can either be used on their own (for example, if the 15 year exemption is used where the full gain is eliminated, there is no further need to think of the other exemptions) or in conjunction with one another, one exemption considered after the other with the choice to elect for use or not. The exemptions should be considered in the following order:

1. Small business 15-year exemption
2. Small business 50% active asset reduction
3. Small business retirement exemption
4. Small business rollover.

The accountant is usually the party responsible to assess if both the basic and specific conditions have been met to use the concessions and therefore, there is often no real need for the financial adviser to be involved with this part of the exercise. However, given the complexities of applying the rules and the high likelihood of getting it wrong, even for accountants, it helps if there is an additional professional person providing input to ensure all necessary requirements are met and the various exemptions applied correctly.

In any case, if the financial adviser is to be involved with contributing any part of the sales proceeds to superannuation, it is desirable that they possess a detailed knowledge of the whole process from the eligibility conditions to reduce the CGT and ending with the contribution of all or part of the proceeds to superannuation.

Benefits of small business CGT concessions and superannuation

Superannuation contributions made under the small business CGT concessions are not tested against the non-concessional (NCC) and concessional contribution caps, but are instead measured against the lifetime CGT cap. This means more contributions than normal could be

**Small business CGT concessions:
Save tax and save for super**

made on the sale of a business. The total super balance of \$1.6m which limits NCC is therefore not relevant in this instance.

The lifetime CGT cap is \$1.48m for 2018/19 and is indexed annually. The actual amount that is available under this cap depends on which exemption is used to make the superannuation contribution. It is important to note that only two of the exemptions, the 15-year exemption and the small business retirement exemption allow contributions to superannuation under this cap.

The 15-year exemption is often considered the most effective of the four exemptions in that it not only eliminates all capital gains but allows the sale proceeds (not just the gain – which can be less than sale proceeds) to be contributed to superannuation subject to the limit imposed by the lifetime CGT cap. This means, depending on the magnitude of the sale proceeds, it is possible to fully utilise the lifetime CGT cap under this exemption.

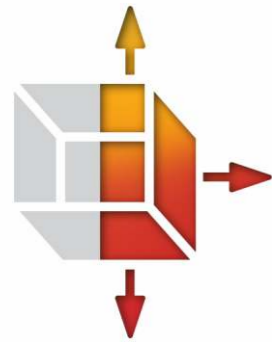
On the other hand, the only other exemption that allows a superannuation contribution is the small business retirement exemption. Unlike the 15-year exemption, this exemption only allows up to \$500k (lifetime non-indexed limit) of capital gain to be eliminated and only an amount equivalent to the gain (as reduced by this exemption) to be contributed to superannuation. Therefore, if this exemption is used, only a maximum of \$500k contribution can ever be made and this could result in the cap of \$1.48m not being fully utilised.

As only the amount up to the capital gain (as reduced by the small business retirement exemption) can be contributed to superannuation, a common strategy to maximise the contribution is not to use the 50% active asset exemption (which is considered before the small business retirement exemption). Doing this allows more gain to flow through and a greater proportion of the gain to be instead reduced by the small business retirement exemption, hence increasing the available level of contribution.

As a word of caution, electing not to use the 50% active asset exemption in this way can result in a contribution increase but it is important to ensure that the implementation of this strategy is CGT neutral and does not lead to any tax increase.

More details on the small business CGT concessions and how it works

The “Small business CGT concessions and superannuation” guide beginning on the next page provides a detailed summary of the conditions and the process required to access the small business CGT concessions, including the specific conditions for each of the exemptions. It also details the tax impact of using the concessions and provides information on how best to use each of the exemptions and the resulting flow of contributions to superannuation.



Selling a small business CGT concessions and superannuation

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At a glance

Follow these steps to assess if a small business owner can benefit from the small business CGT exemptions and contribute to superannuation.

Step 1 – Meeting the basic conditions

Check that the initial basic conditions are met:

- Is it a small business?
- Is the asset an active asset?
- Is the active asset a share in a company or an interest in a trust to which special conditions apply?



Step 2 – Reduce or eliminate CGT

Consider the four possible small business CGT exemptions in the following order. Each exemption has its own specific conditions to be met.

- 15 year exemption

If the 15 year exemption cannot be used, consider one or more of the following exemptions:

- 50% active asset reduction
- Small business retirement exemption
- Small business rollover



Step 3 – Contributing to superannuation

Confirm if it is possible to make contributions to superannuation under the small business exemptions:

- Only the 15 year and the small business retirement exemptions allow contributions that are exempt from the normal superannuation caps
Note: Such contributions, which must be made within strict time limits, have their own specific caps (the lifetime CGT cap) against which they are measured.
- With the other two exemptions, proceeds can only be contributed to superannuation in accordance with the normal rules and caps.

Step 1

Before it can be determined if a client is eligible for CGT concessions, the following basic conditions must be met.

01. Meet the eligibility conditions

Must satisfy one of the conditions:

(1) The taxpayer is a small business entity with less than \$2 million annual turnover (aggregated turnover of business + connected entities and affiliates) based on any of the three methods of calculation -

- (i) Previous year turnover
- (ii) Estimated current year turnover
- (iii) Actual current year turnover

(2) Not carrying on a business but the taxpayers passively held CGT asset is used in a business carried on by a small business entity that is an affiliate or connected to the taxpayer

(3) The taxpayer is a partner in a partnership that is a small business entity and the CGT asset is an interest in a partnership asset or is not an interest in a partnership asset **but** is used in the partnership business

(4) Net value of CGT assets owned by the taxpayer (and entities connected with the taxpayer) + assets used or held ready to use in a business carried on by the taxpayer (or an entity connected with the taxpayer), owned by the taxpayers affiliates (and entities connected with your affiliates), did not exceed \$6 million (the "maximum net asset value" test) just before the CGT event

02. CGT asset must be an active asset

Active asset - an asset owned by the taxpayer and used or held ready to use in carrying on a business (whether alone or in partnership).

(1) Does not need to be active immediately before CGT event

(2) If owned for 15 years or less it must be an active asset of the taxpayer for at least half of the period (does not have to be continuous), or if owned for more than 15 years must have been an active asset for a total of at least 7.5 years

(3) Can be an intangible asset inherently connected to a business (e.g. goodwill) that the taxpayer carries on

(4) Some assets cannot be active assets (e.g. financial instrument, loans etc.)

Note: Passive assets can never be active – e.g. rental property unless rented to an affiliate or connected entity for use in their business.

03. If CGT asset is a share in a company or interest in a trust must meet additional conditions

Must satisfy these additional conditions where the CGT asset is a share in a company or interest in a trust:

(1) Just before the CGT event, either:

(i) The taxpayer must be a CGT concession stakeholder in the company or trust; or

(ii) CGT concession stakeholders in the company or trust had a total small business participation percentage in the taxpayer claiming the concession of at least 90%. (The 90% test only applies if there is an interposed entity between the CGT concessional stakeholder and the company or trust in which the shares or interest are held - the interposed entity is one claiming the concession)

(2) Unless the taxpayer satisfies the maximum net asset value test, it must be carrying on a business just prior to the CGT event

(3) The company or trust must either be a CGT small business entity for the income year or satisfy the maximum net asset value test

(4) The share in the company or interest in the trust must satisfy a modified active asset test (MAAT). Work out the total market value of both (i) the assets of the company or trust and (ii) the assets of any later (interposed) entity in which the taxpayer has a small business participation percentage, multiplied by that percentage. To meet the MAAT, at least 80% (the 80% test) of the above assets must be made up of (i) active assets and (ii) cash or financial instruments inherently connected with the business carried on by the company/trust or a later entity

Note: If the assets are held by a later entity, they are only active assets if **both** conditions are met: (i) The later entity is either a CGT small business entity or meets the maximum net asset value test in relation to the CG (ii) The taxpayer either has a small business participation percentage of at least 20% in the later entity or is a CGT concession stakeholder of the entity

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 If your client meets all the above conditions, turn the page to see which concession they may be eligible for.

Step 2

Meet specific conditions of the exemptions to reduce or eliminate CGT

i To the extent that 15 year exemption can be used, there is no need to consider any other exemption.

15 year exemption

Tax impact:

- Entirely disregard any capital gain, no need to apply any other concessions
- No need to apply capital loss before applying 15 year exemption
- If an individual claimed exemption - payment is 100% tax free;
- If a company or trust claimed exemption - any distribution of the exempt amount to the CGT concession stakeholder is tax free up to the participation percentage

Individual claiming exemption:
Must meet these conditions:

- Owned asset continuously for 15 year period ending just before the CGT event
- When the CGT event happened, the taxpayer is either permanently incapacitated at any age; or at least 55 years old and the CGT event happened in connection with retirement
- If the CGT asset is a share in a company or interest in a trust, the company or trust must have had a significant individual for periods totalling at least 15 years during the entire time of ownership even if not the same significant individual during the whole period.

Company or trust claiming exemption:
Must meet these conditions:

- Owned asset continuously for 15 year period ending just before the CGT event
- There was a significant individual for at least 15 years, even if not the same individual
- The significant individual just before the CGT event was:
 - At least 55 years old at the time and the event happened in connection with retirement, or
 - Permanently incapacitated at that time.
- Distribution of exempt amount - the Company or Trust makes the payment before the later of:
 - 2 years after the relevant CG event; or
 - 6 months after the latest time of an "earnout arrangement"; and meeting:
 - the payment must be made to an individual who was a CGT concession stakeholder of the Company or Trust just before the event; and
 - total payments to each concessional stakeholder not exceeding their participation percentage of the exempt amount.

Reduce CG by current & prior year losses
Individuals must apply 50% general CG discount if asset owned for more than 12 months

i If the 15 year exemption eligibility criteria cannot be met, the remaining exemptions may be applicable either singularly or in conjunction with one another. As there is choice not to use one or more of the exemptions, it is therefore important to consider all options and work through the implications to achieve the most appropriate outcome.

50% active asset reduction

Tax impact:

- The amount of any capital gain is reduced by 50%
- Applies in addition to the individual 50% general CGT exemption making a total exempt amount of 75%

Individual or company or trust claiming exemption:

- If unable to use the 15 year exemption, this exemption may apply
- Once the basic conditions are satisfied, no further requirements need to be met
- Exemption applies automatically but may choose not to use if small business retirement or rollover exemption give a better result
- Small business retirement exemption and/or the small business rollover may also apply to any remaining amount after the application of this exemption

✗
No CGT exempt super contribution allowed

Small business retirement exemption

Tax impact:

- Can disregard a capital gain up to a maximum of \$500k (lifetime limit) per individual taxpayer or per eligible stakeholder for company or trust taxpayers
- Payment received from company or trust satisfying this requirement is 100% tax free
- Earlier exemptions taken (e.g. sale of another business) will reduce \$500k lifetime limit
- Can choose to apply this exemption if not eligible for the 15 year exemption and after 50% active asset exemption

Individual claiming exemption:

- No need to terminate any activity, employment or cease business
- Keep a written record of the CG amount chosen (CGT exempt amount) to be exempt (subject to lifetime limit)*
- If under 55 years of age just before taxpayer chooses to use the exemption, the exempt amount must be contributed into super
- If 55 years of age or older when taxpayer makes the choice, no requirement to go into super (even if under 55 years of age when proceeds received)
- If proceeds received in instalments, super contribution requirements apply to each instalment

Company or trust claiming exemption:

- Must have at least one significant individual just before the CGT event
- Keep a written record of the CG amount chosen to be disregarded and if there is more than one CGT concession stakeholder, each stakeholder's percentage of the exempt amount (together adding up to 100%)*
- A payment to at least one CGT concession stakeholder worked out by reference to each individual's percentage of the exempt amount must be made
- The payment is equal to the exempt amount or the amount of capital proceeds, whichever is less
- If proceeds received in instalments, make payments to a CGT concession stakeholder for each instalment in succession (up to the asset's CGT exempt amount)
- Payment must be made by the later of:
 - 7 days after choosing to disregard the CG
 - 7 days after receiving the capital proceeds from the CGT event
- If the stakeholder is under 55 years of age just before the payment is made, the Company or Trust must pay directly to a super fund
- If 55 years of age or older just before the payment is made, no need to contribute to super

* This must be done by the day of lodgement of return for the year of the CGT event

Small business rollover

Tax impact:

- Allows **deferral** of all or part of a capital gain from a CGT event happening to an active asset by rolling over the gain to a replacement asset
- Can choose to apply this relief if not eligible for 15 year exemption and after considering 50% active asset and small business retirement exemptions

Individual or company or trust claiming exemption:

- Used where it is intended to purchase a replacement asset with the proceeds. Rollover can be obtained even where the replacement asset has not yet been acquired or any expense incurred on the capital improvement to an existing asset
- Only the basic conditions need to be met
- Time limits apply - replacement asset needs to be acquired in the period 1 year **before** to 2 years **after** the sale of the original asset
- If unable to acquire the replacement asset within the time limit, deferred CG will crystallise and subject to meeting the conditions, can opt to use (go back to) small business retirement exemption

✗
No CGT exempt super contribution allowed

Step 3

Contributing to superannuation using the lifetime cap of \$1.48m

Can be contributed to super

- The total proceeds of the sale are eligible for contribution not just the capital gain portion, up to the lifetime cap of \$1.48m
- Must submit CGT cap election form to super fund at or before making contribution

Timing - Individuals must contribute on or before the later of the day their tax return is due for the year of the CGT event or 30 days after receiving proceeds

Timing - Company or trust must make the contribution within 30 days of payment from Company or Trust

Can be (or must be) contributed to super

Individual claiming exemption

- Only the exempt capital gain portion of the sale and up to a lifetime cap of \$500k can be contributed
- Must submit CGT cap election form to super fund at or before making contribution

Timing

- If under 55 years of age, must contribute to super by the later of the day the choice is made (the date the tax return is required to be lodged) or the date the capital proceeds received
- If 55 or older, no contribution to super required but if wish to contribute to super, then it must be contributed before the later of the day their tax return is due for the year of the CGT event or 30 days after receiving proceeds

Company or trust claiming exemption

- Applies only to the exempt capital gain portion of the sale and up to a lifetime cap of \$500k
- CGT cap election form must be provided to super fund at or before contribution

Timing

- If the CGT concession stakeholder is under 55 years of age just before the payment is made in relation to them, the company or trust must make the contribution, up to the relevant CGT exempt amount, to a super fund on their behalf in the same timeframe as in point (6) above, instead of being a payment, it is a direct contribution to the fund
- If the concession stakeholder is 55 years or older just before the payment is made to them, the company or trust is not required to contribute the amount to a super fund on behalf of the member. If the member wishes to contribute the amount to a super fund, the contribution must be made within 30 days of receiving the payment

Definitions

Net value of CGT asset
Assets included are not restricted to business assets. They include all CGT assets of the entity, unless the assets are specifically excluded.

Carrying on a business

- Significant commercial purpose
- Systematic with a view to profit
- Organised in a business-like manner.

A CGT Concession stakeholder
of a company or trust is a significant individual in the company or trust, or the spouse of a significant individual where the spouse has a small business participation percentage in the company or trust.

Small business participation percentage is the sum of the direct and indirect small business participation interests.

Direct small business participation percentage for a company is the smallest percentage out of:

- The voting power
- Any dividend or capital distribution, the entity is entitled to.

Direct small business participation percentage for a trust:

- Where entities have entitlements to all the income and capital of the trust - the lower percentage of the income and the capital that the entity is beneficially entitled to from the trust
- Where entities do not have entitlements to all the income and capital of the trust and the trust makes a distribution of income or capital - the lower percentage of distributions of income and capital that the entity is beneficially entitled to during the income year.

The indirect small business participation percentage is the entity's direct participation interest in an interposed entity multiplied by the interposed entity's total participation percentage (both direct and indirect) in the company or trust.

In connection with retirement
while there is no need for a permanent retirement, there does need to be a significant reduction in working hours or the nature of present activities.

A significant individual
has a small business participation percentage in the company or trust of at least 20%.

Related information

Contribution Caps & Total Super Balance
Contributions to super (CGT exempt amounts) up to the CGT lifetime cap amounts **does not** count toward members contribution caps but **does** count toward Total Super Balance once contributed.

Death and small business CGT concessions
There may also be scope for the LPR or beneficiary of a deceased estate to claim small business CGT concessions if the asset is disposed of within 2 years of death & the asset would have qualified for the concession had it been disposed of just before death by the deceased.

Untaxed elements: A hidden death tax



Untaxed elements: A hidden death tax

Overview

Apart from super benefits paid from an untaxed super scheme – usually Commonwealth and State Government pension funds – there are only limited circumstances where an untaxed element arises in a taxed super fund.

Technically, an untaxed element of a taxable component (untaxed element) includes amounts where the super fund has not paid any tax on the contributions (other than non-concessional) or earnings. There are two common situations where your clients may be impacted:

- The client has a member benefit sourced from an untaxed fund and it is rolled over to a taxed fund. In this case, the receiving fund will identify the untaxed element and deduct 15% tax to convert it to a taxed element; or
- The client elects to structure their life insurance policy through their super fund and the super fund claims a deduction for the premiums paid. This is the situation we will consider in this section.

In the event of a successful claim, the proceeds of the life insurance policy will be paid into the members account. There is no tax payable by the fund on the receipt of these monies and hence an untaxed element may arise.

When does an untaxed element arise?

The Tax Act (S307-275) provides the following guidance:

Element taxed in the fund and element untaxed in the fund of superannuation benefits.

1. The taxable component of a superannuation benefit consists of an element taxed in the fund or an element untaxed in the fund, or both.
2. The *taxable component of a superannuation benefit consists wholly of an element taxed in the fund except as provided in a later section of this Subdivision.

Therefore, an untaxed element will only arise as specified in the subsection. A further sub-section, S307-290, specifically creates the untaxed element in the following circumstances:

Taxed and untaxed elements of death benefit superannuation lump sums

1. This section applies to a superannuation death benefit that is a superannuation lump sum, in relation to which a deduction has been, or is to be, claimed under section 295 465 or 295 470.

Note 1: Those sections allow deductions for insurance premiums that have been paid, and for liability for future benefits. (2)

There are two very important points to understand from the above sections. For an untaxed element to arise:

1. There must be a death benefit payment containing proceeds paid from a life insurance policy where a deduction was allowed for the premium*; and
2. It is paid as a lump sum – including where it is rolled over to another fund (see notes below).

*An untaxed element may also arise where a super does not claim a deduction for the premium but does claim a deduction for future liability to pay benefits. This is a relatively rare situation and normally does not apply to policies held via a retail super product.

How is it calculated?

It is important to remember that any superannuation benefit can be split into the tax-free component and the taxable component. If there is no tax-free component, then the whole benefit consists of taxable component. The taxable component normally consists of a taxed element and, under the circumstances described above, can also include an untaxed element.

In order to calculate the untaxed element, we must first calculate the taxable element as the untaxed element is the amount remaining after deducting the taxed element from the taxable component. Follow these steps to calculate the untaxed element:

**Untaxed elements:
A hidden death tax**

Step 1: Firstly, need to calculate the **taxed element**:

Taxed element = \$Amount of super lump sum x (Service days / (Service days + days to retirement)) – Tax free component

Step 2: Then, to calculate the **untaxed element**:

Untaxed element = Taxable component – taxed element

Where:

- \$Amount of lump sum includes insurance proceeds
- Days to retirement is the number of days from the day on which the deceased died to the deceased's last retirement day (normally age 65)
- Service days is the number of days in the service period for the lump sum
- Taxable component is the \$Amount of the superannuation lump sum less any tax-free component.

This will potentially leave you with three figures:

1. Tax free component
2. Taxed element (as calculated in Step 1) taxable component
3. Untaxed element (as calculated in Step 2) taxable component.

Example

Adrian dies at age 45 with \$50,000 in super, split \$10k tax free / \$40k taxable. A \$1m life policy payment is received into his account for a total member account balance of \$1,050,000, split \$10k tax free / 1.04m taxable. Service days = 2,067 days and days to retirement = 10,803 days.

What is the untaxed element on paying out the death lump sum benefit?

Step 1: Calculate the taxed element:

\$Amount of super lump X (Service Days / (Service days + days to retirement)) – Tax free component

$(\$1,050,000 \times (2,067 \text{ days} / (2,067 \text{ days} + 10,803 \text{ days})) - \$10,000 = \$158,636$

Step 2: Calculate the untaxed element of the taxable component:

Taxable component – Taxed element

$(\$1,050,000 - \$10,000) - \$158,636 = \$881,637$

Result:

Tax free	\$10,000
Taxable component taxed element	\$158,636
Taxable component untaxed element	\$881,364
Total	\$1,050,000

How is the untaxed element taxed?

There are two possibilities. The first relates to tax that may be payable by the individual receiving the benefit. The second relates to tax payable by the fund if the benefit is rolled over to another fund. Any tax payable will reduce the total amount available to the recipient.

Payable by the individual

When paid to an individual, it is taxed under the normal death benefit rules for an untaxed element:

**Untaxed elements:
A hidden death tax**

- Taken as a lump sum (exits super):
 - Where paid to a death benefit dependant = Tax free
 - Where paid to a non-dependant = 30% + medicare levy
- Taken as a death benefit income stream – death benefit dependants only:

Age of beneficiary and deceased (at time of death)	Type of super payment	Effective tax rate
Beneficiary is more than 60 years old or the deceased was more than 60 years old	Untaxed element taxable component	Your marginal tax rate less 10% tax offset
Both beneficiary and deceased are under 60 years old	Untaxed element taxable component	Your marginal tax rate

Source: https://www.ato.gov.au/Individuals/Super/In-detail/Withdrawing-and-using-your-super/Withdrawing-your-super-and-paying-tax/?page=6#Super_death_benefits

Payable by the fund

There will be 15% tax payable where a lump sum death benefit containing insurance proceeds is rolled over to another super fund. The 15% tax converts the untaxed element to a taxed element in the receiving fund.

What does this mean practically?

Great care should be taken **before** advising a client to rollover a death benefit payment where it contains a death benefit insurance component, irrespective of the date of death.

Since 1 July 2017, new rules allow a death benefit dependant to rollover a lump sum death benefit to a new fund to begin a death benefit income stream. In doing so, such a rollover may create a death lump sum benefit with an untaxed element (if it contains a life insurance component) on exit and attract a 15% tax payable by the receiving fund. On the other hand, if the same death benefit remains in the original fund with the

commencement of a death pension, there will not be any untaxed element as no lump sum payment has been created.

It should be noted that where a beneficiary rolled over a 'death benefit' prior to 1 July 2017 under the old rules, it would have been done by serving the prescribed time period with the benefit converted to a member benefit at that time and is no longer a death benefit.

What are the strategies to help minimise the untaxed element?

Because of the way the untaxed element is calculated, there are strategies that can help minimise the untaxed element. These include:

Strategy 1: Maximise the client's service period

The longer the service period, the less the untaxed element will be. The formula takes into account the proportion of days from the payment of the death benefit lump sum to the retirement date. The greater the proportion of days to retirement (the smaller the number of service days), the greater the untaxed element will be. Therefore, if the number of service days can be increased, the proportion of days to retirement decreases and the untaxed element decreases.

Check to see if clients have another super fund with an earlier start date (longer service period) and if so, consider rolling over to the fund with the insurance arrangement to increase the service period.

Strategy 2: Keep large non-concessional contributions in a separate fund

When doing the calculation, the first step is to work out the death lump sum payable (which includes all components and insurance proceeds) multiplied by a proportion determined by the number of service days and days to retirement. From this, any tax free (generally non-concessional contributions) component is deducted to arrive at the figure for the taxed element. The difference between the taxed element as calculated and the total death lump sum is the untaxed element which potentially has a higher tax impost.



**Untaxed elements:
A hidden death tax**

Thus, having high levels of tax-free components will effectively convert an amount that would have otherwise been taxed element into untaxed element.

Strategy 3: Maintain the insurance in a separate super fund

You can ensure that any accumulation balances are not tainted by maintaining the insurance cover in a separate fund. However, remember that some “insurance only super fund” options will not allow the benefit to be taken as a death benefit income stream from that fund. This forces a rollover which in turn triggers the same issue on the rollover that we are trying to avoid.

Conclusion

Once again, this can be a very complex area. Pre-planning can make a significant difference where a death benefit is paid with a life insurance policy amount attached. The key point is that consideration of these strategies should be part of the normal review process as they need to be in place prior to the death of the client, not left until after the event.

Labor's proposed franking credit policy: Lessening the impact (speculative)



Labor's proposed franking credits policy: Lessening the impact (speculative)

With a federal election looming in 2019, the Australian Labor Party (ALP) has unveiled a number of fairly controversial policy proposals. Amongst them, and one that seems to be causing many comments and much angst generally, is the proposed policy to abolish the refund of excess franking credits.

It must be stressed that this is only a proposal at the moment and hence highly speculative still. We have not seen any specific details nor is there any draft legislation or explanatory memorandum that can give us more information and clarification. Even if the ALP win power and come out with draft legislation to put it into effect, it must still get passed by both Houses of Parliament.

Understanding that there is no certainty regarding its final form and outcome, here is an extract of the current information regarding this proposal from the official ALP website, which we rely upon in our analysis:

Labor will unwind the 2000 Howard Government decision that introduced cash refunds for excess imputation credits for individuals and superannuation funds.

This means that imputation credits for individuals and superannuation funds will no longer be a refundable tax offset and will return to being a non-refundable tax offset consistent with the tax treatment of most other tax offsets. Cash refunds will not arise if excess imputation credits exceed tax liabilities.

Labor's policy will only apply to individuals and superannuation funds, and therefore will not apply to bodies such as:

- ATO endorsed income tax exempt charities; and
- Not-for-profit institutions (e.g. universities) with deductible gift recipient (DGR) status.

Source:

ALP Fact Sheet - A Fairer Tax System – Ending cash refunds for excess imputation:
<https://d3n8a8pro7vhmx.cloudfront.net/australianlaborparty/pages/7652/a>

[ttachments/original/1520827674/180313_Fact_Sheet_Dividend_Imputation_Reform.pdf?1520827674](#)

In response to a number of objections, the ALP introduced the following changes to “protect” pensioners from the proposed changes:

Labor will close this tax loophole ... but we'll protect pensioners with our Pensioner Guarantee.

... Labor is making sure pensioners will still be able to access cash refunds from excess dividend imputation credits.

The Pensioner Guarantee means pensioners and allowance recipients will be protected from the abolition of cash refunds for excess dividend imputation credits when the policy commences in July 2019.

Self-managed superannuation funds with at least one pensioner or allowance recipient before 28 March 2018 will also be exempt from the changes.

This means that every pensioner will still be able to benefit from cash refunds.

Source:

http://www.billshorten.com.au/labor_s_plan_to_crack_down_on_tax_loopholes_protect_pensioners_and_pay_for_schools_and_hospitals_tuesday_27_march_2018

History of franking

Dividend imputation (otherwise known as franking credits) was first introduced in 1987. Prior to this, tax was imposed on the company and then on the shareholders, effectively the same income and dividends being double taxed.

Dividend imputation allows the tax paid by the company to be imputed to shareholders by way of a tax credit (franking credit) attaching to the dividends to reduce the income tax payable on the distribution. It eliminates the double taxation of the same income to shareholders by requiring them only to pay tax on the difference between corporate tax and their own marginal tax rates.

From 1 July 2000, our franking credit system advanced a further step by becoming refundable credits, meaning excess franking credits above the individuals tax obligation are refunded by the ATO – this is the system that we are familiar with today. Before that, and since the first

introduction of the system in 1987, such excess credits were not refundable and just wasted.

What is franking and how does it work?

Essentially, it works like this:

- A company earns \$100 profit and pays \$30 (30%) tax to the Australian Taxation Office (ATO)
- It distributes \$70 dividend to its shareholder, advising that it is fully franked and has a \$30 franking credit attached representing the tax already paid to the ATO
- The shareholder includes the whole \$100 (grossed up) dividend in their tax return and pays tax at their personal marginal tax rate
- The shareholder then claims the \$30 as a tax rebate which directly reduces the amount of tax payable
- Depending on the amount of personal tax payable, the franking credit may either reduce the personal tax payable to a lesser figure or eliminate the tax entirely
- Where the franking credit is greater than the amount of personal tax payable, under current rules, the excess amount of the franking credit is refunded to the individual as cash by the ATO.

This franking credit refund is particularly useful for those paying little to no tax (such as retirees) and superannuation funds in pension mode paying zero tax on fund earnings.

Here are a couple of examples to illustrate this:

Under the current rules

Individual taxpayer

John has \$750,000 invested in fully franked dividends at 6% p.a. Assume no other income.

John dividend income	\$45,000
Franking credit (30% paid by companies)	\$19,286
John's taxable income	\$64,286
Tax payable (ignoring Medicare)	\$12,440
Reduced by franking credit	\$19,286
Excess franking credit	\$6,846
Tax payable (no Medicare)	\$0
Cashflow	
Dividend income received	\$45,000
Excess franking credit refunded from ATO	\$6,846
Total income available	\$51,846

SMSF

John, aged 66, has an SMSF which has \$750,000 invested in fully franked dividends. The SMSF is 100% in pension phase so all the earnings are tax free.

SMSF dividend income	\$45,000
Franking credit (30% paid by companies)	\$19,286
John's SMSF taxable income	\$64,286
Tax payable by SMSF on earnings	\$0
Reduced by franking credit	\$19,286
Excess franking credit	\$19,286
Tax payable by SMSF on earnings	\$0
Cashflow	
Dividend income received	\$45,000
Excess franking credit refunded from ATO	\$19,286
Total income in SMSF	\$64,286

What might happen under the proposed ALP policy?

The ALP proposes to eliminate the ability to refund any excess franking credits. This will take it back to the original system introduced in 1987.

The balance of the franking system remains unchanged:

- Companies still pay 30% tax
- Dividends paid still carry franking credits (at up to 100% franked as declared by the company)
- Shareholders still include the grossed-up dividend in the taxable income
- The franking credit will still offset any tax; but
- To the extent that the franking credit is greater than the shareholders tax liability, the excess franking credit amount will be lost – there will be no refund of the excess amount.

As amended, those individuals on a Centrelink pension or allowance and any SMSF that has at least one member, as at 28 March 2018 (Source: <https://www.chrisbowen.net/issues/labors-dividend-imputation-policy/>), who is in receipt of a Centrelink pension or allowance, will be exempt from the proposed changes – that is, excess franking credits should still be refundable to these specific groups.

Winners and losers?

The impact of the proposed changes is probably wider than many initially think. The one consistent point is that there appear to be no winners. No one benefits directly from the proposed changes.

At the investment (product) level, if shareholders and investors can no longer receive a refund of excess franking credits, are those companies paying fully franked dividends still as valuable as an investment? How about managed funds that specialize in the area? Will investors restructure portfolios to hold fewer fully franked investments to balance tax liabilities to available franking credits with a follow-on impact on the securities price?

Similarly, at an individual level, investors may go through the same review process with their advisers questioning their exposure to such companies and products.

Many may be unaffected – that is, those whose tax liability is higher than any attached franking credits and the excluded groups mentioned above.

There will be clear losers – that is, those who have franking credit amounts that are greater than personal tax liability. A similar loss position for those who invest in tax structures that have a nil tax liability – such as SMSF that is 100% in pension phase. The following examples illustrate these points.

Under the proposed ALP rules

Individual taxpayer

John has \$750,000 invested in fully franked dividends at 6% p.a. Assume no other income.

John dividend income	\$45,000
Franking credit (30% paid by companies)	\$19,286
John’s taxable income	\$64,286
Tax payable (ignoring Medicare)	\$12,440
Reduced by franking credit	\$19,286
Excess franking credit - Lost	\$6,846
Tax payable (no Medicare)	\$0
Cashflow	
Dividend income received	\$45,000
Excess franking credit refunded from ATO	\$0
Total income available	\$45,000

Labor's proposed franking credit policy: Lessening the impact (speculative)

SMSF

John, aged 66, has an SMSF which has \$750,000 invested in fully franked dividends at 6% p.a. The SMSF is 100% in pension phase so all the earnings are tax free.

SMSF dividend income	\$45,000
Franking credit (30% paid by companies)	\$19,286
John's SMSF taxable income	\$64,286
Tax payable by SMSF on earnings	\$0
Reduced by franking credit	\$19,286
Excess franking credit - Lost	\$19,286
Tax payable by SMSF on earnings	\$0
Cashflow	
Dividend income received	\$45,000
Excess franking credit refunded from ATO	\$0
Total income in SMSF	\$45,000

Is there a solution?

For many, there may be no need for a solution as they are unaffected and can continue to use their franking credits to the full extent, or they are exempt. For the rest, there may be a need to restructure the holding of franked investments if franking credits preservation is an important consideration.

As mentioned above, it may be time to review the exposure to fully franked investment vehicles in order:

- To better balance the level of franking credits to the anticipated tax liability, and
- Question the investment valuation paradigm should there be less demand for franking credits.

As pointed out above, super funds seem to be at the biggest risk but are all super funds at equal risk?

The answer is – No, not all super funds are at the same risk.

Most retail funds should be largely unaffected. This is because most have both the accumulation and pension products structured under the same trust – that is, within the same super fund tax structure. Their accumulation accounts receive taxable contributions and taxable earnings which are subject to tax.

On the other hand, their pension account earnings are tax free as they support the members pension liabilities. Both “funds” are generating franking credits and because most retail super funds are structured under the same tax entity, the franking credits can be used to offset the tax liability generated in the accumulation accounts. Provided the overall fund tax liability is higher than the franking credits received, there should be no wastage of the credits and benefit of the ‘cash refund’ should flow through to the individual members, whether they are in accumulation or in pension phase.

In the case of the Netwealth Super Fund, where it is expected that the franking credits will be absorbed by the overall fund tax liability, the trustees will immediately credit the value of the pension account franking credits back to the pension members as physical cash that is immediately available for investment.

The key point here for advisers is to check with their chosen super product provider that:

1. The fund is structured to take advantage of this; and
2. That the pension member franking credits are transferred to the pension member account and available for use in a timely manner.

How about SMSFs? Can they use the same strategy? The practical answer is – **No they cannot** (or at least it is extremely unlikely!).

At the extreme end of the spectrum, with an SMSF 100% in pension mode with no accumulation members, the fund receives no taxable contributions and has no taxable fund earnings. In this case, there is no tax liability to use the franking credits and 100% of the franking credits will be lost. Depending on the fund assets and member circumstances and requirements, the practical solution if preservation and recovery of franking credits is important,

is to wind up the SMSF and rollover to a retail fund like Netwealth's.

Even with an SMSF that has both pension and accumulation members, unless the accumulation members taxable contributions and fund earnings are great enough to use all the pension member (and possibly accumulation members too) generated franking credits, then franking credits will be partially or fully lost. Again, depending on the fund assets and member circumstance, the practical solution is to wind up the SMSF and rollover to a Netwealth like fund.

The best possible scenario is an SMSF in 100% accumulation. Then maybe it can utilise 100% of the franking credits, but that is not guaranteed! It would depend on level of taxable contributions and earning and the exposure to franked dividends. It is quite possible that where there is a high level of exposure to franked dividends, there may be insufficient tax liability to fully utilize the available franking credits, resulting in only a partial recovery and waste of excess credits.

Conclusion

There are a few key takeaways for advisers:

- These are only proposed measures, still highly speculative – knee jerk reactions should be avoided
- The system is still intact, it is only the excess franking credits that are lost and no longer refunded in cash
- While there are no “winners”, not everyone is affected in the same way
- Centrelink pensioners, allowees and SMSFs with a Centrelink payee, should be exempted
- Many SMSF's – particularly those in pension mode – will likely be negatively affected
- Retail super funds including the pension accounts, generally are unlikely to be affected and therefore may provide a solution for disadvantaged SMSF.

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