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Tax reforms disappoint

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TAX cuts to encourage people to save, announced in last week's budget, are but a pale imitation of the Henry review's grand plan to tax incomes from savings and investments more fairly.

Experts are disappointed Treasury secretary Ken Henry's vision of a level playing field for shares, property and saving accounts has not been realised.

The government announced it would halve the tax on up to \$1000 of interest income, including interest earned on deposits, bonds, debentures and annuity products.

Interest earned within the cap will be taxed at half an individual's nominal marginal tax rate, with the discount available for direct and indirect interest income such as through a trust or managed fund.

FIG Securities head of strategy and market development Stephen Nash says the reform, effective from July next year, acknowledges a lack of tax neutrality between the asset classes.

While there are at present no tax concessions for interest income, capital gains on assets held longer than a year receive a 50 per cent discount, domestic shares provide dividend imputation and property investors can benefit from negative gearing.

The Henry review found these large variations affect the allocation, ownership and management of the nation's savings. "The tax advantages from borrowing to invest in a rental property, also relevant for shares, leads to investors taking on too much debt and distorts the property market," the panel reported.

The tax cut is designed to remove some of the structural disincentives to save, such as the punitive tax rates on bank deposits, which can be as high as 80 per cent of the real return.

"I think they are starting to address it and over time I think you will see more of this," Nash says.

He says with term deposits paying a one-year rate of 6.3 per cent, halving the tax on the first \$1000 of interest "makes it pretty attractive for people to think about deposits in a little bit more detail or possibly bonds".

However, many are disappointed the government decided to cap the discount when the Henry review had recommended a slightly lower discount at 40 per cent but with no cap.

The review's panel thought a move to a broad 40 per cent discount for income from bank deposits, bonds, rental properties and for capital gains and certain interest expenses would provide more consistent tax outcomes.

It said the discount could be phased in to reduce disruption, and could be part of a long-term alternative to dividend imputation, which would help avoid the double taxation of company profits for shareholders.

But KPMG partner Jeremy Hirschhorn believes the measure has been severely restricted by the \$1000 limit. He says the maximum tax concession will be only \$232.50 and that is for someone in the highest tax bracket. Someone earning about \$37,000 a year with a marginal tax rate of 31.5 per cent will be entitled to a maximum concession of \$157.50.

"At a maximum tax concession of \$232.50 per individual, we do not see this measure increasing savings or addressing the... the structural tax disadvantaged treatment of bank savings," Hirschhorn says.

Savers will need an investment of about \$16,600 to earn \$1000 of interest, assuming the interest rate is about 6 per cent, and will be eligible for only

one 50 per cent discount a year.

ING Australia national manager of technical services Graeme Colley says couples could consider putting both their names on the investment as all taxpayers are eligible for the discount.

"But if they are earning less than the tax-free amount, which is \$16,000 next year, they won't get the access to the 50 per cent discount," he says.

Retirees should keep in mind that they may not be paying any tax on interest income because of the low income tax offset and senior Australians tax offset.

For seniors still paying tax, the discount will reduce their adjusted taxable income, which determines their eligibility for the seniors health card.

For people who are ready to invest in an interest-bearing product now, Nash says there may be timing issues.

"You could want to invest with a longer maturity so you get paid after the tax change comes in," he says.

That does not mean the products included in the reform will always be the best option when it comes to saving.

MLC technical services manager Paul Sarkis says a lot of people with offset accounts attached to their mortgages would probably be better off leaving their savings there.

"They effectively pay no tax and you get a return that is equivalent to your mortgage rate," he says.

For first-home buyers, Sarkis says first-home savers accounts may be an attractive option now the government has decreed savers can use their deposit before the first four years are up.

These accounts offer a 17 per cent government co-contribution, paid on the first \$5000 of personal contributions made each year.