INSIDE

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FINANCIAL MATTERS AFFECTING YOUR LIFESTYLE

- A run-down of the new loss carry back measure.
- Which are you – a saver or investor? Or both?
- 5 tips for creating your own good fortune this Lunar New Year.
- Hyperinflation: addressing the concerns and risks in Australia.

A run – down of the new loss carry back measure

The Federal Budget carried with it a number of tax changes that were designed to assist the Australian economy recover from the impact of the Covid-19 pandemic.

Among the changes announced was the temporary re-introduction of the carry back rules for corporate tax entities (it was previously briefly in force for 2012-13). The ability to carry a loss backwards simply means that a loss incurred in one year can be, effectively, claimed as a tax deduction in a prior year when tax was paid.

The outcome is that the entity carrying the loss back will obtain a refund of tax in relation to the year when tax was paid. Some jurisdictions in the world, other than Australia, have the ability to carry losses backwards as a permanent feature of their tax system. At present, the changes set out below will only be in existence for a couple of years.

The explanatory memorandum to the enacting legislation states that under the temporary loss carry back refundable tax offset rules, a corporate tax entity with an aggregated turnover of less than $5 billion can choose to carry back a tax loss for the 2019-20, 2020-21 or 2021-22 income years and apply it against tax paid in a previous income year as far back as the 2018-19 income year.

The choice to claim a loss carry back tax offset is an alternative to carrying tax losses forward as a deduction for future income years. But note that only tax losses can be carried back – capital losses cannot be carried back because the capital gains tax regime operates on a "realisation" basis.

A STRATEGY OPENS

The ability to fully expense, for tax purposes, the cost of a depreciating asset opens up the opportunity, for otherwise profitable companies, to be in a tax loss due to the purchase of a significant asset. If this occurs the company may then be able to carry back the loss created from purchase of the asset to a prior year where tax has been paid – the result of which could be a refund of tax.

No doubt there will be many incorporated business owners or boards of directors of companies that will be contemplating this strategy. It is a way to save,

tax and receive a refund of tax without any fear of the general anti – avoidance rule of income tax applying.

THE MECHANISM

The benefit of being able to carry back a tax loss is delivered to the relevant entity by way of a refundable tax offset. In order to claim the tax offset, the taxpayer must be a "corporate tax entity" throughout the relevant income year and in the period between the loss year and the profit year that the loss is carried back to.

Carrying back tax losses is optional, and so it follows that if losses are made in one year and are carried back, there is no compulsion to carry back losses from a following year.

The new loss carry back rules contain an "integrity rule" (an anti-avoidance provision). There are some details in these rules to try to ensure that some continuity of ownership can be satisfied – that is, that the entity that incurred the loss should also be the the one that has access to any benefits from these losses. An entity cannot carry back losses that have been transferred between companies. Also amounts of tax offsets to which a corporate tax entity is entitled, and which may in some circumstances be converted into an amount of a tax loss, cannot be carried back.

The aim of such integrity rules is to try to hold off what could be called egregious behaviour at which the integrity rule is aimed and can be as follows:

- Shares in a company are sold to another party who will gain control of the company.
- This occurs between the beginning of the gain year to which losses are to be carried back and the end of the loss year.
- Then an entity, other that the company, obtains a financial benefit that is calculated by reference to a loss carry back offset to which the company is entitled.
- A not incidental purpose of the share sale is to enable the company to obtain a loss carry back tax offset. Source: Butler Settineri

Which are you – a saver or investor? Or both?

Key Points

- Saving is usually associated with money you have in the bank. Savings also tend to be accessible – you can get your money out pretty much immediately.
- Returns from savings tend to be low, especially in the current low interest rate environment where interest payable on bank and Fixed Term deposits are less than 2%.
- Investing is more typically a long-term pursuit. It can last for decades – think superannuation (super) or investing in shares or residential property.
- Investment money is less accessible. Lots of investment choices either lock your money away for the long term (such as super) or take months or even years to turn into a profit (such as a house).
- Historically, returns from investments have been higher. In general terms, longer-term investments like shares and property generate better returns than cash savings.

Whether you are a saver or investor is an interesting and important question because in the long run it could make a major difference to your lifestyle. To determine if you are a saver or investor let's look at the characteristics of the two categories.

What does a saver look like?

- Almost by definition the money you put in bank accounts, Cash Management Trusts or Term Deposits are short-term savings. You may use these for a short-term goal like a holiday or home deposit. It's not targeted at a long-term goal, like using superannuation to save for your retirement, for instance.
- Your savings are accessible. You can go to the bank (or your laptop) to get your money back pretty much immediately.

- The returns are low. Back in the day you could get nice returns on your cash. But low interest rates and low deposit rates have become the order of the day, and it seems interest rates are likely to stay low for an extended period.

A quick search of the latest 12-month Fixed Term deposits shows you'll struggle to get more than 1% on your money. Outside the special short-term offers, your average savings account return would be even lower, especially after you take inflation into account.

Why be a saver?

As you can see from above, there are a range of reasons we save. Sometimes it is to accumulate cash towards a bigger purchase (like a holiday). That's often a sensible alternative to credit card borrowing.

Sometimes it's for security. Financial experts suggest having a rainy-day fund equivalent to around six months of your salary. Coincidentally, that's the time it can take to find a new job. Given the current unemployment rate, there are a lot of smart savers who'll be glad they put money away for the day when the Covid-19 virus rained down on our heads.

So, what does an investor look like?

- Investing is more typically a long-term pursuit. It can last for decades – think superannuation or investing in shares or residential property.
- Invested money is less accessible. Lots of investment choices either lock your money away (such as super) or take months or years to turn into profit (such as a house). While you can almost always sell shares and managed funds instantly, the volatility of the stock market means 'parking' cash in shares could be a bad idea.
- Historically, returns have been higher. In general terms, longer-term investments like shares and property generate better returns than cash savings.
- Sometimes but not always, investment assets can be more tax effective, depending on your tax circumstances. Based on your tax circumstances as well as how your investments may be structured, your investment property can offer tax deductions and depreciation allowances. Many companies listed on the Australian Stock Exchange offer "franked dividends", which means investors/shareholders receive a tax credit than can be offset against other income and super has a whole range of tax concessions.

The good news - you're already an investor

As you can see, saving is important for security and to start you towards being an investor.

Investing – putting money into potentially higher-returning, long-term investment products - is what could eventually enable you to replace your work income with investment income.

The good news is you're already doing it. Almost all working Australians are investors thanks to compulsory super. A recent paper from the Association of Superannuation Funds of Australia (ASFA) points out that as a country we invest over $70 billion dollars in super each year, and that with balances at around $200,000 per family, superannuation is easily the average family's second biggest financial asset (after the home).

So, you're already an investor. That's good news and a great start. But remember that our retirement system is made up of three components – super, investments outside super, and the means tested age pension for those who don't have enough in super and outside super. Source: MLC Insights

5 Tips for creating your own good fortune this Lunar New Year

1 Have a financial spring-clean.

Part of the traditional preparations for Lunar New Year includes cleaning the house, making room for good fortune, and letting go of the past. It's an ideal time for a financial clean-up. Start with your budget and create a solid foundation for building wealth this year.

2 Build your wealth

The third day of the Lunar New Year is considered a good day to visit the temple of the God of Wealth and have one's future told. Instead, you could make your own luck by planning ahead for

the future and tucking some money away in a rainy day or emergency fund.

3 Think about reducing your debt

Just like an ox is known for working hard in the field, sowing the seeds of wealth often begins with paying down debt. While it may not be possible to be completely debt free this year, set yourself a goal to work towards – perhaps you can aim to pay off a personal loan or credit card debt during 2021?

4 Be super wise

An old Chinese proverb says it's wise to "dig the well before you are thirsty". This can also be applied to your super. Making additional contributions now could help you achieve the financial future you are hoping for.

5 Ask an expert

Consider making plans to see your Financial Adviser so you will be financially on track to make the Year of the Ox your best yet. Source: AMP Insights

Hyperinflation: addressing the concerns and risks in Australia

The Reserve Bank of Australia (RBA) has embarked on a significant quantitative easing program since the Covid-19 pandemic began.

However, the risks of inflation getting out of control as a result of this quantitative easing program are not as pronounced as some may think.

Setting the scene

For over a decade, central banks have embarked on quantitative easing or asset purchase programs, spurred on from the Global Financial Crisis (GFC). During this period, we have had high levels of money supply growth, which is what occurs when central bank buys different types of assets (frequently government bonds). At the same time, we have had very low inflation around the world. Here we are again, due to the Covid-19 pandemic, with a huge increase in quantitative easing from central banks worldwide.

They have created new ways to stimulate economies, through purchasing different types of assets, or extending the types of programmes they embark on. At the same time, there has been a huge increase in government stimulus payments around the world in developed markets.

So why the worry?

As a result of the Covid-19 measures and support from the RBA, there is concern that the combination of quantitative easing and government stimulus might work to create very high inflation - and potentially hyperinflation in a post Covid-19 environment.

First, I think it is a risk to consider more for the medium to longer term, rather than immediately post-pandemic. In the short term, these quantitative easing measures were necessary to deal with the severe blow served to economies worldwide. With the exception of China, developed nations are a long way off reaching their pre-Covid levels of growth. We don't expect the majority of developed countries to return to these levels, at least until the second half of the year, though it does vary from country to country (again, note China is already back to its pre-Covid levels of GPD), which means a period of spare capacity is being generated in the economy, where weak inflation will continue.

In the medium term if we continue to see that government stimulus is quite high, along with monetary support, at a time when the global economy continues to recover, this could create some higher inflation risks. However, we believe that governments will balance these risks and start to withdraw some of this stimulus as economies get stronger and restrictions on mobility and certain sectors ease. Source: AMP Capital

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