Build wealth by reducing tax burden

Noel Whittaker

Start your retirement planning now. The sooner you begin, the better off you'll be.

TODAY we will continue our series of articles focusing on ways to build wealth for retirement.

Just keep in mind that small savings in a few areas can make a huge difference to your financial position, as long as you commit them to investment and don't fritter them away.

If a person earns $60,000 a year and spends $59,000, they have just $1000 to invest. But if they can reduce their expenses by just $3000 a year, the amount they have to invest will quadruple to $4000.

It's also important to hold assets in ways that can prevent you paying unnecessary tax.

Unfortunately it's all too common to find couples making a double mistake – holding substantial funds in joint names in low-earning ordinary bank accounts. A much better option would be to boost the pre-tax returns by holding the money in a high-interest online bank account and at the same time save tax by having the account only in the name of the lowest-income earner.

If you are prepared to lose access to funds until you reach your preservation age, at least 55, moving money to the superannuation environment can create substantial tax savings.

Think about a person aged 40, earning $90,000 a year who has $50,000 in share trusts that cost them $30,000. If they leave them in their own name, and returns averaged 9 per cent a year, the portfolio should be worth $321,000 at age 65. However, they could be liable for capital gains tax of $57,000 if they cashed them in then, leaving net proceeds of $264,000.

That's not a bad outcome, but they may be better off if they bit the bullet now, cashed in the funds, paid capital gains tax of $4000 and contributed the net proceeds of $46,000 as a non-concessional contribution to super. Because earnings inside super are taxed at just 15 per cent, the funds would be worth $376,000 at age 65, and best of all, could be withdrawn tax free. That's a bonus of $112,000.

> Moving money to superannuation can create substantial tax savings.

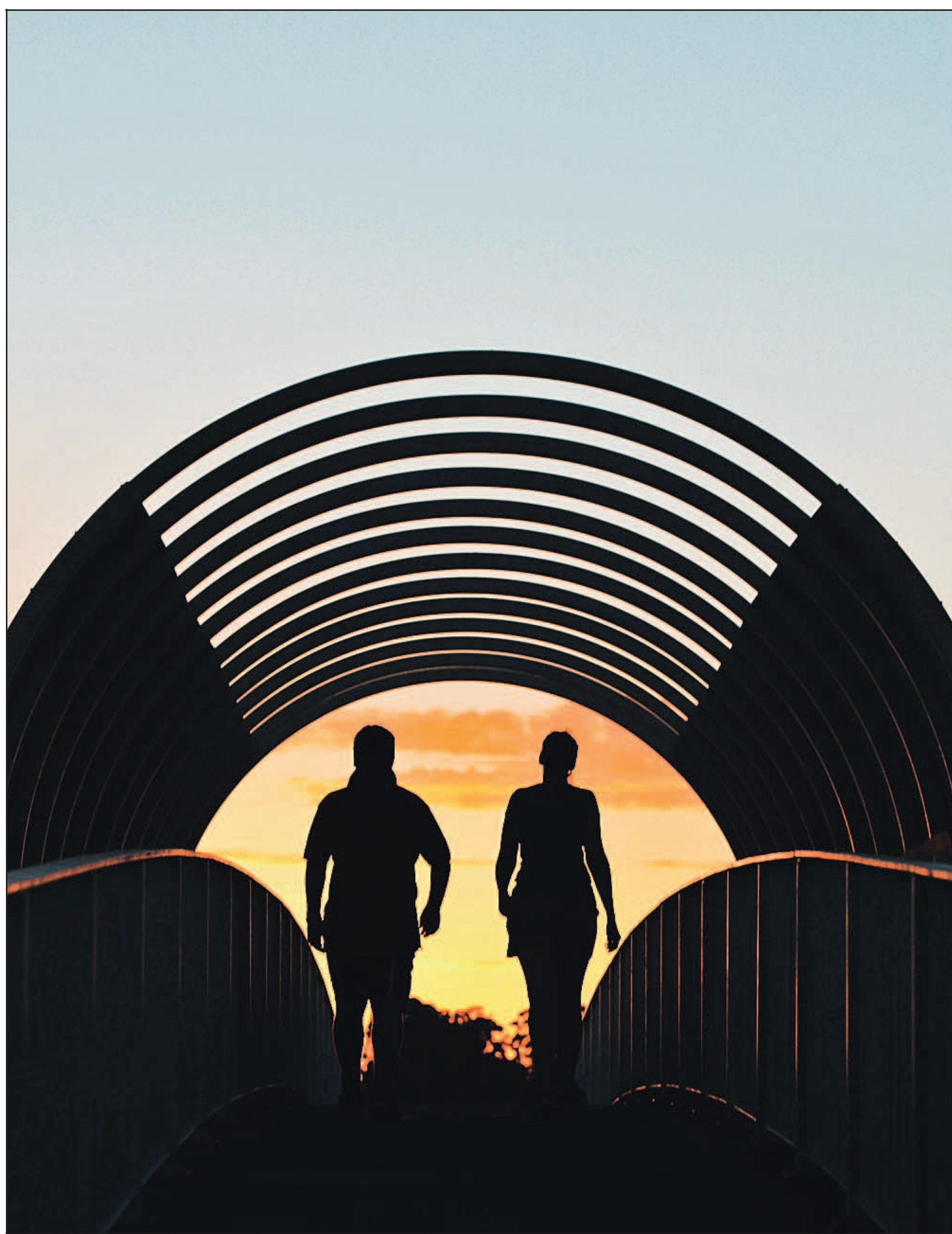
Paying insurance premiums through superannuation is also a great money saver. Think about Jack, a middle-income earner, who is aged 36 and who has figured out that he can afford $700 pre-tax a year for life insurance. For a person in his tax bracket, $700 pre-tax comes back to $410 after tax has been deducted. This would buy him $273,000 worth of cover. If he sacrificed an additional $700 a year to his super fund, he could have the fund pay the insurance premiums and have $550,000 worth of cover. A bonus is that there is no 15 per cent contributions tax on the extra $700 contributed for life insurance.

Transition to retirement pensions are still a no-brainer for anybody 55 and over, even though their effectiveness has been somewhat reduced by the reduction in the concessional amount that can be contributed to super from $100,000 a year to $50,000 a year for those aged 50 and over.

Lower-income earners are generally unaffected by the reduction in the contribution cap. A case in point is a person aged 55 who earns $55,000 a year and who has $155,000 in super. If they salary sacrificed just $18,500 a year, and then started a TTR of $13,000 a year, their super could be boosted by $63,000 at age 65. I appreciate that $63,000 is not a huge sum but it could be enough to replace the car and go for a trip when you are retired.

There is no magic about the above examples yet they all have the power to put a lot more precious dollars in your pocket. As always, the secret is to start now – your future is too valuable to be left on hold indefinitely.

Noel Whittaker is a director of Whittaker Macnaught. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. His email is noel.whittaker@whittaker macnaught.com.au.



Q I am a 17-year-old male who left school a bit over a year ago. I have an average income of $350 a week. I have managed to save $10,000 and have no debt. I was wondering what I should do with the money. Should I invest in a small block of land or in the stockmarket?

A It's almost impossible for a person under 18 to legally buy assets such as property and shares, but you should congratulate yourself on the mature attitude you have already taken to building wealth. Remember, at this stage in your life it is not the amount you invest as much as the habits you get into. I suggest that once you turn 18 you start off with a small investment in an Australian share trust. You could add to it on a monthly basis and cash it in if you need money for buying a car or going on a trip.

Q Do you have a view about buying property through a self-managed superannuation fund?

A My view is that you maximise profits when buying property by borrowing as much as your budget can afford. Therefore, my recommendation is to keep your superannuation fund for interest-bearing accounts and shares and to buy property outside the superannuation environment using borrowed funds.

Q On reaching preservation age, 55 in my case, can I withdraw a lump sum up to $150,000 tax free from my super?

A Even though you may have reached your preservation age, you cannot make withdrawals from super unless you cease a gainful employment arrangement and have signed a statement that you intend to retire permanently.

Send your questions to noel.whittaker@whittaker macnaught.com.au

Take care if rolling all your borrowings into one

By **JOHN COLLETT**

Using your home loan to consolidate your debts could be the worst thing you do.

TYPE "debt consolidation loans Australia" into Google and it returns about 36,500 hits.

Perhaps not surprisingly, given the indebtedness of many households, debt consolidation is a thriving business.

Like most of the financial services industry, those arranging the debt consolidation range from the legitimate and worthwhile, through to commission-driven salesmen who prey on debt-stressed consumers.

The policy director at the Consumer Action Law Centre in Victoria, Nicole Rich, says the centre gets a steady stream of calls from people with concerns about debt consolidation loans and debt agreements that they have entered into.

"A lot of people we see end up refinancing their debts over and over again and it might just mean they end up going bankrupt and owing even more," Rich says.

Debt consolidation is where loans – personal loans and credit card debt – are rolled into a single loan. Approaches vary, but a common debt reduction strategy, at least for those who have a mortgage, is where the higher interest-bearing personal loans and credit card debts are refinanced into the mortgage.

Mortgage interest rates are usually lower than personal loan or credit card interest rates, so the total repayments can be lower.

However, the risk for the borrower is increased as the borrower is turning unsecured debt on the personal loans and credit cards into secured debt against the family home.

If the borrower cannot meet the repayments, the lender can force the sale of the family home and has recourse to the proceeds to repay the debt.

Rich says another potential problem with these mortgage refinancing strategies is that the personal loan being refinanced may have a loan term of five or seven years. But a mortgage is usually repaid over 20, 25 or 30 years.

While the mortgage interest rates are lower than for the personal loans and credit card debt, if the personal loan is paid off over 20 or 25 years, the interest paid off the debt will be far greater.

If the credit card debt is put into the mortgage it may mean that the furniture bought on the credit card is paid off over the next 20 years, long after the furniture has been disposed of.

Rich says another potential trap is that the fees on the new loan could be very high. And even if the interest rate is lower, the home loan debt is now greater than it was originally.

If repayments are reduced with a debt consolidation scheme, the best strategy is to use the money that has been freed up to make extra repayments on the new loan and so extinguish the debt as quickly as possible.

"It is usually better to try and get on top of debt early, rather than prolong it," Rich says.

Before considering loan consolidation, consumers should first check whether they would be better off switching to lower interest mortgages and lower interest rate credit cards, or getting rid of the card altogether.

But any switch to another credit product needs to be considered carefully as many loans have penalty exit fees.

Borrowers should always approach their existing lender first, Rich says. Lenders are often willing to be flexible in working out ways to reduce the risk if one of their borrowers gets into serious trouble. Banks and credit unions are more willing to offer "hardship variations" to the loan contract than is commonly believed. SMH