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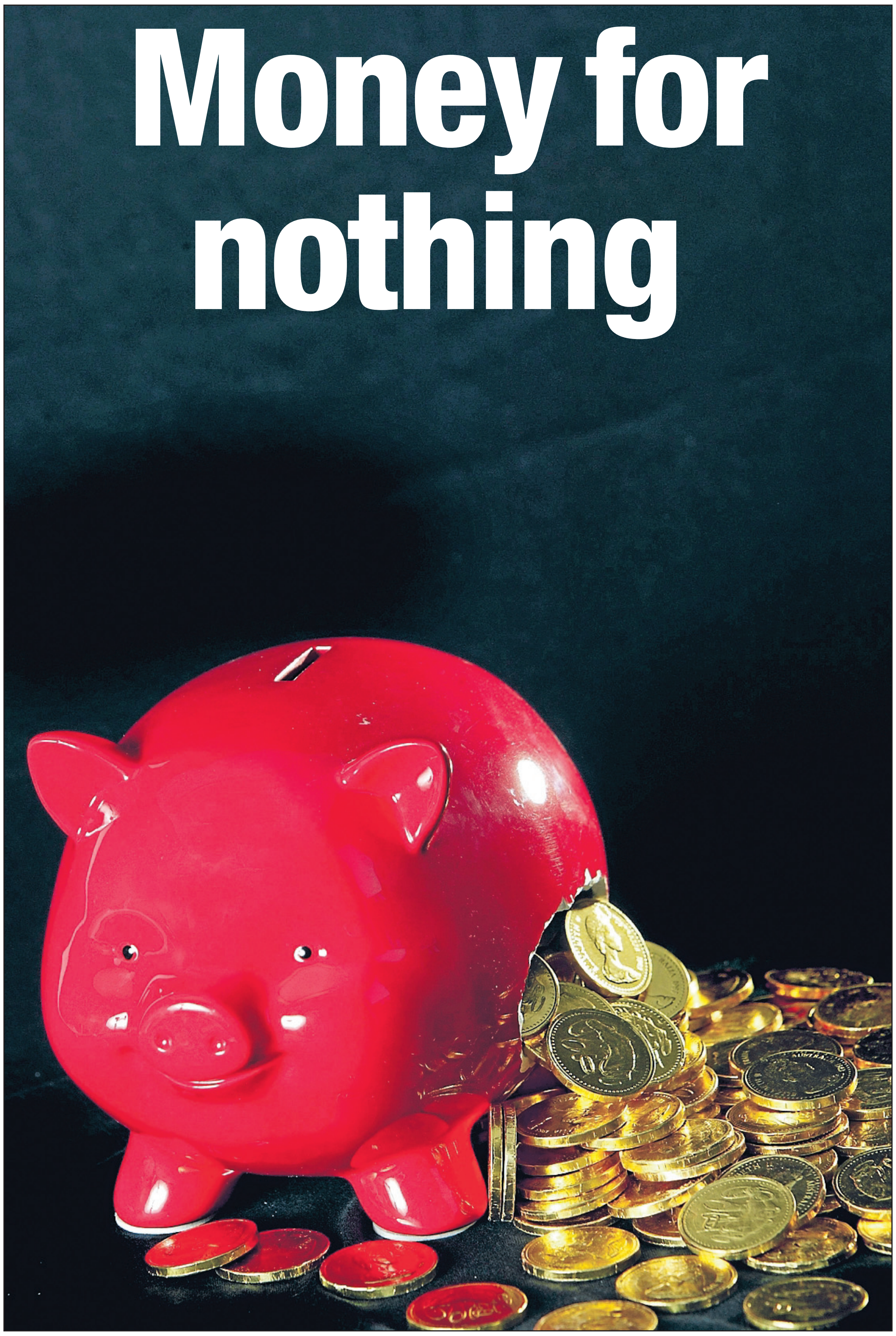
Money for nothing



A simple super strategy works, and need not break the bank.

THE May budget is just a few days away and my mailbox is full of emails from retirees who are concerned that their ability to make lump sum withdrawals from their super will be suddenly curtailed. Invariably the question is: "Should I take all my money out of super before budget night?"

There is no need to worry – Prime Minister Tony Abbott has recently pledged there will be no adverse changes to superannuation in the life of this government. The government is holding an inquiry into the tax system, and reforms to super will invariably be part of that. Yes, changes to superannuation are coming, but not yet.

Nevertheless, it's always worthwhile having a look at your financial situation to make sure you are making full use of the strategies available now. A no-brainer for anybody who has reached their preservation age is a Transition to Retirement Pension (TTR).

The strategy involves reducing your gross income by salary sacrificing a chunk of your salary into super, and then, if necessary, making up the shortfall in your net pay by starting a pension from your super fund.

Think about Jim, aged 56, who earns $130,000 a year plus employer super of $12,350 and who has $400,000 in super. He increases his concessional contributions to super to the maximum of $35,000 by making additional contributions of $22,650 a year.

When the 15 per cent contributions tax is taken into account, this will give him an extra $19,252 in his super fund. If that $22,650 had been taken in hand, he would have lost $8834 in tax and had just $13,816 available to invest. And, human nature being what it is, it may well have been frittered away.

Of course, there is a price to pay. As gross pay has been reduced by $22,650 a year due to the increased contributions, take-home pay is reduced by $13,816. Hopefully at this stage in his life the house will be paid off, school fees may be a thing of the past, and the drop in income can be absorbed by adjusting expenses.

Next, Jim starts an account-based pension of $16,000 a year from his super – it will be fully taxable as he's under 60, but he will enjoy a 15 per cent rebate. The benefit of the strategy is that he saves $1600 a year in tax immediately. When he turns 60, the pension income is tax free, and he will save about $5400 a year. If he did not need the money he could simply re-contribute it to super as a non-concessional contribution – there would be no entry tax, and it would increase the non taxable component of his super account.

The cream on the cake is that Jim's superannuation fund will become a tax-free fund once he starts at TTR. This will boost his after tax return.

In summary, after allowing for the increased net return on his super fund, and the tax savings generated by a better use of his pre-tax earnings, Jim could save about $33,400 in tax in the lead up to his retirement. This means more income working for him inside the more favourably taxed super environment – this simple strategy could put an extra $110,000 in his fund by the time he is 65. It's money for nothing!

An extra $110,000 or so more mightn't sound like a huge sum in the scheme of things, but with the growing pressure in the health care system, it could make the difference between immediate healthcare and waiting for months for treatment after he retires.

Q I bought a house from one of my sons at market value five years ago, and rented it to another son for $150 per week, as he was on a disability pension. My accountant has now advised me that I should have been paying tax at the full rental value of $380 per week. Is this correct?

A You can rent the house for whatever price you choose, but if your deductions exceed your rental income you cannot claim the loss unless you are charging market rent. Note market rent can be the current rent less, say, 9 per cent for not needing to employ a property manager or 10 per cent for a long-term reliable tenant.

Q I am 66 and was made redundant last year. I own two properties debt-free which are worth $800,000 combined – I live in one and holiday-let the other. I have very little super and live on a line of credit which cannot go on forever, so have placed the holiday house on the market. How would you suggest I invest the funds after the holiday house is sold?

A First check with your accountant to find out if there is any capital gains tax (CGT) payable on sale of the property – if so, you'll need to keep cash aside to pay it. If you can pass the work test, which involves working just 40 hours in 30 consecutive days, you may be able to reduce any CGT payable by making a tax-deductible contribution of $35,000 to superannuation from the proceeds of the sale. This is the time to be talking to a good adviser to agree on an asset mix that suits your goals and risk profile.

Noel Whittaker is the author of *Making Money Made Simple* and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making financial decisions. Email: noelwhit@gmail.com.

The difference between good and bad debt is you

By **ALEX BERLEE**

TODAY debt is a way of life, with the average household owing nearly 1.8 times its annual disposable income, and the average person about $80,000 in debt.

But debt doesn't have to be a dirty word. The right kind of debt can be helpful. It's a simple concept: good debt can create wealth and bad debt reduces it.

If you borrow to invest, and the investment earns money, debts can be paid off from the earnings. In this way, the debt is working for you. That's good debt. But if you borrow for a car, or use a credit card to buy things that lose value and don't earn money, you can be behind in two ways – you're left with something that has a lower capital value, while having to afford interest payments. This is bad debt.

If you're trying to win the battle against debt, you should consider paying out any non-deductible debt first, such as credit cards, personal loans and home mortgages. It's important to reward yourself for your hard work, but if you receive a lump sum of money, say from a tax return or a bonus at work, you'll probably be better off in the long term by using it to pay off any non-deductible debt.

Managing debt doesn't stop when you retire. One of the biggest changes to retirement in recent years are people's attitudes about taking debt into their golden years.

This is not such a problem if we're talking about good debt, but bad debt can eat into super or retirement income. In the lead-up to retirement, look at how long it's going to take to clear your debts and stick to a plan.

You might also consider going slow on the mortgage in order to

crank up salary sacrifice into super and then use some of the extra super at retirement to clear the mortgage. You're ultimately paying off the mortgage at retirement with low-tax dollars, via your super.

Retirees should think carefully before going guarantor for their children. This can seem like a great way of helping them make a start, but be aware of the risks, especially if they lose their jobs or get in over their heads.

Before attempting to build up your assets, you need to be clear about what you owe – how much, in what form and at what interest rate. Once you know this, you can work out whether your debt could be arranged more efficiently.

If you have several bank accounts and credit cards, consider consolidating them, which will help to reduce fees and charges, and make it easier to track spending.

Maybe roll any non-deductible debt into your home loan, as this will usually have the lower interest rate.

Arranging for income to be paid directly into a home loan and using a credit card for daily purchases can help make considerable savings on interest payments. Of course, this will only work if you pay off your credit card debt each month. Without a budget, there's no way of knowing how much is left at the end of the week to save, invest or go towards reducing debt.

Set up an automatic spending plan: pay your debts down first, allow an amount for larger short-term expenses such as holidays, then spend what's left (avoiding credit cards), rather than spending first and trying to reduce debt later.

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