Changes sap creep's effect

NOEL WHITTAKER

Bracket creep might not be as bad as the Federal Treasurer maintains.

TAXABLE INCOME	RATE
Zero to $18,200	0%
$18,201 to $37,000	19%
$37,001 to $80,000	34.5%
$80,001 to $180,000	39%
$180,000+	47%

The higher brackets include Medicare levy

Today's tax bands are wider and rates lower. *Picture: Virginia Star*

FEDERAL Treasurer Joe Hockey celebrated his second anniversary in government by promising to cut income tax to protect us from bracket creep. Certainly, tax cuts are welcome, but achieving them in the context of a worsening budgetary position is going to be a major challenge.

Frankly, I'm not sure bracket creep is as bad as Mr Hockey would like us to think. The term refers to extra earnings that bring a person into a higher tax bracket, which means they pay a higher rate of tax on the extra dollars earned. For example, you're earning $80,000 a year and receive a pay increase of $10,000 a year. The extra $10,000 is taxed at 39 per cent because you've crossed over the line where the 34.5 per cent tax rate ends and the 39 per cent tax rate starts. The bottom line is that you're paying an extra $450 tax on that extra $10,000 of income, which is not really a huge amount in the scheme of things.

It was a big issue 15 years ago, when the 43 per cent tax rate cut in at $38,000, and the 47 per cent rate cut in at $50,000. In those days, bracket creep was criticised as a huge disincentive, because anybody wanting to increase their income by working overtime would be losing almost half the increase in tax.

Today it is completely different as the tax bands are much wider and the rates lower until you reach the top. If a worker is earning $55,000 a year, and the best they can look forward to is increases of 4 per cent per annum, it's going to be a long time before they hit $80,000 where the 39 per cent tax rate cuts in.

Those who are in the two highest tax brackets are the least likely to be hit by bracket creep. Once you earn $80,000 you can earn another $100,000 a year before changing brackets; and for the high flyers earning more than $180,000 a year bracket creep is not relevant, because every extra dollar they earn is taxed at the top rate anyway.

The other issue here is that the numbers of actual taxpayers are relatively small. Only 1.5 per cent of adults are in the top bracket; 9.4 per cent are in the 39 per cent bracket; and 27 per cent are in the 34.5 per cent bracket. When we exclude the top bracket, we are left with only 36.4 per cent of Australians who are even potential candidates for bracket creep.

A much bigger issue is the effective marginal tax rate (EMTR), which refers to the withdrawal of benefits when income increases. A classic case is the age pension, where every $10 of extra investment income earned causes a reduction of $5 in the pension, equivalent to a marginal tax rate of 50 per cent.

If you think you are going to be a victim of bracket creep, you can protect yourself by using tax-effective strategies. The best of these is salary-sacrificed contributions to superannuation, which reduce your gross income. Another is investment vehicles with an in-built tax advantage. These include superannuation earnings within the fund, which are taxed at 15 per cent, and insurance bonds earnings within the fund, which are taxed at 30 per cent.

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 any financial decisions. Email: noelwhit@gmail.com.

Q We have a home loan of $210,000 on 5.94 per cent interest. We have recently sold our investment property and will net about $320,000 before CGT. Is it better for us to invest the whole amount in a term deposit or to put $210,000 in the loan offset account and the balance in the term deposit? It is our intention not to pay off the home loan due to the possibility of converting it to an investment property in near future.

A If you place the money in a term deposit you will be paying tax on the interest at your marginal rate, but if you place the money in an offset account you will be notionally earning after tax an amount equivalent to the rate you are paying on your mortgage. Obviously the offset account is a much better option, especially as you wish to maintain the debt on the property to maximise your tax benefits when you rent it out.

Q I am looking at using my current super balance of approximately $80,000 to buy property. Can I buy land with the intent to build a home on it within a couple of years?

A You are not allowed to intermingle your superannuation money with your own. But, of course, if you have reached your preservation age and are able to access your super then there are no restrictions on what you do with the money once you have withdrawn it.

Five tried and true ways to plan for your retirement

By **OLIVIA MARAGNA**

FINANCIALLY, many working people are not adequately preparing for a comfortable retirement, with 37 per cent of existing retirees around the world admitting they have not planned as well as they should have. So what's going wrong?

Here are five lessons from existing retirees who find themselves in the position of only wishing they had done something different.

Starting early

Almost two in five retirees admit to not saving for their retirement early enough. Starting early and making small contributions to your super fund allows your money to grow through compounding and reduces the burden of saving much larger amounts later in life in order to catch up.

Whether it is through additional investing or superannuation salary sacrificing, there are many ways that can help boost your pool of funds in retirement. Taking advantage of the government's co-contribution, spouse contribution or an employer offering you a dollar-for-dollar matching of superannuation contributions are all incentives to consider to boost your retirement.

Not being able to afford it

A quarter of retirees say they cannot afford to prepare adequately for retirement. With better budgeting and a closer eye on their finances many could have allowed for some surplus funds to be directed to extra savings or superannuation.

Retirees can be guilty of estimating their costs at a lower level than they actually are, so a simple budget check or looking at what you have actually spent over a month will tell you if you are spending more than you think you are.

Setting up some systems to add discipline to your everyday banking or automating your savings by directing funds to another bank account is a smart way to ensure you are putting away extra for retirement.

Didn't know how much to save

They say if you fail to have a plan then you plan to fail but if you don't know how much you need, how can you even have a plan, let alone have confidence that it is going to work? Three in 10 retirees say they did not know how much they needed to save for a comfortable retirement. Not knowing what you are aiming for certainly makes it difficult to get a successful outcome.

Ensure you work out how much your lifestyle is costing you and work out what your investments are earning. If there is a gap between what you earn and what you need, then get some professional advice on which direction you should be taking and how much you need to be tucking away on a monthly basis to get to your goals.

Monitoring this regularly will keep you on track and ensure you reach your goal.

Paying off a mortgage

One in 10 retirees cites paying off the mortgage as one of the biggest obstacles in preparing for a comfortable retirement. The burden of paying off debt in retirement puts a large strain on cash flow and is usually unsustainable. Ideally, all mortgages should be paid off before retirement or alternatively downsizing should be considered.

Use a simple mortgage repayment calculator to ensure you are making enough repayments now so that by the time you get to retirement, it is paid off in full.

Paying off other debts

Other debt repayments were a barrier to preparing for a comfortable retirement for 16 per cent of retirees. Paying large interest bills on credit cards or personal loans sucks up cash flow in retirement as the level of repayments can be similar to paying the equivalent of a small mortgage.

Don't fall into the trap of having a large credit card limit that you can't afford to pay off in full each month. An outstanding credit card bill will incur up to five times more interest than a regular mortgage so don't get caught out.

With the benefit of hindsight, these are valuable lessons to ensure the working generation don't fall into the same position.