Super reforms a no-brainer

NOEL WHITTAKER

The anomalies in the system can be fixed without too much pain.

SUPERANNUATION was left mostly untouched in the May Budget, but you can bet changes are afoot.

There is still a view in Treasury that superannuation is the preserve of the wealthy, and that the present tax concessions are unsustainable in the long term.

To make it worse, some institutions are taking it upon themselves to make recommendations to the government about the way superannuation should be changed.

The latest missive from Taxpayers Australia is typical. It has just released a six-point plan that would limit lifetime concessional contribution limits to $600,000, and lifetime non-concessional limits to $1.8 million. It also believes that the income of a superannuation fund in pension mode with a balance of more than $1 million at the start of a financial year should be taxed at 15 per cent with a rebate on the first $15,000.

Furthermore, it is pushing for accumulation accounts with balances of more than $2.5 million to be taxed at a flat 30 per cent.

It believes "such proposals will ensure that the very wealthy cannot park their assets so as to have a tax-free retirement income stream".

I have said repeatedly that people are losing faith in the superannuation system because of the continual changes. However, there are anomalies that could be corrected without too much pain. What follows is the Noel Whittaker plan to reform and simplify our superannuation system.

A major anomaly is the difference between accumulation mode and pension mode. Currently, a fund pays tax at 15 per cent per annum on its earnings while money is being contributed to it, but becomes a tax-free fund once it starts to pay a pension. This increases complexity because a person who is drawing a pension, and contributing as well, is required to have two separate funds. A pension fund cannot accept contributions.

It would be much simpler to eliminate the difference between accumulation mode and pension mode and have a flat tax of 15 per cent on earnings from cradle to grave. This would plug a big hole in government revenue and make the system consistent. Then, a person could open a superannuation fund when they started work and stay with that fund for the rest of their life.

It is manifestly unfair to place a limit on how much can be accumulated in a fund, or to punitively tax anybody who builds up a hefty superannuation balance, as it's effectively a penalty on those who can choose a portfolio that will maximise returns. The simpler system is to retain a cap on contributions and index it.

The cap should be the same for everybody. Many women are insufficiently superannuated because of gaps in their careers while having and raising children. When the Howard government changed the rules in 1996, its policy was a cap of $50,000 on concessional contributions without respect for age. It was Labor who chopped it in half.

I understand the thinking that wealthy people should not be allowed to accumulate money in superannuation indefinitely – it is a problem that is simply solved. Change the rules so that, once a person reaches their preservation age, they are required to draw a minimum amount from their superannuation in line with the regulations that govern pension funds now.

All those who are keen to punish "the rich" should think ahead. A person who is 25 and earns $35,000 a year would have accumulated over $4 million in superannuation at age 65 just relying solely on the employer contribution.

Don't shoot yourself in the foot over some misguided class war.

Q My wife and I receive the part age pension plus $7800 a year from a fixed-interest investment account. This interest is treated as a wage, and we receive no other income. I retired in August 2013 and paid full tax on $65,000 in holiday and long service leave. Will this tax be treated as wages or an asset by Centrelink in 2014?

A A tax refund is not income for social security purposes. However, it may be assessed as an asset depending on how it is treated. For example, if deposited into a bank account it would be asset tested and deemed. The investment income is not treated as a wage for social security, but as a financial asset and deemed. While the holiday and long service leave payment is assessable for tax, it is not assessed as income for social security, although it may be asset and income tested according to what is done with it.

Q I was born in 1947, so may not be eligible for the PBS, but could you tell me what the pension age for women would have been on September 20, 2009?

A To join the Pension Bonus Scheme, you must have qualified for the age pension before September 20, 2009. To qualify, men must have been born before September 20, 1944, and women before January 1, 1946.

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.

Now's the time to reduce debt, not lock in more

By **CATHERINE ROBSON**

PREDICTING interest rate movements is a bit of a national pastime and while this can become an obsession for some, their future course is well worth thinking about by all of us.

Most economists believe rates are unlikely to go much lower.

While some are predicting small rises starting from the fourth quarter of this year, others believe it will take until the first quarter of 2016 for the Reserve Bank to raise rates from the current 2.5 per cent a year level.

The policy of keeping interest rates low encourages greater borrowing and spending.

However, it's often beneficial to do the opposite of what the herd does.

With rates that have been low for such a long time, it's easy to become desensitised to and complacent about debt.

During the past decade there has been a move away from principal and interest lending (which requires some repayment of principal with each monthly payment) to a predominance of "interest-only" loans.

TAKE CARE: With rates that have been low for such a long time, it's easy to become desensitised to and complacent about debt.

The flexibility of these loans are attractive yet there's often a risk that principal repayments are indefinitely deferred, with borrowers forgetting that making the monthly interest payment is getting them no closer to being debt-free.

Knowing that rates can't stay low forever, one strategy is to lock in a fixed rate for a longer term, with some institutions now offering five-year fixed rates at less than 5 per cent a year.

However, paying off debt is an even better approach. While it may seem counter-intuitive, it offers many benefits, including in-built protection for when rates start to go up.

Making additional principal repayments gives you greater ability to absorb the increasing cost of interest, because you can keep your repayments the same and have a lower proportion allocated to the principal (which will naturally absorb the higher interest costs).

This strategy will also give you a greater sense of control over your finances when interest rates inevitably begin to rise.

Furthermore, cheap credit often fuels asset price expansion, and this is one of the reasons it's currently difficult to find compelling value in either the equity or property markets.

Rather than borrowing more to buy over-valued assets, a better way to create equity in your current investments is to reduce debt.

If your debt is mainly consumer debt (personal loans or credit cards), then avoiding the high cost of these types of lending products is a good idea at any time, however now is a better time than ever.

By reducing consumer debt, you'll be in a strong position to use your cashflow to buy well-priced assets as opportunities present.

Rates will not stay low forever, so take advantage now and reduce your debt, instead of acquiring more.