Rethinking pension policies

Q My ex-wife has been overpaid an amount of $30,000 in child support because of an administrative error. She won't pay it back, nor will child support even though it was their error. Am I able to claim any or all of this amount as a loss through the tax department?

A You are not able to make a claim through the Australian Taxation Office, however the overpayment will be taken into account for adjusted taxable income purposes for future child support payments.

Q Is there a formula for the best time to move into an investment property held for 15 years, with a view to minimising the capital gains tax eventually payable?

A Any capital gains tax will be apportioned on a pro rata time basis. For example, if you owned the property for 18 years and it was rented for 15 of those years, capital gains tax would be payable on 15/18 of the capital gain. The impact would be softened by the 50 per cent discount because you've had the asset for more than a year. Obviously you would need to live in it for a long time to reduce capital gain, which suggests there are more important factors such as the potential of the property, and where you would prefer to live, that should influence your decision.

Politicians are floating a raft of ideas to cope with the ageing population. One, means testing the family home, has administrative implications.

NOEL WHITTAKER

PENSIONERS have had a scary week. Senator David Leyonhjelm started the ball rolling with a major newspaper article in which he stated: "We are not entitled to an age pension merely because we have paid taxes all our life. Pensions are not for everyone; fundamentally they are welfare reserved for the poor."

He then pulled out the old chestnut about pensioners living in multimillion-dollar houses while drawing the full pension. His solution for them was to take out a reserve mortgage to "avoid the need to move".

Next, Parliamentary Secretary to the Treasurer Kelly O'Dwyer pointed out that means testing the family home would "almost certainly" need to be debated following the release of the next intergenerational report, which is due in a few days.

It has also been reported that both National Seniors Australia and Council on the Ageing Australia are prepared to put the issue on the table as long as other sections of the community pull their weight too.

Minister for Social Services Scott Morrison was quick to take to the airwaves to assure pensioners that the government had no such agenda. He promised that if means testing the family home ever became policy, the new rules would be grandfathered and would not affect existing pensioners.

Mr Morrison pointed out that the present system had anomalies. Suppose an asset-rich, cash-poor pensioner couple lived in a house they had bought many years ago in a suburb which had become fashionable. The house may well be worth $2 million today because of general property appreciation in the area, but this does not put a dollar in their pockets. In fact, their rates bill might be escalating as their property increases in value and they may be unable to live on the full pension of $33,000 a year.

If they downsized to a $700,000 property, they could release $1.3 million of cash, which would cause them to lose the pension. Now comes the Catch 22 – the income from $1.3 million invested would be less than the pension they had been getting.

Yes, as I wrote last week, the present pension system is unsustainable, with 80 per cent of people over 65 with $1 million in financial assets plus their home receiving a part pension – the challenge is finding solutions that everybody can agree to.

In most cases, a reverse mortgage is not an appropriate solution. The essence of a reverse mortgage is that the borrower makes no repayments of principal or interest. At current reverse mortgage rates of about 7 per cent, the debt would double every 10 years. This might be fine if the borrowers were in their late 80s, but could be scary indeed if they were just 65 with another 35 years of living ahead of them.

Means testing the family home has horrendous administrative problems. Last year's Audit Commission report recommended that only homes over a certain threshold – $500,000 for singles and $750,000 for couples – be included in the Centrelink assessment. The report also suggested that this be programmed to start in 15 years so that it would not affect existing pensioners.

If implemented, it would give favouritism to areas where prices were lower, and would unfavourably affect those who live in expensive cities such as Sydney, where the median house price is already $812,000.

And how would the valuation work? Would the government insist that every pensioner's house be valued on a regular basis? Who would pay for it?

This is a debate we have to have and is gaining traction. The key is to stay informed as governments at all levels continue to float ideas. Just this month, the South Australian government flagged a new tax system and introduced it with the words "nothing is off the table". Its proposals include land tax on every single property, including the family home. Watch this space.

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.

Risk profiling an important component of investing

By **THABOJAN RASIAH**

SELECTING the right investments is critical to achieving the best outcomes for your portfolio. But the most important step is to work out how much you should invest into growth investments (stocks and property) versus defensive investments (cash and bonds).

A number of standard methods are used to determine how much an investor should hold in growth versus defensive investments.

One of these is the old rule of thumb, in which your percentage allocation to bonds, or defensive investments, is equal to your age. So a 60-year-old would have 60 per cent in defensive and 40 per cent in growth investments. This method has some merit, but ignores many factors, which deems it unsuitable for most investors.

The method used by financial planners is risk profiling, which is based on an investor's risk tolerance, and can be described simply as their comfort with uncertainty.

Risk tolerance assessment is required by law and is determined by the investor answering a series of questions about investment risk. It is a very important step in the process. However, it should not be the sole determinant of portfolio construction.

Risk profiling is a very important first step in the process and provides a starting point for the investor based on their tolerance to risk. Risk tolerance tells us how an investor feels about investing, so although a portfolio built on this basis may be comfortable for the investor, it may not deliver on more important factors such as reaching goals and required cash flow. This brings us to the next stage.

The second factor that is critical in the process is understanding an investor's goals in life. This is not usually simple and requires considerable reflection and consideration of what is really important in one's life. There is also much interplay between income and expenses, which affects the outcomes.

Once someone knows what their goals are, they can calculate the return they require to achieve those goals. Then the investor has a choice. Either they invest in a portfolio that is expected to provide the required return, or they change their goals.

The third factor that needs to be considered is most relevant for those who want their portfolio to provide them with cash flow, typically retirees. So how do we secure our future cash flow without having to worry about sharemarket fluctuations? First, we need to determine what our future cash flow looks like: what we are planning to spend. We could then make an assumption that if the sharemarket falls, it could take five to 10 years to recover. One way to manage this is to hold, say, 10 years of future cash flow in defensive investments.

In an ideal world, we would all be able to invest in a portfolio that fits with our risk tolerance, has an expected return that will meet our long-term goals and can always provide us with the cash flow we need.

In reality, however, what is required is a clear understanding of what we need a portfolio to provide and then construct it with the optimal exposures to growth and defensive investments. Once we have done this, we can consider the most suitable investments to hold in our portfolio.

BALANCE: Choose between defensive and growth investments.

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