The negative point of view

NOEL WHITTAKER

It can be a tough road trying to be self-sufficient by the time you retire.

WEALTH creation is becoming a dirty joke in Australia. For months we have been subjected to attacks on the money we've accumulated in superannuation; now Labor and the Greens have upped the ante by calling for the abolition of negative gearing.

It's an attack on middle Australia. Contrary to the spin, Australians who are using negative gearing to increase their wealth are not millionaires flouting the tax system – the majority of them earn less than $80,000 a year and are only buying a single investment property.

Let's think about a typical couple who have secure jobs and earn $80,000 a year each. They are about to turn 50, have just paid their house off, and are well aware there's unlikely to be much of a pension available to them when they retire.

The options available to them are cash, property and shares. Cash is particularly unappealing, with rates at historic lows and likely to fall further.

They are terrified of shares, which they regard as a bit of a punt and are becoming increasingly wary of super, due to the barrage of calls to change the rules yet again.

The only option left for them is property.

They are not interested in non-residential property, where vacancies of a year or more are common, so their choice of asset to build a portfolio for their retirement is residential real estate.

They decide to bite the bullet and borrow $450,000 at 5 per cent, secured by a mortgage over their existing home, to buy a property for $450,000. Repayments of $3560 a month will have the property paid off in 15 years when they want to retire.

In year one, the net income from the property will be $18,000, and the interest for the first year on their loan will be $22,500. Hence they are negatively geared to the tune of $4500 and should qualify for a tax refund of around $1250 each when depreciation allowances are taken into account. The total cost to the taxpayer is just $2500 – hardly the stuff that grand tax schemes are made of.

Now fast forward to year five, when their net rents are likely to have increased to $21,000, while their loan is down to $339,000. Their interest deduction for the year is just $16,950.

Lo and behold, they are now positively geared. In fact, the surplus rents may well push them into a higher tax bracket, unless our squabbling politicians have got their act together and agreed to personal tax cuts in that time.

By the time they get to 65, the debt should be paid off and the property could be worth $670,000, assuming capital growth of 4 per cent per annum; producing rents of $24,000 per annum assuming annual increases of 3 per cent.

Let's hope by now they're feeling better about their employer-paid superannuation, because they're going to need it. They're well outside pension eligibility, but the rents from the property probably won't be enough for them to live on, particularly with increasing maintenance costs as the property ages.

Once they exhaust their super they'll be forced to sell the house to provide enough funds to live on. This will certainly generate a hefty capital gains tax bill.

Let me stress that this is not the kind of strategy I recommend – I much prefer the flexibility and growth potential of a diversified share portfolio. However, the couple in question are typical of many Australians in their tax bracket.

Instead of being attacked, they should be commended for trying to be self-sufficient, and for the substantial contribution to taxes they will make in the future.

Investing in property for retirement can be a good option for some.

Q My wife and I are thinking of buying a second property, however, I am the main money earner (95 per cent) and pay quite a bit of tax. We want to reduce my tax but I cannot get the property loan solely on my own. Can we get the loan in both our names and keep the title in my name only to get the maximum tax benefit?

A Keep in mind that buying an investment property is usually a long-term process and you could be in very different tax brackets if you sell it in 20 years' time. However, I do agree that it is better to take a tax break sooner rather than later so talk to your accountant and your bank about the possibility of buying the house in your name with the loan in your name but with additional security over the additional house and also a guarantee from your wife. This should keep everybody happy.

Q I am 63 and retiring soon. I have $540,000 in a Wrap account and $190,000 in another superannuation fund. All the advisers I talk to recommend I start an allocated pension, however I would like to know the implications of taking it all out and placing it in a term deposit.

A Your decision should be based on minimising tax. As you are over 60 you can withdraw the money tax free, but you will then have moved $730,000 out of the low-tax superannuation area and will then have to pay tax on its earnings at normal personal rates. Obviously how much this tax will be depends on what other income-producing assets you have. If you hold the money in an allocated pension fund, and draw an allocated pension, the whole $730,000 will be in a tax-free environment and you will be drawing a tax-free income from it. Your accountant or adviser will be able to do the sums for you.

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 decisions. Email noelwhit@gmail.com.

The end of financial year is no time to celebrate

By **DAVID POTTS**

MY invitations to end-of-financial year parties seem to have gone astray, so unless I've offended somebody this must be because there's not much to celebrate.

Apart from the $20,000 instant write-off on goodies for small business, this year's June 30 will be a drab affair.

Even then, don't think having an ABN number will pass muster for a new tax-deductible lounge suite in the home, err, office. You have to prove you're running a business, for starters, and the deductible item has to be up and running, if not down and sitting, by June 30.

Nor is it a $20,000 refund, either. On the 37 per cent marginal tax rate, for instance, the net cash outflow would be $12,600. And rustle up all the receipts you like for work expenses – hint: claim under $300 in total and you won't need them – but super is the best EOFY sale.

The attention-seeker as usual is salary sacrificing – putting some of your pay into super so it's taxed at 15 per cent instead of your normal marginal rate. Unless you were already doing this, it's probably too late for this financial year. And it can't be more than $30,000 if you're on this side of 50 on June 30, or $35,000 on the other side, including the 9.5 per cent contribution your boss makes.

Although the dependent spouse offset was ditched in the budget – "it is recommended that you do not claim this offset" says the Tax Office's website – there's another spouse offset. This one's for super contributions. It flies so low under the radar that not even the Treasury's tax discussion paper picked it up. Mind you, the entire document has been booted off its website, so that shows you what Treasury thinks of its relevance.

Anyway, every dollar you contribute to the super of a spouse earning below $10,800 will give you an 18 per cent rebate which tapers out at $13,800. The maximum is $540 on a $3000 contribution but it can't be salary sacrificed. That would be too generous, I'm afraid. Still, in this low-interest environment, where else are you going to get a guaranteed 18 per cent up front? Wait, I can think of something even better, which I'm coming to.

But mum's the word. We don't want Treasury getting any ideas on this one either. It's another variation on the theme and far better even than salary sacrificing.

The deal is you put $1000 (though not salary sacrificed) into the super fund of your partner, who must have at least a part-time job and be earning below $34,488, and the government will put in another $500. That's an even better 50 per cent guaranteed return for one year.

Compare that with a term deposit's 3 per cent if you're lucky.

Which reminds me, if against my better judgment you're planning to make or roll over a one-year term deposit, set the maturity date to July 1 next year. That'll put the tax, not that it'll be much, back a year.

For managed funds, it's the opposite problem. If you're thinking of investing in one, wait until July 1, otherwise you might be picking up somebody else's unwanted capital gain. Worse, you might not even know about it, if unlike some, you don't wait to the last minute to file your return. That's another thing. Find a tax agent and you might be able to put the whole exercise off for up to six months.

Since you're going through the figures, you may as well review your shareholdings, especially if you've made a capital gain. Turfing out a dud miner will produce a loss that you can offset against it.

Even if you don't have any realised capital gains, maybe you need to find one, though put it off to July 1.

Known as rebalancing, the idea is to maintain the original percentage that a stock had in your portfolio. Why would you want to do that? Because it forces you to think whether you had the right mix and if not, because there have been new developments, what you should do.

Consider it a financial nip and tuck. So when a stock gets out of whack relative to the rest of your portfolio because its price has soared, you'd sell a few shares and reinvest the proceeds into one that's fallen – so long as you still think it's a worthwhile investment – or some other bargain.

The upshot is, you're reviewing your share investments and taking some profits – or losses on a dud – without having to form a view about the coming financial year.