

Get debt smart and shrink your tax bill

We all have to live with debt at some point in our lives, but with the right strategies you can pay off your debts faster and reduce the amount of tax you pay.

Mortgage offset

If you have a home loan and a mortgage offset account, you earn interest at the same rate as your home loan (which will generally be higher than interest on a normal bank savings account) and pay no tax on it.

Let's say your home loan is \$200,000 at 6.24% interest. In a 31-day month you'd be charged \$1,059.96 in interest. You also have \$15,000 in a normal bank savings account earning 4.5% interest per annum.

Assuming tax at a marginal rate of 30%, you would have a net income of \$40.14 from your savings. But by putting your \$15,000 in a mortgage offset account instead, you earn 'nominal' interest on your savings at the same rate as your home loan as the table below shows.

Because you don't pay tax on the offset interest, you could get almost double the amount. The offset interest isn't credited to your savings account; instead it's taken off your loan interest, so in this example you would only pay interest of \$980.46 for the month instead of \$1,059.96.

Using this strategy you could save thousands in interest payments and reduce your loan term. And your savings are still at call if you need them.

Mortgage offset example

Interest on \$15,000	Gross monthly interest	Tax payable at your marginal rate of 30%	Net income from savings
Savings account @ 4.5% per annum	\$57.33	\$17.19	\$40.14
Offset account @ 6.24% per annum	\$79.50	Nil	\$79.50

Gearing in joint names

It's common to invest a combination of borrowed funds and your own money. If you have a partner, splitting ownership of your investments could help reduce the tax you pay.

Cath and Steve

Cath pays tax at a marginal rate of 16.5%⁶, Steve at 41.5%⁶. They have \$40,000 in savings and want to borrow more money to invest.

They decide to invest the \$40,000 in a managed fund in Cath's name. Cath allows Steve to use her investment as third party security for a margin loan, so he can borrow \$60,000 to invest in other assets⁷.

Cath's investment earnings will be taxed at her marginal rate, which is much lower than Steve's. Steve holds the geared investments in his name and claims the interest payments as a tax deduction. Because Steve's marginal rate is much higher than Cath's, he gets more benefit from the tax deduction.

⁶ Includes a Medicare levy of 1.5%.

⁷ Assumes Steve and Cath's investments have a security ratio of 60%

Borrowing to build wealth

If you wait until you've paid off your home loan before you start investing, you may not give your investments enough time to grow to meet your long-term goals. By using 'gearing' (borrowing to invest), you can potentially pay off your home loan years earlier and really concentrate on growing your wealth.

Gearing allows you to invest more than you could afford using just your own money. This means you potentially get higher returns if your investment increases in value. The cost of investing (including interest) may also be tax-deductible, which means your overall tax bill is reduced. But gearing can be risky because instead of increasing, your investment could fall in value.

Time to review your debt?

It's a good idea to review your debt as your circumstances change throughout your life. Getting married or divorced; buying a house; changing jobs; inheriting money; getting ready to retire; all these life events can change your debt position. Talk to your financial adviser about strategies to create a wealthier future for you and your family.



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