

Smart tax strategies

There are a number of strategies you may benefit from if you take action before the end of this financial year. While it's still uncertain whether we've reached the bottom of the market, we're definitely at a low point so now is a good time to be considering such investments.

Making the most of your bonus

If you know you'll be getting a pay rise or bonus soon, you can arrange with your employer to salary sacrifice the extra money into your super fund. The benefits of this strategy are twofold.

Firstly, you'll be bumping up your super balance. Secondly, you reduce your tax liability. Instead of paying tax at your marginal rate, the amount you salary sacrifice becomes a taxable contribution received by the fund. The contribution (plus any income earned on the investment) is generally taxed at a maximum rate of 15%.

Once you turn 60, pension payments and income from your super fund are paid to you tax-free.

Case study: Bryan

Bryan will be receiving a bonus of \$5,000. If he takes it as part of his normal salary, it will be taxed at his marginal tax rate of 40 per cent.

If he then invests this cash for a year and receives interest at 4 per cent, this also becomes part of his taxable income for that year. This is again taxed at Bryan's marginal rate of 40 per cent.

If Bryan salary sacrifices the \$5,000 to his super fund, the fund will tax the contribution at only 15 per cent. He directs this to his super fund's cash management account where it earns 4 per cent for the year, which is also taxed at 15 per cent. The table shows Bryan's investment at the end of the year.

Even if the super fund deducts an administration fee of 5 per cent from his super investment, Bryan is still better off to the tune of about \$1,000.

Additional contributions

Personal after-tax (known as 'non-concessional') contributions aren't taxed on entry by your super fund and any earnings on investment are taxed at a maximum rate of 15%. When you access these contributions in the future they are paid to you tax-free.

There is a cap on non-concessional contributions of \$150,000 per year. Anything over this attracts tax at 46.5%. Provided you're 64 or under on 1 July in any financial year, you can take advantage of the 'averaging rule' to bring forward two years worth of non-concessional contributions – up to \$450,000 over the three-year period.

Top up your spouse's super

If your spouse's income is between \$10,800 and \$13,800 you can claim a tax rebate of up to \$540 by making contributions to your spouse's super. The maximum contribution you can claim as a tax offset reduces by \$1 for every \$1 extra that your partner earns.

Gearing – prepay interest

Pre-paying some or all of the interest due on your gearing loan for the 2009-2010 financial year in the current financial year can be of benefit if your marginal tax rate is likely to be lower next year.

	Scenario 1: Bonus taken as salary (\$)	Scenario 2: Bonus salary sacrificed to super and taxed by super fund (\$) ²
	5,000 ¹	5,000
Tax payable	2,000	750
Net amount invested	3,000	4,250
Interest on investment after 1 year	120	170
Tax on investment	48	25.50
Net investment income	72	144.50
Total net investment after 1 year	3072	4394.50 ³

Assumptions:

¹ Bonus amount is over the 40% threshold for tax.

² Bryan has a salary sacrifice agreement with his employer prior to earning or knowing his bonus amount.

³ Total amount before administration or other fees.

Time to lock in your home loan?

One of the curly choices you need to make when taking out a mortgage is whether to opt for a variable or a fixed interest rate loan.

There are advantages and disadvantages to each of these options and the choice you make will depend on which type of loan best suits your circumstances. So let's examine the pros and cons.

Variable rate: pros

- You may get a 'honeymoon' rate for the first year, which means you start with a lower repayment.
- If interest rates drop, so does your payment. This frees up money or allows you to pay more off the principal.
- It's generally easier to increase or decrease your monthly repayments if your circumstances change.
- Low or no penalty for paying off the loan early.

Variable rate: cons

- If interest rates go up, so do your payments.
- If rates go too high you may be forced to sell.

Fixed rate: pros

- The interest rate won't change for the fixed rate period even if standard interest rates do.
- The repayment amount won't change so it's easier for you to budget for repayments.

Fixed rate: cons

- If rates go down, you miss out on lower repayments.
- You may have to pay fees to switch from a variable to a fixed-rate loan.
- Fixed rate loans are generally less flexible with sometimes heavy penalties if you pay out early or refinance.

Why the fee to pay out a fixed rate loan?

Break fee, economic cost, exit fee, early repayment adjustment, prepayment fee – banks have different names for the same charge. Most lenders will allow you to pay a small amount off your loan each year without charge. But if you go over this amount or pay out the loan, you'll be charged this fee.

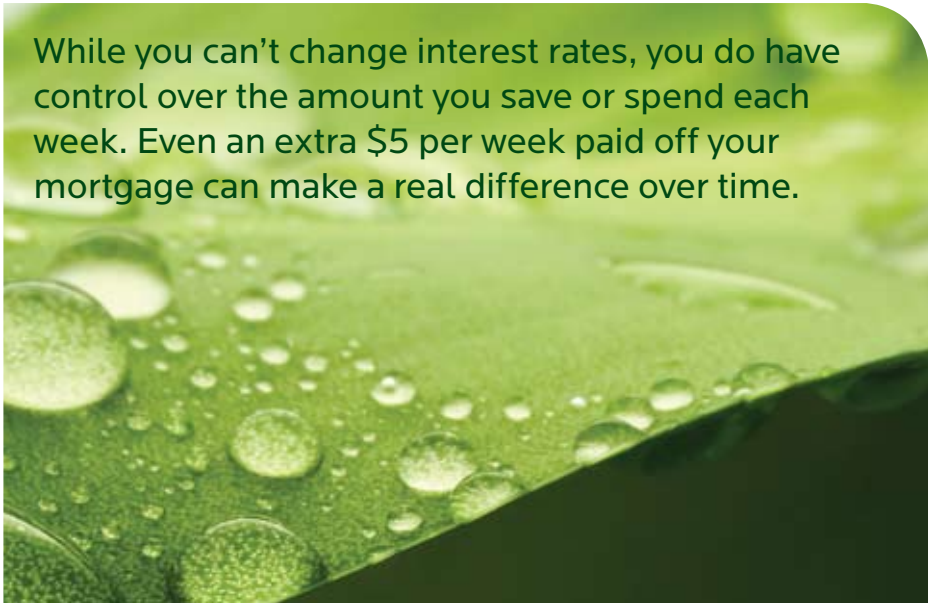
When a bank funds a fixed rate loan they borrow money from the wholesale

money markets. Their interest rate is locked in at the same time as yours; but the bank doesn't have the option to repay their loan early. So, when you repay yours they still have to pay the interest on their loan.

If the cost of borrowing money on the wholesale market has dropped between when you fixed your rate and when you pay off your loan, the bank has an 'economic cost' to carry until they can repay their loan. They pass this cost on to you as a break fee.

Best of both worlds?

While both fixed and variable-rate mortgages have their benefits, you may be able to split your loan into a fixed and a variable rate component. This allows you to take advantage of the lower variable rate and flexibility for part of your loan and maintain the security of a fixed rate for the other component.



While you can't change interest rates, you do have control over the amount you save or spend each week. Even an extra \$5 per week paid off your mortgage can make a real difference over time.