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Did You Know?

Recent figures reveal that a comfortable retirement lifestyle will cost an Australian couple around \$47,500 pa.

Source:
www.superannuation.asn.au

The editors of Timely Tips welcome feedback from readers. If you have any topics you would like to see addressed in future issues, or for that matter any other suggestions or comments, please forward your suggestions to:

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Borrowing Money for Superannuation Contributions

With all the recent activity surrounding the ability of people to make undeducted contributions of up to \$1,000,000 before 1st July 2007, we have received a number of questions regarding the borrowing of money to make large, "one-off" contributions.

Unfortunately, the answer to this question is not simple. Whether or not borrowing to make a contribution to super is appropriate will depend on the personal circumstances of the borrower.

In this article we will address a number of the key issues that should be considered before making the decision to borrow. Before doing so, let's return to the reasons behind making a significant undeducted contribution to super.

As part of its Superannuation Reforms announced in its 2006 Budget, the Government imposed a restriction on the amount of undeducted contributions a person could make to super. An undeducted contribution is a personal contribution for which a tax deduction is not being claimed. Prior to last year's Budget, there was no limit on the amount of undeducted contributions that could be made. Effective from 10th May 2006, however, a limit was imposed on undeducted contributions. The limit is currently \$1,000,000 per person and applies to undeducted contributions made during the period 10th May 2006 and 30th June 2007.

From 1st July 2007, the limit will be \$150,000 per person per year, with those people under 65 years of age being able to bring forward up to 3 years contributions. From age 65, the person making the contribution must meet an annual work test (minimum 40 hours gainful employment or self-employment worked over a period of not more than 30 consecutive days in the financial year in which the contribution is to be made).

Some of the issues to consider before deciding to borrow to make a large undeducted contribution include:

Security for borrowings

When borrowing money, a lender will inevitably require some form of security to be offered against the funds borrowed. Often existing assets such as the family home or other property and investments, such as shares or managed funds, may be offered as security. It may be possible to use shares and managed funds as the basis for a margin loan that can provide cash, which can be used for making an undeducted contribution to super.

It is important to remember that assets of a superannuation fund cannot be used as security for borrowings, so if taking a loan to make a large undeducted contribution, the borrowings cannot be secured against the superannuation entitlement.

Servicing the loan

Loans are generally arranged on one of two bases; either interest only or principal and interest.

When we borrow money, we will be required to pay the loan off at some stage. In the meantime, we will be paying interest on the outstanding borrowings. As the funds borrowed have been contributed to superannuation, the money will be invested within the superannuation environment and all investment earnings will accrue within that same environment. Depending on our personal circumstances (i.e. not yet retired), we may not be able to draw the investment earnings out of super to meet the borrowing costs.



getting you from **a** to **b**

We will need to have access to other non-super income in order to service the loan commitments.

Of course, at some stage in the future the loan will need to be repaid. If this can be timed to occur after retirement and after reaching age 60, then lump sums withdrawn from the superannuation system, under the current superannuation reforms, will be paid out tax-free.

Why borrow?

Complying superannuation funds receive concessional tax treatment. Investment earnings of a superannuation fund are generally taxed at a maximum rate of 15% and most capital gains are taxed at 10%. Compare this to holding investments in your own name where investment earnings are taxed at your marginal tax rate (up to 45% plus Medicare Levy). Capital gains are also taxed at the marginal tax but may be eligible for a 50% discount.

In certain circumstances it may be appropriate to borrow to make an undeducted contribution to super. For example, if you were planning to sell an asset in the future but the sale would not occur before 30th June 2007, and it was your intention to apply the sale proceeds to super, then it may be an appropriate strategy to borrow against the pending sale and make the contribution prior to 30th June 2007. When the sale is finalised in the future, the sale proceeds are simply used to pay out the borrowings.

In general terms, borrowing to make contributions to superannuation does carry risks and these should be carefully examined before borrowing. Once contributions are made to a superannuation fund they become preserved. That is, they can not be accessed until a "condition of release" is met. This is generally having retired on or after reaching preservation age (currently 55), or having reached the age of 65. Consider the implications if you were to borrow a large amount of money to make an undeducted contribution to super and you were to then lose your job. If you are unable to meet a condition of release you may find yourself in a dire financial position with the lender then seeking to foreclose on the assets being used as security for the borrowings.

Is the interest tax deductible?

When borrowing money to make an undeducted contribution to superannuation, the interest paid on the borrowed funds is not tax deductible to the borrower.

Important note

While borrowing to make a large undeducted contribution to superannuation may be a very effective strategy for maximising superannuation savings for some people, it does carry some risks. With this in mind, it is very important to seek appropriate financial planning and taxation advice before embarking on this strategy.

Source: Peter Kelly – Professional Investment Services

Smart Coverage



Holding life insurance cover through a superannuation fund can be effective from both a cost and cash flow perspective.

Many superannuation funds offer optional life insurance cover, often arranged at competitive premium rates. The super fund pays the premium from your fund. This means you do not need to find extra money from your "after tax" income to pay your life insurance premiums.

The smart solution is to speak with your financial adviser to determine if life insurance through super can be an appropriate part of your asset protection plan.

For example, many people have income protection insurance within their superannuation policy. This is often a cost effective means of obtaining income protection cover, however, this cover generally provides for only two years of income protection. If you require longer coverage your adviser may recommend you take out a separate policy that has a two-year waiting period and a longer pay out period, such as until age 65. The two-year wait period will reduce the cost of the premiums for this longer acting policy. Also, you can achieve even greater savings, as income protection premiums are tax deductible.

Source: Professional Investment Services

About our services:

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- Wealth Accumulation
- Superannuation/Rollovers
- Retirement Planning
- Mortgage Elimination
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