$80k a year

STORY JASON PETERSEN

Tax-effective investments that won't strain your vital cash resources should be at the top of the list

A 30-year-old earning $80,000 has similar challenges to those on other incomes: a substantial tax bill ($20,000pa), a barrage of information about where to invest and, above all else, a desire to live life on their own terms. With little in the way of surplus funds – and possibly a sizeable HELP debt – it's easy to feel financially stuck. And without a hefty deposit or high income, getting a home loan can be tough, especially with banks under pressure to lend more responsibly. This means you need to think about other ways to grow your wealth.

As a young person, superannuation is unlikely to be top of mind. Nonetheless, it's smart to take control of your super early to get it working harder for you sooner. First, with most funds charging 1%-2% in fees, make sure your choice is cost effective, with total costs of not much more than 0.5%. An extra 1% in super fees over 30 years reduces your super balance by about $160,000, or $60,000 in present value. There are a few funds (Macquarie and Netwealth, for example) that offer very low fees and also enable a key strategy to be adopted: the use of self-funding instalment warrants (SFIs).

With an assumed super balance of $30,000, you could take just 20% ($6000) and buy an instalment warrant over an exchange traded fund (ETF) invested in the top 200 stocks through the ASX. A good example is the Vanguard Australian Shares Index Fund (ASX: VAS). Add 20% of your $7600 super guarantee (SG) contributions to this instalment warrant ($1500) every year. From this small component of your current superannuation, you've added an extra $295,000 ($120,000 present value) at age 60. More importantly, you've created an income stream of about $19,000pa compared with the $8000pa you would have achieved without the ETF. Of course, the remaining 80% of your superannuation would continue to work independently of this strategy, with your balance at age 60 expected to reach $620,000 in present value. This ignores any other super strategies, such as salary sacrifice, that you can adopt in later years closer to retirement.

Why the focus on superannuation? With super largely taken care of, in a financial sense, you only have to think about the next 30 years, not the next 60.

Going outside super

On a $80,000 income, cash flow can be a problem. It's therefore important to focus on tax-effective strategies that don't place a large strain on your cash resources.

Because they also work effectively outside super, instalment warrants fit the bill. Being self-funding – aside from an initial investment – there is no further commitment from the investor. All dividends go towards paying interest on the instalment loan. Interest is tax deductible up to the protected borrowing rate of 6.7%, and the franking credits are paid directly to you. Even better, you can add as little or much as you like depending on your circumstances, as SFIs are simply traded on the ASX. In addition, the amount of gearing can be set at a level where the interest is reasonable and the dividends work to pay down the instalment loan over time.

Compared with a margin loan, a 75% SFI has a similar interest rate but there are no margin calls, 75% of your investment is protected and you don't need to find the funds to make interest payments. The example in the table (top right) shows an instalment in action over 10 years, with assumptions of 4.5% dividends, 75% franked, instalment interest of 7% and growth of 5%. The marginal tax rate for our $80,000 investor is 34.5% (including Medicare).

In both circumstances – super or non-super investments – there are fundamental considerations and opportunities:

- Tax bracket. Instalment warrants enable you to choose the most appropriate tax outcome for your situation, for example, keeping you within the lower tax bracket as required.
- Dollar-cost averaging and rebalancing. Regularly investing and ensuring your asset allocation remains consistent assists in not having to time the market, thereby avoiding the dangerous herd mentality of many investors. Putting additional funds into lower-performing assets systematically enables your portfolio to have far greater upside potential when asset performance ultimately turns in the right direction.
- Diversify using exchange traded funds. A key tenet of investing is diversification. ETFs enable you to access a significantly diversified portfolio across and within asset classes without having to pick winners or spend a lot of money on multiple trades. In the strategies above, two ideal ETFs paying good dividends and offering great diversification are the SPDR S&P Global Dividend Fund (WDIV) and the Vanguard index fund mentioned earlier.
- Managing risk. Instalment warrants offer a level of protection in that they can be set up with limited recourse loans, whereby the investor isn't at risk of losing their investment or having to pay back the funds borrowed.
- Novated leasing using the employee contribution method. Aside from buying a home, the other big-ticket item is a car. An effective way to buy is through novated leasing. This is where a portion of the costs of owning a car can be paid using pre-tax dollars. For example:

Cost of car: $19,000 (GST $1700)
Total costs: $8500
Annual finance costs: $4000
Annual running costs: $4500 (fuel, registration, insurance, maintenance)
Lease term: five years, residual of $5800 (GST of $525)

Over a five-year term, about $5000 of the costs come from pre-tax dollars, saving about $1800pa in tax. In addition, for a $19,000 car you only fund the ex-GST price of the vehicle, saving around $1700 on the upfront cost. Note that GST is paid on the final residual value – in this case around $525 in GST. Making the smart decision to continue owning the car beyond five years allows you to roll over the lease and continue until the residual is even lower while retaining the tax benefits.

Over the term, tax saved is about $9000, while the GST saved is around $1200, so a benefit of around $10,000 is gained, compared with not salary sacrificing.

Novated leases are not always plain sailing and there are a few considerations:

- First of all, your employer needs to allow this arrangement.
- Some providers set you up with additional costs that negate any tax benefit. This means it's essential to get quality advice before acting.

Instalment warrants and novated leasing are useful strategies across varying income brackets. They are, however, highly effective for those on $80,000pa. This is because neither requires large excess funds, you're not locked in and you gain tremendous opportunities while not taking on excessive risk. Long-term in nature, they do require a degree of discipline in order to enjoy all the benefits these strategies can create.

Jason Petersen is a certified financial planner and head of wealth management at 5 Financial.

How a self-funding instalment warrant works

YEAR	1	2	3	4	5	6	7	8	9	10
Ongoing investment[1]	$20,000	$20,600	$21,219	$21,855	$22,511	$23,185	$23,881	$24,597	$25,336	$26,096
Opening loan bal.	$15,000	$30,600	$46,775	$63,495	$80,721	$98,409	$116,506	$134,950	$153,669	$172,582
Opening invest bal.	$20,000	$41,784	$65,459	$91,134	$118,924	$148,947	$181,328	$216,193	$253,674	$293,908
Dividend income	$900	$1880	$2946	$4101	$5352	$6703	$8160	$9729	$11,415	$13,226
Franking credit	$203	$423	$663	$923	$1204	$1508	$1836	$2189	$2568	$2976
Loan interest	$1050	$2142	$3274	$4445	$5650	$6889	$8155	$9446	$10,757	$12,081
Net tax	-$184	-$367	-$547	-$723	-$892	-$1052	-$1201	-$1336	-$1455	-$1554
Fund growth	$1000	$2089	$3273	$4557	$5946	$7447	$9066	$10,810	$12,684	$14,695
Clos. invest balance	$21,184	$44,241	$69,279	$96,414	$125,762	$157,447	$191,595	$228,339	$267,813	$310,158
Closing loan balance	$15,150	$30,862	$47,104	$63,838	$81,020	$98,595	$116,501	$134,667	$153,010	$171,437
Net balance	**$6034**	**$13,379**	**$22,176**	**$32,575**	**$44,742**	**$58,852**	**$75,094**	**$93,671**	**$114,802**	**$138,721**

Source: 5 Financial. [1]Based on initial investment of $5000 of own funds and $15,000 borrowed. Each year new contributions are added and the amount has been adjusted for 3%pa inflation.

No self-funding instalments used

Annual investment	$5000	$5150	$5305	$5464	$5628	$5796	$5970	$6149	$6334	$6524
Opening invest bal.	$5000	$10,356	$16,086	$21,993	$28,300	$35,028	$42,200	$49,838	$57,968	$66,615
Dividend income	$225	$466	$485	$744	$1020	$1315	$1630	$1966	$2324	$2704
Franking credit	$51	$105	$109	$167	$230	$296	$367	$442	$523	$608
Net tax	$44	$92	$96	$147	$202	$260	$322	$389	$459	$534
Growth	$250	$518	$539	$826	$1134	$1462	$1811	$2184	$2582	$3005
Fund balance	$5206	$10,781	$16,529	$22,672	$29,232	$36,229	$43,689	$51,634	$60,091	$69,085
Benefit	**$829**	**$2598**	**$5647**	**$9903**	**$15,510**	**$22,622**	**$31,405**	**$42,307**	**$54,712**	**$69,636**
Present value	**$805**	**$2449**	**$5168**	**$8799**	**$13,379**	**$18,946**	**$25,535**	**$33,184**	**$41,932**	**$51,816**

Source: 5 Financial