THE SUPER OR THE HOUSE?

Whether it is a bonus or pay rise, it is nice to have a choice of where to invest. And two of our biggest and most important financial investments are the family home and super.

We consider the options of investing in either of the two…

Advantages of your mortgage

- When you sell the family home, any capital gain is tax-free, making it very tax effective.
- If you invest in a savings account, the return will be taxed at your marginal tax rate. If you invest in your super, the return is taxed at 15%. By investing in your mortgage, you are reducing your debt and in effect 'earning' a tax-free return of more than just the interest on your mortgage (because your home is tax-free).
- Peace of mind knowing you own your own home.
- Most loans allow a redraw of additional repayments, giving you easy access to your money.
- Paying off non-tax-deductible debt as quickly as possible means paying less interest overall and freeing up your short-term cash flow.
- As the value of your home rises, you have greater equity. This can be used to borrow against and invest in other assets (eg. investment property) or renovate your home.

Disadvantages

- Possible opportunity cost when super returns are stronger than property.
- Heavy exposure to the property market.
- Home loan repayments come from after-tax dollars whereas super contributions can be made from pre-tax dollars through salary sacrifice or through claiming a tax deduction. These are taxed at only 15% on the way in and 15% on investment earnings.

Advantages of super

- By making extra contributions through the Government's Co-Contributions Scheme (if you qualify and total income is below $48,516 (2013/14) you will be giving your superannuation balance an extra boost of even more than you contribute.
- Superannuation provides a tax-effective environment to help save for your retirement. The earnings on your super are taxed at a maximum of 15%.
- The self-employed can claim a tax deduction on contributions up to $25,000 a year or $35,000 for individuals aged 59 and over at 30 June 2013.
- Salary sacrificed contributions are also a very tax effective way to contribute to super. While they are also taxed 15% on the way in, may be taxed on withdrawal and earnings are taxed 15%, this is potentially more tax effective for those in higher tax brackets.
- After-tax contributions (otherwise known as non-concessional contributions) are returned to you tax-free. This includes personal contributions, spouse contributions and the Government co-contribution.

Disadvantages of super

- Switching your home loan to interest-only may not sit well with many people, and you will also have to be able to make salary sacrifice contributions. It will mean you will not be able to discharge your mortgage until retirement.
- The strategy above is best suited to growth investors as a strong long-term average earning is required (around 8%).
- Money invested in superannuation is generally not accessible until you reach at least age 60 and are retired from the workforce. You need to think about when you will need this money.

IN CONCLUSION

Whether you put your windfall or bonus into your super or mortgage comes down to five major considerations:

- How far away from retirement are you?
- Where does the money come from? Is it a pre-tax bonus which gives you the option of making a salary sacrifice contribution? If the money is from post-tax dollars, investing in your mortgage is more tax-effective
- What is your tax bracket? The higher you are the more tax effective it is to invest in super.
- How and when you intend to withdraw the money from your super. If you are going to retire after age 60, avoiding 15% withdrawal tax could tip the figures towards super.
- What you are going to invest in, within your super, and how much you expect property to rise by the time you retire. At the end of the day, this is also about returns, not just tax effectiveness.

It is a good idea to reduce your debt as soon as possible It reduces costs and frees up your cash flow. And as the family home is free from capital gains tax, it is also a tax-effective move.

If retirement is looming, the tax effectiveness of salary sacrificing, claiming a tax deduction on the contribution or getting a Government Co-contribution, will generally tip the scales towards super.

Either way, both options are far more valuable than investing in a straight savings account. Your decision should be made depending on when you need the money, when you believe you'll retire and which investment will provide the best return.