

Plugging the leaky bucket.....

By Phillip Win (Director and Senior Financial Planner, Profile Financial Services)



“there’s a hole in my bucket, dear Liza, dear Liza.....”

This popular children’s song summarises what many dentists face when it comes to their superannuation retirement savings.

There are many dentists who believe they are doing the right thing by contributing into their super fund, in the belief that it will provide an adequate retirement nest egg. The big question is, how much is actually going towards wealth creation? Obviously, there are fees to be deducted - and of course there’s the matter of what investment markets might do!

However this article focuses on one of the less obvious costs - insurance premiums. My concern is that because of these leakages, retirement savings are not going to accumulate to the projections provided by online calculators. Many Australians are going to get a rude shock when it’s too late to do anything about it.

Insurance and superannuation

Traditionally, investors have used their superannuation funds to pay for life insurance premiums. Some investors may not even know that they have life insurance in their superannuation fund! The premiums for life insurance would typically be met from the employer's compulsory Superannuation Guarantee (SG) contributions of 9% of salary, up to a salary of \$160,680 pa – giving a maximum super contribution of \$14,461 pa. A successful dentist often earns well in excess of \$160,680 pa. But because of the cap, they may still only be contributing \$14,461pa - less than 9% of their actual earnings. Of course, some dentists who are sole traders may not be contributing to superannuation at all.

The government has commissioned many reports that have advised them what we already know – 9% super is inadequate to meet our future retirement needs. The figure thrown around is more akin to 12%.

Over recent years, many dentists referred to Profile Financial Services have raised concerns that their superannuation balance was less than what they thought it should be. Yes, we have just experienced one of the largest corrections in investment markets, but there is often more to it than that. The Tax Commissioner provided a Tax Determination (TD 2007/3) on 28 March 2007 that allowed income protection insurance premiums to be tax deductible in superannuation funds up to age 65 (previously, deductions were only allowable for 2 years). This led to a barrage of marketing from insurance companies encouraging people to “get income protection insurance and not have to pay for it!” As intelligent professionals, we all know that there is no such thing as a free lunch and this is no different. We **are** paying for the premiums, just not directly out of our back pocket! While I applaud the awareness that insurance companies have drawn to the importance of income protection, I do not agree with the tactics employed.

Yes, it is important to have insurance in place and, yes, it is important to structure it in the most tax-effective and cashflow-friendly manner. But for many professionals, superannuation may not be the best structure.

Case study

For a 36 year old dentist earning \$250,000, including insurance in their superannuation could reduce their effective contribution rate to only 4.97% of salary.

Here's how we arrive at the end figure:

| | |
|---|--|
| 9% x \$160,680 (max salary on which SG is levied) : | \$14,461.20 |
| <i>less:</i> | |
| Contributions tax payable (15%): | -\$2,169.18 |
| Income protection insurance premium: | -\$2,800.00 |
| Life and TPD insurance premium : | <u>-\$1,500.00</u> |
| Net contribution: | \$7,992.02 (\$7,992.02 / \$160,680 = 4.97%) |

Of course, these calculations do not take any fees into account – which reduce the effective superannuation contribution still further!

So what should you do? It is a very important issue because you need adequate insurance arrangements in place – and you also need adequate retirement savings.

Designing the optimum strategy

Each person's circumstances are unique, and your ideal contribution rate should take into account:

- (1) your required income in retirement;
- (2) the most tax-effective structure for your insurance premiums;
- (3) your willingness to draw on capital in retirement; and
- (4) the anticipated earning rate of your superannuation fund.

Once you have determined the above, you may need to seriously consider increasing your contribution rate to meet your retirement savings objective. Don't concern yourself with what the law says you need to contribute - chances are, your retirement objectives are going to be far more ambitious than the averages that the government uses in its calculations.

In the example above, the additional contribution required to offset the insurance premiums equates to \$360 per month.

There is nothing wrong with paying for your life insurance premiums through your superannuation fund. Just be aware that your retirement savings may not accumulate as quickly as you need, due to the net amount being contributed. Remember, time is one of your biggest assets and well as one of your greatest enemies. I encourage you to critically analyse your existing arrangements to ensure you are structured correctly. A financial planner can help you do this with the benefit of access to the latest tools and rates available in the market.

About Profile Financial Services

Profile is an independently-owned boutique financial planning firm with offices in the Sydney CBD and North Parramatta. We have operated for over 20 years, and specialise in serving the wealth creation and protection needs of professionals and small business owners. Many of our clients are dentists, and we run regular education seminars on financial planning specifically for dentists. To find out about upcoming seminars, or to book an obligation-free meeting with a Profile planner, call Aine Love on 02 9683 6422 or email aine@profileservices.com.au

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