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Wealth tips for professional income earners

Foreword:

This article uses references and case studies drawn from the medical profession, but the principles and strategies presented are not exclusive to doctors. They can be similarly applied to the legal, accountancy, engineering, academic or artistic professions – in fact, any profession or vocation where income is earned by virtue of an intellectual or manual skill.

There is an aphorism within the medical profession which posits the secret to achieving financial success. During your years as a junior doctor, live like a student; as a registrar, live like an intern. When a consultant, live like a 'Reg' – and make your unspent money work for you.

Doctors earn great money. But do they? Whilst this perception might be reality for surgeons with private patients, many of our doctors remain servants of the public, diligently (over) working in our enviable health system. They are more likely to drive a Volvo than a Maserati – but there is a lot the 'average' doctor (or professional income earner) can do to seriously grow wealth.

An obvious step might be to buy the worst, affordable home in the best street and 'do it up' to create a glorious capital gains tax-free profit, and repeat the process of climbing up the property ladder every seven years. By your mid 40s, this strategy should deliver a lifestyle in an affluent suburb.

Superannuation, on the other hand, also offers great opportunities for tax-effective wealth creation – the downside being that you can't generally access it on the sunny side of 60, although that fact is also part of the allure of super – delayed satisfaction!

Although treated as belonging to an individual member, superannuation should never be seen as a personal asset, or being just like any other property. It belongs to the family unit (whatever form that may take) and having that mindset really helps. As per my mantra, when considering contributing to superannuation, it should be as much as you can, as soon as you can, for as long as you can. This principle should be considered across the 'family' unit.

The secret is to start early, so that compound interest can do much of the heavy lifting.

Staying within the 'medico' scenario, after four to six years at Uni, most doctors transition from dirt poor Youth Allowance beneficiaries (in fact, all Australian students over 22 are entitled to this Centrelink benefit, regardless of their parents' income) to earning a base annual salary of around $80,000 – plus the possibility of overtime taking those earnings nearer to $100,000 pa. They will be universally employed by training hospitals, which usually direct 17% of that annual income into superannuation. Keeping it simple, let's say this contribution amounts to $17,000 in year one, which, in wealth creation terms, is a great start.

Interns usually start in the second week of January – (which is probably a really good time to avoid hospital)!

Pro-rata tax will be deducted on earnings of around $80,000 pa, with the result that due to the sudden jump in income in the second half of the financial year (in terms of PAYG Withholding Tax) they will have been over-taxed by around $10,000.

Come August, and on lodgement of a tax return, this beautiful, enforced saving is returned by the ATO – providing an excellent opportunity for a super top up.

By contributing this unexpected $10,000 tax refund into super as a personal Concessional Contribution (CC), $27,000 can be achieved as a total gross CC, just $500 short of the maximum allowable amount (or a net $22,950 after payment of 15% tax on the way into super). For the young

doctor, contributing this net amount into their long-term savings is a brilliant start to enjoying the benefits of compounding interest.

Remaining with our junior doctor example, the carrot at the end of the stick is a consultant's salary in a public hospital, earning around $400,000 pa. The sting is that almost half of this remuneration will be paid in tax. But there are great ways for these, and all professional income earners to redirect income to enable them (and their families) to maximise government incentives to save for the future.

The first rule is to aim to get the current maximum allowable Concessional Contribution (CC) of $27,500 into superannuation each year. Be careful not to exceed this amount, as there are significant penalties and a lot of bureaucratic hassles involved in correcting this mistake after the event.

For those who don't utilise their maximum CCs every year, there is now a catch-up opportunity.

Since 2019–20, carry-forward rules allow any worker who fits the criteria below (which would include most professionals under the age 40) to make concessional contributions above the general concessional contributions cap – without having to pay extra penalty tax.

The CC carry-forward arrangements involve accessing unused concessional cap amounts from previous years. An unused cap amount occurs when the Concessional Contributions made in a financial year were less than your general Concessional Contributions cap.

To use unused cap amounts, two conditions need to be met:

- Your total super balance at the end of 30 June of the previous financial year is less than $500,000.
- You made Concessional Contributions in the financial year that exceeded your general Concessional Contributions cap.

Before taking up a consultancy position (this can apply not only to doctors, but to professionals moving from public sector employment to earning an income within the private sector) most will have established a life partnership. Depending on a partner or spouse's income, there may be ways to ensure that they also contribute personal Concessional Contributions of up to $27,500 pa to super, creating a NET tax benefit of $8,800 pa (based on a personal tax rate of 47% versus the maximum super fund tax rate of 15%).

On becoming a consultant (or GP) I recommend seeking accountancy, legal and financial planning advice to examine the viability of establishing a corporate structure to hire out your services.

Depending on tax structures and your employment conditions, part of your consulting income may be payable to a family-owned trust, which may reduce the total amount of tax paid, and spread the benefits of your labour amongst your loved ones. For example, your service company may employ your partner to manage your practice, allowing up to $27,500 per annum in Concessional Contributions to be paid to their superannuation (as per the example outlined above) – thus reducing the overall family tax burden.

If, in the future, there are children in your family working part time, you could contribute $1,000 per year to superannuation on behalf of each child (subject to meeting all of the criteria). This would mean they will be eligible to receive a co-contribution from the government of $500 per year. This free top-up is not only a great way to kick start your children's long-term savings habits, but it also provides an opportunity to educate them about compounding interest.

While most professional income earners live in Australia's capital cities, they are not without representation in our major regional and rural centres – examples include Rockhampton in Queensland and in remote Queenstown, Tasmania. The cost of housing in such centres is dramatically lower than our east coast hot spots. I know of one couple in 'Rocky' who paid $300,000 for a gorgeous little house in the 'beef' capital, just two years ago. Before too long they will own it outright, meaning it will be time to upgrade – but there is a limit to how much it is wise to invest into

a regionally situated home. Eventually, they will be over capitalised if they pursue this strategy too far – but if they plan to never sell, it doesn't really matter how eccentrically grand their home is.

The same philosophy can be applied to homes in our capital cities, but the results will take longer to achieve due to the current high cost of housing in Australia.

Before overcapitalising, there is another excellent way to get cash from a high-tax to a low-tax environment. The government currently allows additional contributions to super from after tax savings (currently up to $330,000 over three years) per person.

Bear in mind that superannuation also has a ceiling (currently $1.7 million per person) where this golden contribution opportunity runs out. It is vital, therefore, to ensure that BOTH parties are maximising their $1.7 million threshold. Nevertheless, in simple terms, and based on a conservative 5% pa return, a couple with a combined $3.4 million at retirement will have an income of $170,000 pa – tax free from the age 60!

To avoid exceeding the $1.7 million threshold, it is recommended that when that point is close to being reached, contributions (other than the mandatory Super Guarantee) are ceased.

If you have been diligent in making superannuation contributions from an early career stage, there is a good chance that many professionals will reach the cap by their mid-50s.

So, what about other strategies?

In terms of superannuation funding strategies, some will be encouraged to consider establishing a Self-Managed Superannuation Fund, but I generally do not encourage this step unless you the have the expertise and the time. I encourage experts to stick to their lane – I wound up my own SMSF in favour of a 'Public Offer' accumulation fund over a decade ago (despite being appropriately equipped by experience and qualifications to run it) on the basis that it simply required too much time.

There is also an investment structure which is ideal for helping people save money in a tax-effective manner outside the superannuation environment, known as an 'Investment Bond'. I have written on this topic previously, therefore I won't go over old territory, but for more information you can search the Eureka site or talk to your financial adviser. The benefit is that after ten years, the investment earnings are 100% tax-free.

Many Australians also love the allure of buying an investment property and using the negative gearing legislation to their tax advantage. While most property investors have recently enjoyed a massive capital gain on their property, if owned for more than a year, approximately 25% will need to be shared with the ATO – 50% if held for a shorter time. In my view, a better strategy would be to upgrade the tax-free family home and invest in super.

A further strategy as a consulting professional, might include purchasing your own premises, if this is in an area which is likely to appreciate. Using a further 'GP' example, this could include the development of 'medical precincts' as bases for pharmacies, physiotherapists, and allied health professionals – however that starts a significant shift away from core expertise and training. If you are committed, making this purchase via an SMSF is one of the few times I believe that structure is worthy of careful consideration and professional advice.

And just because you were the smartest person in the class at school, that doesn't mean you are a real-estate guru. The other issue is, do you want to deal with the hassles of tenants with a blocked toilet at 3 o'clock on a Wednesday morning? Just because you 'can', doesn't mean you should. There are opportunity costs – and mistakes can be made by the inexperienced.

It is an old story, but the key to all investment is diversification. Don't get too heavily into shares or property without diversifying across asset classes and investment management styles – in other words, look to spread the risk as insurance against the inevitable downturns.

And if, after examining all these strategies, you have excess cash, ensure you are investing in your partner's name, as well as your own, so that your family receives the benefits of the graded tax scale, if they have an income less than yours.

Remember, everyone knows that most highly qualified professionals (doctors included) are good earners and generally smart savers. However, be very cautious about being enticed into get-rich quick schemes by brokers, friends, and family. There is merit in getting rich slowly – and staying rich.

A final point – remember to establish insurance early at an early stage. Your income earning potential is your prime asset! Income Protection insurance will pay up to 70% of your salary in the case of disability and is not as 'expensive' as it seems; the cost of this insurance is tax deductible, and if you are unfortunate enough to join the patient cohort, your family and lifestyle will be secure financially.

Similarly, professional income earners are not immune from death or becoming Totally and Permanently Disabled mid-career, so ensure you have sufficient life insurance and TPD cover to support your family upon your unexpected demise – and hope they never need to claim.

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