Understanding the basics of superannuation

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Super basics

We all have different dreams for retirement. Some of us want to be adventurous grey nomads travelling the world, others want a colourful social life full of concerts and champagne, while some crave the comforts of home complete with a cup of coffee and a newspaper.

WHATEVER YOUR RETIREMENT DREAM, ONE CERTAINTY IS THAT IT WILL COST MONEY.

Developing an effective superannuation strategy is essential to making sure you have enough income to live the life you choose in retirement, and to do this, smart investors will take advantage of the tax benefits the government provides to those who invest in super.

Super funds are concessionally taxed - that is, the earnings inside the fund are only taxed at a rate of 15% - so money invested inside a super fund will be worth a lot more come retirement than if we had invested those same funds elsewhere and paid tax of (potentially) 46.5% on our investment earnings. This tax concession is what drives super. Basically, governments are giving us an incentive to invest in super and "pay for our own retirement" rather than become dependent on the public purse and scrape through on the aged pension and other welfare benefits.

A little encouragement

IN ORDER TO ENCOURAGE US TO FUND OUR RETIREMENT, THE FEDERAL GOVERNMENT HAS:

Mandated that employers contribute at least 9% of our salary into super (the 'superannuation guarantee' applies up to $183,000 pa);

Made contributions by self-employed individuals tax deductible;

Introduced the 'super co-contribution' of up to $1,000 ($500 in 2012/13);

Provided concessions for small-business owners to allow them to roll over capital gains made on the sale of their business into super;

Made taking insurances (such as 'total and permanent disability') through _ your super fund relatively attractive; and

Made taking money out of super, either by a regular pension or lump sum payment, tax free for those over 60 years old.

The lifecycle of a super fund

THERE ARE 2 BROAD PHASES THAT CHARACTERISE THE SUPERANNUATION LIFE-CYCLE

The accumulation phase the time when you (and, if you work for someone else, your employer) put money into your super; and

The pension phase the time when you withdraw money from the fund, either through a pension or lump sum payment.

These phases are not mutually exclusive and as you approach retirement, it is possible to start withdrawing money from your super while making contributions at the same time. This strategy has certain tax benefits that you can read more about in our section on Transition to retirement.

For all funds, particularly self-managed superannuation funds (SMSFS), there are two other phases: set up and wind-up.

Putting money into your super

Super contributions fall into two categories

CONCESSIONAL CONTRIBUTIONS These are contributions where the person putting the money into the fund is claiming a tax deduction (concessional). They include:

- **Contributions** made by your employer or company;
- **Contributions** made under a salary sacrifice arrangement;
- **Personal contributions** claimed as a tax deduction by a self-employed person.

The concessional contributions cap is $25,000. This is scheduled to be reviewed in time for the 2014/15 financial year. In 2011/12 and earlier years, persons over the age of 50 were able to access a higher concessional cap of $50,000, however, this policy has been discontinued.

Concessional contributions are included in the super fund's assessable income and, for most people, are taxed at 15% inside the fund. Those earning $300,000 or more will have their concessional contributions (within the cap amount) taxed at a higher rate of 30% from 1 July 2012. If an individual breaches the cap, he or she is liable for additional tax of 31.5% on the excess amount.

NON-CONCESSIONAL CONTRIBUTIONS These are contributions where the person making the contribution is not claiming a tax deduction. They include:

- **Contributions** made by you or another member of your fund; and
- **Spouse** contributions.

Non-concessional contributions are capped at six times the concessional cap, or $150,000. For individuals under 65, there is what is known as the 'bring forward option', which is a way you can increase the cap in one year by up to three times by bringing forward the next two years of contributions.

Non-concessional contributions are not included in the super fund's assessable income, which means the fund pays no tax. However, as with concessional contributions, if an individual breaches the non-concessional cap, he or she is liable for additional tax of 31.5% on the excess amount.

Non-concessional contributions don't include the super co-contribution, a contribution from a structured settlement or payout, and the capital gains tax small-business concession.

When can I withdraw my benefits?

Except in a special set of defined circumstances, such as severe financial hardship or permanent incapacity, you can't withdraw your super until you reach the 'preservation age' and satisfy a 'condition of release'.

THE PRESERVATION AGE, which is the age you must be before you can withdraw your money, is 60 years old for most people. For those born before July 1, 1960 it is 55, and there is a phased transition for those born up to June 30, 1964.

To satisfy a condition of release, you have to be retired or turn 65 years old. An exception to the condition of release requirement is the transition to retirement pension.

WHEN YOU ARE ELIGIBLE to withdraw from your fund, you can choose to take these benefits as a lump sum payment, income stream pension or annuity, or a combination of the above. Income streams are either account-based or non-account based - the key difference being that with an account based income stream, there is no limit on the annual payment that can be made. On the other hand, the non-account based option can be for life and may have a residual capital value. In other words, the money supporting an account based pension could run out before death, whereas there may be surplus funds left over with a non-account based pension following death that is available to a surviving spouse or other member.

How are super funds regulated?

Super funds are governed by the Superannuation Industry (Supervision) Act (SIS Act). As the funds hold their members' money in trust, they are administered by a 'trust deed'. This deed acts like an instruction manual for the fund and outlines the rules under which it must operate. Trustees are the individuals (or a corporation) charged with the responsibility of administering the fund. When you start an SMSF, you become the trustee and therefore take on legal responsibilities.

SUPER FUNDS MUST MEET WHAT IS KNOWN AS THE 'SOLE PURPOSE TEST', which is designed to make sure the fund is maintained for the single purpose of providing retirement benefits to its members or their dependants if the member dies prior to retirement.

The test is divided into core purposes and ancillary purposes. It can be met by satisfying one or more of the core purposes, or one or more of the core purposes and one or more of the ancillary purposes. You could face civil and criminal penalties if you fail the sole purpose test and your SMSF will be deemed 'non-complying'. A non-complying fund loses its taxation concessions and must pay tax on its investment income at 46.5% rather than the 15% tax rate paid by complying super funds.

Types of super funds

THERE ARE SEVERAL TYPES OF SUPER FUNDS

- **Corporate** funds
- **Public** sector funds
- **Industry** funds, such as Australian Super
- **Retail** funds, such as 'Colonial First State First Choice Super Trust' or 'BT Super for Life'
- **Small** APRA funds
- **Self-managed** superannuation funds (SMSF)

With the exception of SMSFS, all other funds are regulated by the Australian Prudential Regulation Authority (APRA). SMSFS are regulated by the Australian Taxation Office.

What's a self-managed super fund?

There are more than 458,000 SMSFs in Australia with combined assets of more than $400 billion. This represents almost 31% of the entire super industry's assets. However, the 867,000 individual members of SMSFs account for only 7% of the total number of Australians in super, showing that SMSFs are clearly the preferred way for those with higher super balances to manage their retirement incomes. As a result, SMSFs are very popular among professionals and small business entrepreneurs.

THERE ARE THREE CRITERIA THAT SET SMSFS APART FROM OTHER SUPER FUNDS

- **An SMSF** must have four or less members; and
- **Each member** of the SMSF must also be a trustee, or if the fund has a corporate trustee, each member must also be a director of the corporate trustee (company) ; and
- **Simplified** reporting and regulatory requirements.

As you would expect, there are also some other requirements, however these are the key elements that distinguish SMSFS from other super funds.