Superannuation

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Why Superannuation Is Important

Although talk of retirement is enough to make the eyes glaze over of those under the age of 40 (and even a few of those under age 50), it doesn't have to be dull - unless of course the thought of having a lump sum of around $1,000,000 to play with bores you to tears.

That is what someone who enters the workforce at 21 and works until they are 65 can expect to have courtesy of the compulsory superannuation system.

But the possibility of a big fat lump sum payment aside, there are compelling reasons why you should make the most of your superannuation, the least of which is that a life spent on the old age pension would be a very dull one indeed.

So what? You think. Surely you can worry about it later.

It is true that you can - but by adopting a head in the sand approach you can be missing out on one of the crucial benefits of long term savings - compound interest.

The idea is deceptively simple - it simply means earning interest on your interest. But the end effect of compound interest is startling.

Say for example, you want to have a lump sum of $500,000 at age 60. If you start saving for it when you were 30 you need to put away around $233 a week (assuming a return of 8 per cent). If you start when you are 40 you will need to save around $845 a week. If you waited until you were 50, you would need to save around $2715 a week.

It Pays To Plan Ahead

Gone are the days when you retired at 65 and keeled over a few years later. Now women can expect to live for around another 24 years after they retire, and men another 20.

The Government wants us to accumulate money in our superannuation funds and keep it there until we retire. Once we are retired it wants us to buy an income stream with our superannuation proceeds, rather than take it as a lump sum.

It knows the Australian population is aging and that it faces a social security blow out in the future if people don't start to provide for themselves in retirement.

It is prepared to offer people generous taxation concessions to achieve this goal. Equally, it is prepared to levy significant penalties for those who want to take their retirement benefit as a lump sum, and set high hurdles for those who want to access their super before they retire.

Points to Remember

- If you can afford it, 15 per cent of your income into superannuation is a good target to aim for.

- It makes sense to superannuation salary sacrifice when ever you can

- Even if you can't salary sacrifice, making undeducted contributions is still a good option

- Don't, under any circumstances, contribute money to superannuation if you think you will need it before you retire. The rules for accessing super are very strict and only allow it in the case of extreme hardship.

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If you don't work or don't earn as much as your partner, consider getting your spouse to contribute to super on your behalf.

- It is becoming increasingly hard to access superannuation contributions and ETP rollovers. Be sure that you won't need the money before you contribute it.

- Most superannuation funds now accept rollover money, meaning DA and ADFs are not as relevant.

- Allocated and complying pensions can be a good choice if you are after a tax effective income in retirement, and you may even still qualify for the pension.

- Think about making undeducted contributions to super as retirement age approaches. It will result in a tax-free income stream when you are retired.

- If you have lost track of your super and want to find out where it is, the Australian Tax Office can help you with its lost members register. Contact it on 13 1020 or http://www.ato.gov.au

Types of Superannuation Funds

There are many different types of superannuation funds and it pays to have a fair idea on what each of them are about. There are:

- Employer funds (sometimes called corporate funds)

- Industry funds

- Retail funds and

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For the really handy, there are Do It Yourself (DIY) Funds

Retail superannuation funds

These are run by fund managers in the same way that managed funds are. In fact the underlying investments of the retail superannuation fund are often exactly the same as their managed fund counterparts. Most of these funds are covered by InvestorWeb Research, which gives you detailed analysis and recommendation on these products. Use our Fund Search to find the best retail superannuation funds.

Employer or corporate funds

Employer funds are ones that are run by organisations and are only open to people who work for that organisation. The advantage of these funds is that often the company will make an extra superannuation contribution, as part of a salary package arrangement, for employees who choose the corporate fund

Industry funds

Industry funds are available for people who work in a particular industry, and are often linked to a union. Increasingly, industry funds are expanding their membership base so that people from any industry can be a member. Many choose industry funds because they have attractive fee structures, but it is also important to look at the expertise of the people who are managing the money.

Do It Yourself Funds, are officially known as Self-Managed Superannuation Funds. This is special class of super fund that can only have less than five members. The people who are trustees of the fund must, by law, also be the Members of the fund. DIY funds appeal to those who want to have substantial control over where they put their retirement savings, and the fees that they pay to save for their future.

There are two types of fund within each of these categories. They are:

- Accumulation funds and

- Defined Benefit funds.

Accumulation Funds

Most funds these days are accumulation funds. They work in the same way that managed funds do, in that they pool the money of lots of small investors and invest them in a range of asset classes from shares, to property, to fixed interest and cash or a combination of all of these. Your contributions and earnings on the contributions are credited to you and when you retire, the amount that you have accumulated is paid out to you.

Defined Benefit Funds

Defined Benefit funds, on the other hand, pay out a specific or "defined" amount of money regardless of how much you have put into the fund and how well the underlying assets of the fund have performed. The amount you are paid on retirement is generally worked out with a mathematical formula that takes into account your annual salary and the number of years you have been with the employer.

Contributing to Super

Whether you are aware of it or not, your employer will be making superannuation contributions for you at the rate of 9 per cent of your salary. This amount is set down by the Government and is called the Superannuation Guarantee amount.

That is all well and good but will it be enough?

The Australian Retirement Income Stream Association, (http://www.arisa.com.au), says a person needs to contribute 15 per cent to superannuation over their entire working life to have an indexed annual retirement income of 60 per cent of annual their salary.

While this is bad news for anyone who was hoping the 9 per cent contribution would be enough for a comfortable retirement, the good news is that you can contribute extra to your superannuation fund. And if can be done tax effectively.

It is called Salary Sacrifice.

Salary Sacrifice

Quite simply, if you forego receiving some of your salary and instead "sacrifice" it into your superannuation fund, your employer is allowed to contribute it from before tax salary.

So say you wanted to put an extra $50 a week into superannuation, and you earn $500 a week gross. If you decided to salary sacrifice that amount, instead of paying tax on your salary and then putting $50 into super, it is possible for the $50 to be deducted from your $500 gross. This would leave you with a gross income of $450 and the tax would then be calculated on the $450.

The advantage of this strategy is that you are contributing to your super fund in a way that leaves you more money in your pocket.

Although it is becoming more common, not every employer gives every employee the opportunity of salary sacrificing his or her income.

Undeducted Contributions

There are still some advantages to be had by making contributions to your superannuation fund yourself, from your after tax money.

This is called making an undeducted contribution and any undeducted contributions come back to you tax-free on retirement. This is in addition to the tax-free amount of $123,808 that everyone is entitled to. Undeducted contributions can play an important role as part of a strategy to receive a tax-free income in retirement.

Even if you don't work you can have superannuation contributions made on your behalf by your spouse. What's more, your spouse can receive a tax deduction for making these contributions.

Co-contribution

To help boost retirement savings, the Commonwealth Government is encouraging you to make personal (after-tax) contributions to superannuation.
If your assessable income plus reportable fringe benefits is less than $58,000 in the 2006/07 financial year, the Commonwealth Government will make additional contributions to your account on your behalf, up to certain limits. For every dollar of after-tax personal contributions you make to your superannuation account up to $1,000, the Commonwealth Government will match it with up to $1.50.

The maximum co-contribution applies to people who earn under $28,000 and contribute $1,000 with a pro-rated amount applying to income above this.

Assessable Income:	Personal Contribution required*	Maximum co-contribution available:
- $28,000 or less	$1,000	$1,500
- $32,000	$867	$1,300
- $36,000	$734	$1,100

- $40,000	$600	$900
- $44,000	$467	$700
- $48,000	$334	$500
- $52,000	$200	$300
- $56,000	$67	$100
- $58,000 or more	N/A	Nil

* Personal contributions must be made from after-tax salary to be eligible, i.e. salary sacrificed contributions or contributions on which a tax deduction has been claimed, are ineligible for co-contributions.

Pensions and Social Security

The government is keen for Australians to provide for their own retirement, and it has made it very attractive for them to take their superannuation pay-outs as an income stream rather than as a lump sum.

There are two main options when it comes to income streams - allocated pensions (which are called allocated annuities if they are offered by a life company) and complying pensions and annuities.

Allocated Pensions

Allocated pensions will pay you a flexible income for a set period of time.

The advantage of taking your

money as a pension rather than a lump sum is that:

You don't have to pay lump sum tax. This is levied on superannuation amounts over around $123,808

While the money stays in the pension account the earnings are tax free

When you take the money out as income you only pay tax on it at your marginal tax rate less a 15 per cent rebate. This investment product can only be purchased with superannuation money.

If you don't have much money in your superannuation fund, but like the sound of investing in an allocated pension, there is nothing to stop you contributing extra to the fund as retirement approaches.

If you make those extra contributions from after tax money there are extra tax concessions to be had. This is because any money contributed from after tax salary comes out of the superannuation fund tax-free. If you opt to buy a pension with the superannuation fund proceeds, then a proportion of the undeducted contributions is returned to you each year as a tax-free income.

The amount of income you will receive from your allocated pension in all will depend on:

- How much you have to buy the pension with in the first place

- What the underlying investments are (ie: what sectors you decide to invest in)

- How much you withdraw each year as an income.

Although the traditional

wisdom has been to invest in conservative investments once you are retired, with those aged 65 having a life expectancy of at least 15-20 years it make sense to invest some of your retirement investments into growth options.

This, of course, is also one of the down sides of allocated pensions. Because the underlying investments are growth investments the balance of your pension account will fluctuate up and down in line with market movements. This can be disconcerting for people who are tying to live off their investment proceeds.

The other downside is depending on how much money you withdraw, and how markets move, you may run out of money, quite possibly leaving you high and dry and reliant on the old age pension.

Complying Pensions

If the prospect of this frightens you there is another alternative. You can rollover your money into a complying pension instead.

One of the advantages of a complying pension is that it will pay you an income for the rest of your life (or for a set period of time, if you prefer). So if you live to be 100, you will receive an income until then.

The downside is that if you die early, you may not end up getting as much as income paid out to you while you are alive as you originally contributed.

The other problem with complying pensions is that the price of having a certain income is that the underlying investments are conservative.

This means the return won't be as high as you would get over the long time with an allocated pension that was weighted towards growth investments.

The rate that you are paid when you first take out a complying pension is the rate that is paid to you for the rest of you life. It determined by fixed interest rates at the time of taking out the pension.

If you took one out ten years ago, you would be laughing. But with fixed interest rates now hovering around the 5 per cent mark, it is not much of an income to earn for the rest of your life.

The good news is you can have the best of both words. If income certainly is important to you, you could take out both an allocated pension and a complying pension. The complying pension can cover all your fixed living costs, and the amount from the allocated pension can be the icing on the cake.

The Pension Income and Assets Test

Ordinarily, the pension assets test cuts in at $229'000 for a home owning couple and $161,000 for a single homeowner. Once your assets hit $509'500 and $330'000 respectively, no pension is received.

The incomes test meanwhile, cuts in at $228 a fortnight for couples and $128 a fortnight for singles. Income over these amounts reduces the rate of pension payable by 40 cents in the dollar (single), 20 cents in the dollar each (for couples)

One of the reasons why allocated and complying income steams are popular choices is because it is possible to receive an income from these investments and still receive the pension.

On the Incomes test front, both complying pensions and allocated pensions have special treatment. This is because social security allows what is called a non-assessable amount. This will be different for everyone as it is worked out by dividing what you paid for the pension product by your life expectancy.

Superannuation
Choice

To make the most of your super you really need to have a say about how and where it is invested. Government legislation enabling people to choose where they want their superannuation to be invested has been on the cards for years. While the

Government has been busy dragging its feet on the issue, many superannuation funds and employers have gone ahead and introduced investment choice, and in some cases fund choice, anyway.

There are a myriad of different funds and different assets classes around, and it pays to ensure you are not only with a fund that suits you, but that you are invested in an asset class that suits your time frame.

It's worth checking out what is on offer at your workplace. Some employers that offer choice pay more into the corporate fund than they do into any other superannuation funds, so it is worth checking out what is on offer.

Accessing your Superannuation

The big disadvantage of superannuation, of course, is that you can't get at it until you are retired. The age that you can access your super depends on when you were born.

If you were born:

- Before July 1960 it is age 55
- Between July 1960 and June 1961 it is 56
- Between July 1961 and June 1962 it is 57
- Between July 1962 and June 1963 it is 58
- Between July 1963 and June 1964 it is 59

- After June 1964 it is 60.

This is enough to put many people off. But it shouldn't. Superannuation savings are not something to be seen in isolation, but as part of your complete financial situation. All it means if that you have to have money saved outside the superannuation system as well.

The investment you choose for your non-superannuation money will depend on your time frame and the level of risk you are prepared to take.

In line with this thinking, in 1986 the Government introduced a system of preservation, which meant that some parts of your superannuation could not be accessed until you reached retirement age.

This included:

- Superannuation guarantee contributions made by your employer
- Contributions made under an award
- Any salary sacrificed contributions made from your before tax money.
- Most other types of contributions, often called unpreserved benefits, such as extra contributions made from after tax money (called undeducted contributions) could be accessed., usually when you changed jobs.

But in July 1999 the government made the preservation laws even tougher, extending preservation requirements to all superannuation contributions.

Any extra money contributed from 1 July 1999 can only be accessed on retirement or in the case of severe hardship - which will be covered later).

The unpreserved benefits that date from before the cut off point can still be accessed. But the earnings on them can't.

Preservation Age

So keen is the government for our superannuation benefits to be used entirely for a retirement income, it is also progressively increasing the age when you can access your superannuation money.

This so-called preservation age is being progressively lifted for those born after 1960, from 55 to 60.

It is possible to access your superannuation money under the so-called hardship provisions. To do this you need to apply to the superannuation industry regulator, The Australian Prudential Regulation Authority (APRA).

You may discover, however, that the regulator's view of hardship is in fact a lot tougher than your own view.

Eligible Termination Payments

When you change jobs, usually if you have been made redundant, you will receive an eligible termination payment (ETP).

This redundancy payment can be taken in cash or it can be rolled over and stay in the concessionally treated superannuation environment.

There are definite advantages to keeping your money in the superannuation environment, especially if you are on one of the higher marginal tax rates.

This is because as long as your money is in the super fund the investment earnings are only being taxed at 15 per cent. And capital gains are only being taxed at 10 per cent. This is significantly better than paying tax at the highest marginal tax rate. And as you are paying less tax, it means there is more money left behind to work for you.

Although there are tax advantages in rolling over your ETP, there are times when it may make sense to cash in your ETP. For example, if you think you are heading towards a Reasonable Benefits Limit problem, you may be better off not to rollover your ETP. (The RBL is the amount in a superannuation fund that the government allows to be concessionally taxed. Once the superannuation payout exceeds this limit, the excess is no longer subject to concessional rates of tax.)

It makes sense to take the cash if:

- If you have a mountain of debt hanging over your head
- If you are very young
- If you think it will be a while before you are able to find another job, it may make sense to take the ETP in cash rather than rolling it over.

Rollover Choices

You have a few different choices if you have decided to keep your ETP in the concessionally taxed superannuation environment and roll it over.

Your options are to transfer your ETP into:

- A superannuation fund,
- A retirement savings account
- An approved deposit fund (ADF)
- A deferred annuity (DA).

ADFs and DAs are a hangover from the days when many superannuation funds did not accept ETPs. With more and more superannuation funds now accepting ET payments, rollover funds would appear to have a limited life.

They are not that complex, but are merely vehicles that let you hold your ETP in the concessionally taxed superannuation environment until you reach retirement age. At this time you can take the money as a lump sum, or roll it over into a product that will provide you with an income stream. (The income stream option can be very tax effective, as we will see later.)

The underlying investments of rollover funds cover the gamut, from shares, property fixed interest or a mix of the lot.

Rollover funds have the same tax advantages as superannuation funds, but as, for the most part, the money has to leave the rollover environment at age 65 it may mean you are withdrawing your proceeds at a time when the share market is in the doldrums. This may mean your total return is negatively affected compared to if you had been able to leave the money in the rollover for a while longer.

In other types of investments, you could leave your money in a little longer to ride out the storm.

Because of this, it is an idea to review the investment mix in your rollover investments as retirement age approaches, just to ensure you won't get caught out.