Super: a tax effective way to save

We see creating and looking after your wealth as a lifelong commitment. That's why we offer regular wealth advice and guidance throughout the different stages in your life. Together, we can build the financial wealth that lets you enjoy the truly important things in your life.

From time to time people waver in their commitment to contributing to superannuation, reducing their contributions or ceasing them altogether, if the stock markets go down.

When it comes time to retire, they may regret this mistake, because superannuation still remains the most tax effective way to save.

First things first: let's not confuse investment performance with the benefits of superannuation.

Many superannuation funds in Australia are invested directly or indirectly in shares, because historically this kind of investment has provided the highest long-term returns.

However, superannuation can be invested in many different asset classes, whether it be fixed interest securities, mortgages, property trusts, or Australian or international shares, provided the fund complies with superannuation regulations.

Some people are confused by the complexity of superannuation regulations – this is understandable, as superannuation law is complex. That's why most people need professional financial advice when it comes to planning for their retirement.

The one thing to remember is this: although you will pay a tax of 15% on any superannuation contribution for which you are able to claim a tax deduction, any capital gains in your superannuation are taxed at between 10% and 15%, while investment income within super (in accumulation phase) is taxed at only 15%.

This puts it way ahead of non-superannuation investments in terms of tax effectiveness. For high income earners (those on $95,000 or more per year), the tax rate paid on superannuation investment earnings is 33.5% lower than the tax they would pay on investment income earned outside super. Even for someone on an income higher than $21,600, the tax rate for superannuation income is 16.5% lower than tax on other investment earnings.

As a further tax benefit, on retirement you can convert your superannuation into an allocated pension that is taxed at a very low rate and, depending on your circumstances, can even be tax-free.

But these aren't the only benefits of saving through your superannuation. Risk insurance, such as death cover or income protection insurance, can work out much cheaper if purchased through super. Also, the law protects your superannuation from creditors should you go bankrupt, subject to certain conditions and up to a limit of $1.29 million.

Who can contribute?

Generally, if you are under 65, you can contribute to superannuation. If you are between 65 and 75, you can contribute to super provided you work at least 40 hours in a consecutive 30-day period during the year in which you make the contribution. (You may be asked for proof of employment, such as a group certificate or invoice for your services.)

To deduct or not deduct?

There are two types of contributions made to superannuation and these are treated differently once you retire. Contributions for which a tax deduction has already been claimed (either by an employer or employee) are known as 'deductible contributions'. Deductible contributions are subject to an entry tax of 15%.

Contributions made from after-tax earnings (that is, no deduction has been claimed) are called 'undeducted contributions'. These don't attract an entry tax and can be withdrawn tax-free when you retire.

Do you have to retire?

Once you turn 75, you must convert your super into a pension or take it out as a lump sum.

Up to this age, many people choose to reduce their work commitments and enjoy other interests rather than retiring completely. Luckily, retirement is not an 'all or nothing' decision in every case. Once you turn 65, you must take your superannuation as a lump sum or pension unless you work a total of 240 hours during the previous financial year. Or, you can opt to continue working and also receive a retirement income (such as a self-funded pension) at the same time, although there will be tax implications of having two incomes.

In certain circumstances, you may be able to work and receive a retirement income even if you are aged between 60 and 65. (Note that age limits are affected by the year you were born.) For example, if you have two part-time jobs, a resignation from one job may be enough to allow you to access your superannuation, while you can continue to work part-time for your other employer.

Recent changes have also meant that from age 55 you may choose to 'transition to retirement', meaning that you may commence a non-commutable income stream from your superannuation while still working. There is no work test on this income stream, and all of the normal tax calculations apply. The only restriction on this income stream is that it cannot be commuted to a lump sum until a fresh condition of release has been achieved.

When you retire

Once you retire, the tax benefits of superannuation continue. If you convert your superannuation nest egg into an allocated pension, you do not pay lump sum tax and investment earnings are tax-free. And, provided you are drawing on investment income and capital to fund your retirement income, a portion of the regular income you draw down may be tax-free.

For those looking to maximise Centrelink allowances, a complying income stream may be a better alternative. This allows you to receive a fixed amount of retirement income from your superannuation. It's also partially exempt from the Centrelink assets tests and income earned is taxed at a lower, 'concessional' rate, so it may help you access a higher level of age or service pension and/or receive travel or health concessions.

When should you start planning for retirement?

There's only one person ultimately responsible for ensuring that you have a comfortable retirement: you! The government has made it all too clear that it expects today's and tomorrow's retirees to fund their own retirement, except in cases of financial hardship. It's never too early to start planning for your retirement, but conversely, it's never too late. You can always benefit from advice from a wealth adviser, even if you're about to retire.

So, when should you start thinking about your retirement funding? If you've read this far, no doubt you already have.

At Genesys, we want you to get the most out of life so you can take advantage of any opportunity and be prepared for any challenge – that's what wealth advice is all about.

For more information or to arrange a no-cost, no-obligation first consultation, please contact:
Chiltern Peak Pty Ltd*
(03) 9852 7500
Suite 3, 400 High Street, KEW, VIC 3101
PO Box 2548, KEW, VIC 3101
* MEMBER FIRM AND CORPORATE AUTHORISED REPRESENTATIVE OF GENESYS WEALTH ADVISERS LTD
ABN: 20 060 778 216 AUSTRALIAN FINANCIAL SERVICES LICENCE NO. 232686 PRINCIPAL MEMBER OF THE FPA
© Genesys Wealth Advisers Limited 2005