Super Guide:

When it comes to Tax, Superannuation is an Investor's Paradise

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This guide is brought to you by THE SMSF CLUB

About The SMSF Club

The SMSF Club is a membership program designed specifically for anyone who has or wants a SMSF.

"Business and investing are team sports. The average investor or small business loses financially because they do not have a team. Instead of a team, they act as individuals who are trampled by very smart teams." **Richard Branson**

With an extensive network throughout Australia, The SMSF Club integrates a tailored education program with administrative, compliance, and investment support. We help members throughout every stage of the SMSF process. This includes the establishment of a SMSF, full ongoing bookkeeping, ongoing accounting, legal and compliance support, plus investment education. We ensure our members are informed, responsible, and compliant trustees of their SMSF.

Having the right team to support you in meeting your obligations is critical to the success of running your own SMSF.

With the guidance of The SMSF Club you can be in control of your retirement savings for yourself – not by yourself.

When it comes to Tax, Superannuation is an Investor's Paradise

Superannuation Tax Explained

As Australians we all love to complain about the amount of tax we pay, and we ought to be complaining as Australia has one of the highest income tax regimes in the world. However, when it comes to superannuation, high tax is merely a myth.

The Government provides significant tax breaks within superannuation, but what are they?

If living the lifestyle you deserve in retirement, and having the flexibility to do what you want when you want is not enough incentive alone, the Government provides us with huge incentives to focus on superannuation. The Government has made superannuation the most generous taxation environment in which to invest. The closer we grow to retirement we should want more and more of our wealth in superannuation.

Superannuation Contributions tax

The main way many Australians invest money into their super is through Superannuation Guarantee (SG) contributions.

These contributions are the compulsory component of your income that your employer must pay into super on your behalf. The compulsory contribution amount is 9.25% of an employees' salary (as at July 2013) increasing to 12% over the next decade.

The government makes these contributions compulsory because they understand that if the decision to save for retirement were left to us as individuals, most of us would not have the required discipline to accumulate assets over the long term. If this 9.25% that is going into your super were paid as income, most of us would spend the money.

These SG contributions are also referred to as pre-tax contributions or concessional contributions.

Pre-tax contributions

This is where money is contributed into super in lieu of taking it as wages. This can be via employer contributions (SG Contributions as described above); salary sacrifice or self employed people making contributions for which they receive a tax deduction. A flat 15% contributions tax usually applies to these contributions for most Australian's. Concessional (pre-tax) contributions are limited to $25,000 per financial year if you are under 60 years of age. If you are 60 or older as at 1 July 2013, the concessional contribution limit is $35,000. As at 1 July 2014, if you are 50 and over you can make a concessional contribution of up to $35,000.

Example

John earns $100,000 per annum before tax. John's employer is required to make contributions to his nominated superannuation fund. This amount for the 2013/2014 financial year is 9.25% of his salary being $9,250. A 15% tax rate applies to these contributions. That is, John will pay $1387.50 in tax. Had John been paid this amount as normal income, John would pay $3,422.50 in tax (37% rate). John is $2,035 better off because of the superannuation tax paradise.

Low income superannuation contributions

On the 1st July 2012 superannuation became even more attractive as a vehicle to accumulate assets for lower income earners.

For Australians who earn up to $37,000 per annum, the Government will make an additional contribution into their super fund. The payment will be 15% of the eligible concessional contributions (including employer contributions) made up to $500. This effectively reduces the contribution tax for those eligible Australians to zero.

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Example

Sophie earns $35,000 per annum working as a receptionist. Sophie's employer is required to make contributions into her nominated superannuation fund. This amount is 9.25% of Sophie's salary being $3,237. A 15% contributions tax rate applies. That is $485 will be paid in tax. As Sophie's income is less than $37,000 she is eligible to receive the low income superannuation contribution. That is, the Government will make a contribution of 15% of the $3,237 being $485 back into Sophie's Superfund thereby rebating the entire tax paid. When we add back this government contribution the effective contributions tax rate is zero.

Whilst superannuation contributions are taxed, now with the low income superannuation contribution scheme the tax rate is either equal to or a lot lower than the marginal income tax rate for all Australian's.

After-tax contributions

This is where money is contributed into super from after-tax money. No contributions tax applies to these contributions, as income tax has already been paid on the money.

After tax contributions are known as non-concessional contributions.

Non-concessional contributions are limited to $150,000 per financial year. However, if you are under age 64 at any time during a financial year, you are able to 'bring forward' up to two future years' of contributions, which entitles you to contribute a maximum of $450,000 over a three-year period.

Tax on earnings in the accumulation phase

Tax on Income – All investment income earnt within superannuation is taxed at a flat rate of 15%.

Tax rate for any realised capital gains – Where the asset has been held for longer than 12 months any realised capital gains are taxed at 10%.

When an asset is sold within 12 months of the date of purchase, any gains will be taxed at 15%.

In most cases, these rates of tax are less than our personal rate of tax.

Example

Sue inherits $100,000 from a relative and is trying to decide whether to invest the money in her own name or in her superannuation. Sue is aged 45 and works full time earning $80,000 per year. Sue is a balanced investor, so let's assume an annual return of 8% (4% income and 4% growth).

The table below shows a total tax saving of $2,120 in the first year by investing the money into superannuation as a non-concessional contribution, assuming that Sue sells her assets just prior to the end of the first year.

	Personal Name	Superannuation
Initial investment	$100,000	$100,000
Investment income	$4,000	$4,000
Less income tax	($1,660)	($600)
Capital growth	$4,000	$4,000
Less tax	($1,660)	($600)
Investment value	$104,680	$106,800

Sue has saved $2,120 in just the first year by investing those funds in superannuation rather than her own name. Sue has made an after tax return of $6,800 by investing the inheritance in her superannuation; versus only $4,680 had she invested in her personal name. This is over a 40% greater return just because the inheritance was invested within super.

Tax on earnings in pension phase (when you are over 60 and deemed retired)

Upon reaching the age of 60 and permanently retiring, the tax rate in superannuation drops to zero. This Is for income earnt within your superfund and any capital gains realised. This means that you can wait to sell your accumulated assets in superannuation until the age of 60, and sell those assets completely tax free! Or you can earn income from you're assets held within super and pay no income tax.

Example

Sue has now reached age 60 and wants to retire. Sue has not sold any of her assets since investing the inheritance so has significant capital gains. When Sue retires she wants to draw an income stream from her investments. Sue would also like to go on a big overseas holiday, so she needs to sell down some of her super. We have assumed Sue's investment is now worth $300,000 and she has $200,000 in unrealised capital gains.

The table below shows that Sue will save a massive $35,200 in tax by having her money invested in super and deferring the sale of her investments until retirement.

	Personal name	Superannuation
Capital gains	$200,000	$200,000
Less tax	$35,200	0%
Net proceeds	$264,800	$300,000

This is again a huge difference and highlights that superannuation can be simple and when it comes to saving tax, an investor's paradise!

Transition to retirement

Transition to retirement is a tax effective way for you to access your super before you totally retire.

The benefit of the transition to retirement rules is that you can maintain the same level of income in a tax effective way, but reduce your working hours.

If you are over 55 years old and still working you can access part of your superannuation as an income. What this means is that you can draw an income stream from your superannuation while you're still working. This gives you the capacity to reduce the number of hours you work to travel, renovate your house, spend time with the grand kids, basically do whatever you desire and supplement your lost income as a result of working less by drawing the shortfall from your super.

Transition To Retirement will benefit you if you have reached the preservation age, you are still working (but thinking about retiring), and you have a superannuation balance that is of sufficient size to meet your income needs.

Not only do you work fewer hours and have the capacity to maintain your income, but you will also save tax.

Example

Samantha is aged 61 and works full time as a HR Manager earning $120,000 per year.

She enjoys her job but would like to gradually reduce her workload to three days per week. The only reason Samantha would not reduce her workload is because of the reduction in pay.

By commencing a transition to retirement, Samantha can maintain her after tax income despite the reduction in pay as a result of working fewer hours.

	Current Situation	Transition to Retirement
Working days per week	5	3
Income	120,000	72,000
Income tax payable	33,050	15,450
Income after tax	86,950	56,550
Income from super	0	30,400
Tax on super withdrawal	0	0
TOTAL AFTER TAX INCOME	86,950	86,950
Total tax paid	33,050	15,450

Samantha has achieved her goals of reducing the number of days she works to three days per week and maintaining her after tax income. Samantha has also reduced her tax bill by a whopping $17,600 as a result of this strategy.

As Samantha has commenced drawing an income stream from her superannuation, any capital gains and income derived within her super fund will now be tax free.

The only negative of commencing a Transition To Retirement is that the income drawn down from her super will result in a reduction in her overall super balance which could result in less capital and income once she does retire. However, the reduction may be offset by the ongoing contributions made as a result of her part time work and by the fact all her investment earnings will now be tax free.

Why does the government provide so many tax benefits for Australians to invest within superannuation?

We would all like to think the tax incentives provided within super are a gift provided by the Government in recognition for all the hard work and personal contributions made to the growth of the economy for decades through taxes. So the least they could do is ensure we live the life we deserve in retirement without paying tax. However, in reality we all know the Government always has its own agenda.

The Government has two options when dealing with funding the lifestyle of the aging population once they reach retirement.

1. Age pension; and

2. Provide incentives for Australians to save and invest for retirement in the hope they will become financially independent.

As baby boomers fast approach retirement, the Government will either have to pay these baby boomers the age pension to fund their lifestyle in retirement – the financial consequences of which would be dire – or provide as many incentives as possible now to ensure people accumulate sufficient assets to be financially independent in retirement.

Superannuation tax summary

Contributions Tax

Concessional contributions – If you earn less than $37,000 per annum your effective contribution tax is reduced to zero with the assistance of the Governments low income superannuation contribution.

If you earn more than $37,000 you pay 15% tax on contributions.

Non concessional contributions – For non concessional contributions no tax applies as the money is invested into superannuation in after tax dollars.

Tax on income

Flat 15% tax on investment earnings during accumulation phase;

Tax free income stream in retirement (after age 60).

Capital Gains Tax

15% capital gains tax if the asset is sold within the first 12 months;

10% capital gains tax during accumulation if held for longer than 12 months (33% discount on the Capital Gain Tax Rate of 15%);

0% capital gains tax during the pension phase (retirement).

Sure when it comes to income tax, Australians have the right to complain, however when it comes to superannuation we should start thanking the Government for such an investment paradise.

Important Information

The information contained in this guide is general information only. No part of this guide is to be considered personal advice. Any information contained in this guide should not be relied upon. When it comes to superannuation and tax planning it is important to seek professional advice. All investment and tax planning decisions should be based on your individual goals, time horizon and tolerance for risk.

Becoming wealthy is for everyone.

So start now, strap in and enjoy the journey. I can attest that living wealthy, seeing the world, working less and loving more are far better than doing things tough. Real estate is merely your tool to get you there, so get started today.

NEED MORE?

Reading and education definitely is invaluable. However it could never do justice to a topic as serious as property investment, property taxes and your future wealth. It is highly recommended that you visit us at our **next free Property Investor Night** – **click here to find your nearest location.**

An Investment in knowledge pays the highest dividend"

Benjamin Franklin

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