An Introduction to Superannuation

Superannuation refers to the preparations people make in Australia to accumulate funds in a particular tax effective structure, in order to provide them with a pension or income during their retirement.

In Australia, superannuation in is encouraged and mandated by the Federal government and supported with tax benefits and enforced with heavy fines or penalties. The government has set minimum standards for contributions for employees as well as for the management of superannuation funds. Employers are required to make superannuation contributions for their employees on top of the employees' wages and salaries. The employer contribution rate has been 9.5% since 1 July 2014, and is planned to increase gradually to 12% in 2021.

Superannuation is therefore not an investment in itself. Rather, it is a highly effective trust type structure, with strict rules as to who can contribute to superannuation, how monies in superannuation can be invested and lastly; who can withdraw funds from superannuation and in what manner (pension, lump sum etc.).
Also, thanks to this mandatory or compulsory savings, we currently have in excess of $2 trillion in superannuation in Australia!

There are 3 main stages or phases to superannuation

1. **Contribution Phase**

   This is the phase where there are rules and regulations in force to mandate who can contribute into superannuation and how. There are two broad categories of contributions. Concessional contributions (also known as deductible or taxable contributions) and non-concessional contributions (also known as non-deductible or non-taxable contributions).

   Concessional contributions are usually tax-deductible to the contributor (i.e. the employer), but carry a 15% contributions tax. Non-concessional contributions are not usually tax-deductible to the contributor (i.e. the client or another entity), and do not have any contributions tax.

2. **Accumulation Phase**

   This is the stage, where the monies currently invested and new contributions are invested in the chosen fund option. The vast majority of superannuation funds invested in managed funds. If a client does not nominate a fund option, the superannuation would invest in the “default” option, which is generally a balanced managed fund.
Wrap platform based superannuation funds also offer direct shares as well as managed funds. Clients have to meet work and aged based tests in order to remain in this phase.

There is a 15% tax on earnings during this phase

3. Benefits or Pension Phase

This is the final phase of superannuation. Once a client satisfies a condition of release (they usually need to above a certain age and are no longer working), they can access funds from their superannuation.

Currently, they can withdraw the entire balance of their funds from superannuation in one go. However, once the funds are removed from superannuation, there could be tax consequences on any future earnings outside superannuation.

Hence, given the low tax environment of superannuation, most clients would prefer to roll-over the funds into a pension based superannuation fund. The difference here can best be explained by the following analogy:

Think of the superannuation structure as a “bucket”. Monies are contributed into this bucket and the monies in this bucket accumulate over time. No monies can be released by this bucket, as the bottom is sealed shut and does not leak. However the client can “roll-over” these monies into another bucket, as long as no monies are “spilled” out of the bucket (i.e. no funds are withdrawn by the client).

During the pension phase, we continue to use this bucket analogy. However, in this case, the bucket is modified. The top of the bucket is sealed – no new contributions of monies can be put into this bucket. Also the bottom of the bucket has an opening – the size of this leak or opening is controlled by the client. It can
be made larger or smaller at will – i.e. larger to take out larger amounts of money or made smaller to limit the amount of money that is withdrawn. However, the client is forced to take out a minimum amount of money each year and this is mandated by the government, on a formulae based on age.

The client is still free to invest in a wide choice of managed funds during this pension phase, although most clients would tend to be more conservatively invested in this phase. There is zero (0%) tax on any earnings during this phase and withdrawals are generally tax free up to certain limits.