Control Your Own Super Fund:

How to Maximise Your Greatest Investment Asset

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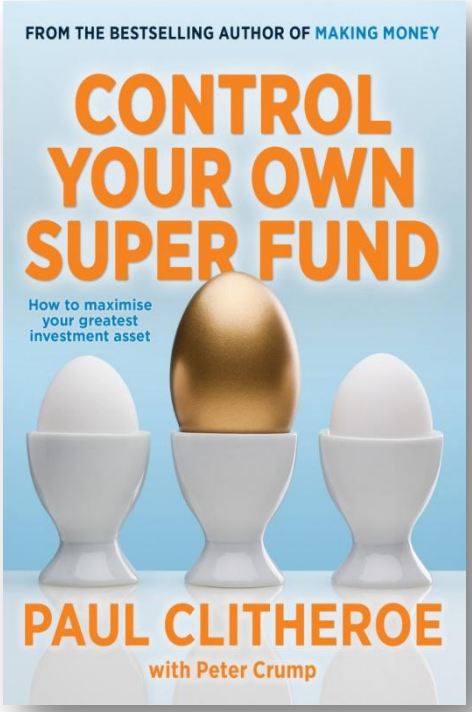

Extract

Introduction

Weighing up superannuation

The rules governing superannuation keep changing, which is a source of frustration to many. Australians in general are not as inclined as citizens of other countries to a good conspiracy theory but the fact is change rattles people's cages, and I am asked on a regular basis if future governments will keep changing the rules, tax super out of existence or just steal it. My answer to these three questions is yes, no and no.

Australia has well over one trillion dollars in super today, and it will grow to many trillions very quickly. Any government has reason to be excited about this treasure trove and its potential to be taxed, or to be directed into investments that suit the government such as infrastructure, new roads, bridges and so on. It would be naive to think that future governments will not look at this vast pot of money and want a say in it. We have seen big changes lately with the maximum tax-deductible amount most of us can contribute restricted to $25 000 a year.* (*Higher limits apply for those over age 59 in the 2013/2014 financial year and for those over age 49 in the 2014/2015 financial year.)

The introduction of this restriction is no great surprise. The reality is that the biggest benefits in super belong to the highest taxpayers. If you are paying around 47% tax on your income, the ability to pay 15% on money going into super is like a gift from the heavens. But it makes the number-crunchers in government uneasy, reasoning that you have just quite legally avoided around 32% in tax. They argue this money could go to roads and schools. You argue the government will just waste it and it is better that you put it into super so you can live without government support at retirement.

In fact, both you and the number-crunchers have a valid argument. I suspect you are both correct, and are never going to agree. But like it or not, for good reasons or bad, successive governments will play with our super for what they believe are very good social, community and policy objectives.

One change I will foreshadow, and agree with, is a limit on how much tax-free super we can access at retirement when we are over 60. The idea that we can pop money into super at a 15% tax rate, enjoy a maximum 15% tax on earnings inside super, then retire after 60, take the lot tax free, pay off our debts, buy a car, take a holiday and then put out our hand for a pension is actually quite ridiculous. The notion of legally avoiding tax while we are working may be appealing, but the objective of superannuation is to allow us to reduce our tax to build up money that we then gradually use in retirement – basically, it is our own personal pension scheme. The more money we whack into super, the bigger our personal pension – and the better lifestyle we can afford. That actually makes sense. So expect in time to come that a fair chunk of our super will be legislated to stay in super for us to draw out to live on. That saves the aged-pension system money and makes the tax break we get a fair deal.

So the bad news is that yes, we are going to see more changes to the laws governing super. Some we will agree with; some we will hate. Some we will not like because they do not suit us, but we won't be too cranky because the changes may actually be fair to our community, if not to us personally.

The good news is that no government will tax super out of existence, or steal it. Let's think about these two conspiracy theories. Neither overtaxing super nor simply pinching it is going to work in a democracy. No political party would get away with it, for a start. And even under a dictatorship, stealing super makes no sense. If a government takes our savings from us, then that government will have to support us.

For any government, super is a balancing act. It makes sense on a number of levels to have us putting some of our pay aside to pay for our future lifestyle plans. It also makes sense to make this compulsory, or most of us just won't do it. Then to add some incentive in the form of tax breaks to make us feel positive about our superannuation scheme, and to encourage us to put in a bit more, is good economic management and sound government.

History of superannuation in Australia

Super has been around for longer than most people may think, and even before it came into existence the principles that underpinned its early forms were very old. Some form of benefit to long-serving employees has been around for ages, and in Australia, records from the 19th century show that companies and the public sector often had some form of payment or pension to reward long service. The paid workforce was mainly men, and with male life expectancy well below

60 years in the 1800s I doubt this was a large cost to government or industry.

Let's take a look at a chronology of events related to super:

1908: Invalid and Old Age Pensions Act is passed, paying 26 pounds a year to eligible men and women aged over 65

1910: Women's age for pension reduced to 60

1912: Family home removed from aged pension test

1915: Employer contributions to super become tax deductible

1961: Super funds exempt from tax if they hold Commonwealth Bonds

1972: 32% of workers covered by super

1975: Age pensions linked to 25% of average weekly earnings

1977: Fraser Government rejects a compulsory super scheme

1983: Hawke Government expresses support for employee super

1984: Age pension assets test introduced

1986: Australian Labor Party and ACTU seek 3% compulsory super

1987: Super funds top $41 billion

1998: 51% of employees covered by super

1992: Compulsory super starts

1993: 72% of employees covered by super

1995: Super funds reach $187 billion

1996: Treasurer Peter Costello introduces 'super surcharge' tax

1997: 81% of employees covered by super

1998: CGT on super funds reduced to 10%

2002: Compulsory contributions move to 9%

2003: Government co-contributions for low-income earners introduced

2004: Employee 'choice of super' introduced

2005: Super surcharge abolished

2006: Simpler Super announced, no tax on lump sums

2007: The largest super funds exceed $1 billion in assets

2009: Rate of co-contributions are lowered

2009: Limit on concessional contributions reduced

2010: Cooper's 'My Super' report released

2012: Proposal to tax contributions at 30% for higher-income earners

2013: Compulsory super contribution first increase for a while, on its way from 9% to 12% (by 2019)

As you can see, superannuation has undertaken quite an evolution. But there has been no sign of tax destroying super, or of governments trying to pinch it.

Are there better ways to save?

Whether or not super is the most effective way to save for retirement is a very valid and sensible question. The disadvantage of saving through super is the plethora of rules and rule changes that are sure to come. The advantage lies purely in the tax breaks.

Compulsory superannuation contributions are now in excess of 9%. There's little point arguing over this as a method of saving, as we have no choice in the matter. It makes sense though for the 12 mil- lion or so of us who have superannuation to at least take a minimal amount of interest and make sure we are in a decent, low-cost fund and that we are not paying for things we do not need. For example, a super fund is a good place to buy insurance, but only if you need it. But is super the place to put your voluntary savings?

The answer here depends a lot upon your age, your tax rate and your attitude to risk. As I write this, I am 58, I pay maximum tax on the top part of my income and in my pre-retirement stage of life I don't really fancy taking on large debts to fund investments.

I am a lower risk-taker than I used to be – in fact I am increasingly moving towards wealth preservation. So for me, super is an attractive proposition. I can contribute voluntarily $25 000 from my salary via salary sacrifice. On this $25 000 I pay 15% tax, so I end up with $21 250 in my super fund to invest in property,

shares, fixed interest or whatever. But if I take my $25 000 in pay, I end up with around $13 250 after tax. I do not need to be Albert Einstein to realise that $21 250 invested is going to make me a lot richer than $13 250 invested. In fact, I'll need to earn some 60% after tax on the money in my pocket just to catch up to the amount in my super fund, even if it earns nothing.

The other risk factor that diminishes with age is the government messing around with the rules. In a couple of years at age 60, I could technically retire, turn my super fund into a tax-exempt vehicle on earnings and pull out lumps of money tax free whenever I like. For me, super is a no-brainer.

But for each of my three children, who are aged between 18 and 25, super is not so flash as a place for voluntary saving. Firstly, they are quite low taxpayers, so the difference between their personal tax rate and the 15% tax going into super is not terribly remarkable. Secondly, while I am not a conspiracy theorist, retirement for them is many decades away. Who knows what will happen over 40-plus years. Finally, they all like the idea of owning a house or apartment, so for them about the best deal going is the government's first home saver account – where your balance is increased by a contribution from the government, up to a limit each year if you qualify. What's more, you only pay 15% tax on the interest the account earns.

The first home saver account is beyond the scope of this book, but let me complete this line of thought. The older you are, the higher your taxable income and the more comfortable you are with lower risk due to no borrowings, the more super will appeal. You can borrow with your own super fund to buy property, which changes the risk picture a lot – we come to this in Chapter 7 – but right now, let's keep focused on the principles.

Interestingly, not only can you invest pre-tax earnings into super, and claim a tax deduction on your super if you are self-employed – you can also whack in a big lump of your own cash. The reasons for doing this follow the logic above. I think it is a terrific idea for me, but a shocker for my kids. You see, anyone can put $150 000 of their own after-tax money into super every year. You can also contribute the equivalent of three years of this in one year (with no contributions in the following two years). That's $450 000. This is fabulous for some- one in my position because my fund only pays 15% tax on investment income and 10% on capital gains on investments held over a year.

But if my kids won lotto, my advice would be not to put the winnings into super – I would see that amount as a fair chunk of a home to live in or as an investment.

Where does super 'fit' in my planning?

Well, so far we have really only looked at the two extremes of super, using my young adult kids and my own situation as examples. Clearly for me super is just a brilliant option because of my age, my level of personal tax, my conservative attitude to risk and my future lifestyle plans.

But at the other extreme, for my low-tax-paying kids, with decades to retirement and a broad plan to own a property, apart from the compulsory super (increasing to 12%), investing extra money into super is not the best thing for them at this stage in their lives.

Extremes are nice and easy – the answer tends to be an absolute yes or no. But I suspect that most readers are likely to be less certain about whether additional super is the best option, and if it is, the question is how do you run your super most effectively? Is the right answer an industry fund, a retail fund, or do you set up your own do-it-your- self super fund?

The starting point is not about super – it is about you and your plans. How much money will you need? If we can sort out where you are now and what you want to achieve in the future, your decision in regard to the whys and hows of super will become a lot clearer.