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Did you know?

The generation born between 1946 and 1960 are known as the Baby Boomers. They are followed by Generation X, being people born between 1961 and 1981.

Generation Y are generally those born between 1981 and 2000 and those born after the year 2000 are being referred to as Generation Z.

Source: www.wikipedia.org –
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Back to basics - what is Superannuation?

Even though most working Australians are members of a superannuation fund, we often get asked to explain what super is, why do we have it, and what are the rules that govern the operation of superannuation.

But first a little history – if we venture back to the 1980's, the Government at the time recognised that the baby boomer generation were in their 40's and would, 20 years later be moving into retirement. With life expectancy continually improving, there were questions being asked about the ability of the age pension system to provide income support to this generation in retirement. The need for people to supplement their retirement income needs with private savings became critically important.

With this in mind, the Superannuation Guarantee system was legislated into being in 1992. This replaced an earlier "productivity" super initiative. Contributions were initially set at 3% but this was to increase over a number of years until the contribution percentage reached 9%. This is the rate that still applies today, although many argue that it needs to be increased.

The Superannuation Guarantee scheme is now enshrined in the Australian workplace landscape and as mentioned earlier, has resulted in most working Australians, and many retirees, being members of a superannuation fund.

There are a number of different types of superannuation funds. These include:

- **Retail or public offer funds** – these are funds offered by institutions such as banks, life insurance companies, and funds management companies and are available to individual investors, be they employees or self employed people.
- **Industry funds** – originally established for employees of specific industries (such as hospitality, retail, construction etc). Trade unions were often involved in the establishment of these funds. Many of these now accept membership from people working outside their specific industry.

Employer sponsored funds – superannuation funds established by employers for their own employees.

- **Public sector funds** – employer sponsored funds specifically to cater for employees of the various States and Commonwealth public services.
- **Self Managed Super Funds** – small superannuation funds operated by the members. These are generally operated as family super funds.

With that background covered, let's move into some of the interesting aspects of superannuation.

An investment.....or something else?

Many people regard superannuation as an investment and their attitude to super is dictated by the investment performance the fund has delivered. If the performance has been good, they have a positive attitude to super, but if performance has been mediocre, then they may not regard super in a favourable light.

But superannuation is not an investment – rather it is a tax structure through which we can hold investments!



We can hold investments in a variety of different ways. For example, we may hold in our own name, a bank account or term deposit, we may own some shares, managed funds, or property. If the investments produce income – interest, dividends, distributions or rent, then we include that as part of our income when preparing our taxation return. We pay tax on that income at our personal tax rate. If we hold investments through a family trust, the distributions we receive from the trust are taxed in our personal hands. Individuals can pay tax at a rate of up to 45%, plus Medicare Levy.

Superannuation is no different – we can generally invest through our super funds into cash, fixed interest securities,



shares, managed funds, and property. Any investment earnings and capital gains arising from those investments are paid to the superannuation fund and the fund pays tax on those earnings. In many cases, a superannuation fund is taxed on a far more favourable basis than we are taxed as individuals. Superannuation funds that are in the accumulation phase (i.e. they have not yet started paying a pension or income stream to their member/s) are taxed on their earnings at a rate of 15%, whilst capital gains are taxed at a rate of 10%.

Once a super fund commences paying an income stream to a member, the investment earnings that arise from the assets used to fund the income payments, is taxed at 0%.

Why is super favourably taxed?

As an incentive to encourage people to save for their own retirement, the Government has introduced favourable tax treatment of superannuation funds that comply with all the rules set out in the Superannuation Industry (Superannuation) Act 1993.

The trade-off for this favourable tax environment is that superannuation benefits are **preserved**, meaning that they can not be accessed until the member meets a **condition of release**. Conditions of release include retiring from the workforce on or after reaching preservation age (which is currently 55), reaching age 65, on death or diagnosis of being terminally ill, or upon becoming totally and permanently disabled. In very limited circumstances, preserved benefits may be accessed in cases of extreme financial hardship and on compassionate grounds.

In the next edition of Timely Tips, we will look at the sole purpose test, who can be a member of a super fund, and how contributions are made.

Source: Peter Kelly – Professional Investment Services – March 2008

Terminal illness benefits



For some years, many life insurance policies have included what is known as a “terminal illness benefit”. In simple terms, a terminal illness benefit meant that if the life insured was diagnosed with a terminal illness, the proceeds of the life

insurance would be paid out on diagnosis rather than after death. This benefit has proved to be very important in that it allowed person who is not expected to live for long to get their affairs in order financially prior to their death. Perhaps the insurance proceeds were used to pay off the mortgage, invest to provide an income for the surviving spouse and family, pay for medical treatment, and the like.

Where the life insurance (with a terminal illness benefit) was held within superannuation, some complications could arise where the benefit was paid out by the insurer.

Firstly, as the superannuation fund owned the life insurance policy, the proceeds where paid to the super fund. Generally they were then added to the members account.

Secondly, as most superannuation benefits are preserved, in order for the benefit to be paid from the super fund to the member, a condition of release had to be satisfied. If a condition of release was not satisfied, the insurance proceeds were frozen within the super fund.

Once a condition of release has been satisfied and the benefit became payable to the member, there were often tax consequences to be dealt with.

During the course of 2007, the former Government introduced changes that resulted in superannuation benefits being paid out to a member who has been diagnosed as being terminally ill, being tax-free.

The present Government has continued reform in this important area by implementing changes to the Superannuation Industry (Supervision) Regulations. They have included a new condition of release that will allow superannuation benefits to be paid out to a person who has been diagnosed as being terminally ill.

So now, once a person has been diagnosed as being terminally ill, they can not only gain access to their superannuation benefits, but that can receive them tax free.

In order to qualify for access to these concessions, a person must not be expected to survive for more than 1 year. Medical certification is required. For a terminal illness to become payable under a life insurance policy, the life insured must meet the requirements as prescribed in their life insurance policy.

Source: Peter Kelly – Professional Investment Services – March 2008

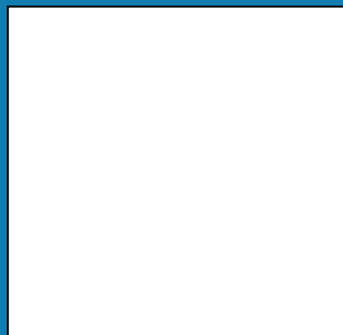
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