Booklet 1

Getting the best out of your superannuation savings

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Contents

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Introduction

For most people, superannuation is likely to be the most important investment they make in their lifetime apart from their home. It's also one of the most tax-effective ways you can save for your retirement.

This booklet is the first in a series of four booklets that Macquarie Technical Services has developed to help you understand how superannuation works and to give you some tips on how you can get the most out of your super. The focus of this booklet is on the *accumulation phase* which is the period of time when you are likely to be working and contributing to your super.

The other booklets in this series are:

- **Booklet 2: Superannuation: dealing with life's changes** which focuses on some important superannuation-related issues to consider whenever you experience changes in your circumstances, whether planned or unexpected.
- **Booklet 3: Account-based pensions: making your super go further in retirement** which focuses on using account-based pensions to provide income in retirement.
- **Booklet 4: Super and estate planning** which covers information about the treatment of superannuation death benefits and how you can use your super as an estate planning tool.

This series of booklets provides information about *taxed superannuation funds*. A *taxed superannuation fund* is a fund that pays tax on assessable contributions and investment income while your benefits are accumulating. Most Australians belong to a taxed superannuation fund. We have not included information about untaxed superannuation funds, such as certain government or public sector funds. Different arrangements apply to these funds which are beyond the scope of these booklets.

We aim to answer some common questions people have about superannuation and how it works. But you'll probably have some questions relating to your own circumstances. If so, we recommend that you talk to your financial adviser who will be able to give you advice that is tailored to your specific needs.

In this booklet, we discuss some of the advantages of saving through super and how a super fund works. We look at recently introduced super contribution caps and the tax penalties you may incur if you exceed these caps. If you have reached 65, you will also need to think about whether you are eligible to contribute to your super. We include information about the restrictions that apply from age 65 including the *work test* and contribution age limits, and then take a more detailed look at the different types of super contributions.

We also outline how you can share some of your super with your spouse and touch on some important issues to consider while your super is accumulating. These include choosing your fund and investment strategy taking into account your 'risk profile'.

Many superannuation funds offer insurance to members as an ancillary benefit. We outline the different types of insurance available and some advantages of holding insurance cover through your super fund. Finally, we briefly outline when you can start accessing your superannuation benefits.

Technical terms that are used throughout this booklet are shown in *italics* and are explained in the glossary at the end of the booklet.

Saving through super

Superannuation provides a tax-effective investment vehicle to save for your retirement.

When you give up work, you'll probably want to maintain a similar standard of living to the one you had while you were working. The more time you expect to spend in retirement, the more important it is to ensure you have adequate financial resources to fund your lifestyle. While the Government may provide a safety net in the form of the age pension, you need to take responsibility for your retirement savings if you want a better standard of living in retirement.

Five key benefits of saving through super are outlined below.

1. Superannuation is tax effective

To encourage Australians to save for retirement, the Government provides tax concessions for superannuation.

The tax arrangements applying to super contributions depend on whether they are *concessional contributions* or *non-concessional contributions*.

Concessional contributions are generally those your employer makes, or that you make and claim as a personal tax deduction. These contributions are taxed at 15% instead of your marginal rate. There is an annual limit on the total amount of *concessional contributions* that you can make, known as the *concessional contributions cap*.

Non-concessional contributions are generally contributions that are not tax deductible. They are typically personal contributions for which you do not claim a tax deduction or contributions that are made for a spouse. These contributions are not taxed when they are made. *Non-concessional contributions* are also subject to an annual contribution limit which is known as the *non-concessional contributions cap*.

The concessional and non-concessional caps are explained in further detail on page 10–11.

While your super is accumulating, investment income is taxed at a maximum rate of 15%, which generally compares favourably to marginal tax rates. This tax can be reduced through other concessions and will usually be less than the tax that you would pay if you held the same investments outside the superannuation environment. Once you start a superannuation pension, generally the investment earnings on your account are completely tax free.

Typically, the tax advantages of superannuation help your retirement savings grow faster than they would in non-super investments.

Example 1: Saving inside super compared with outside super

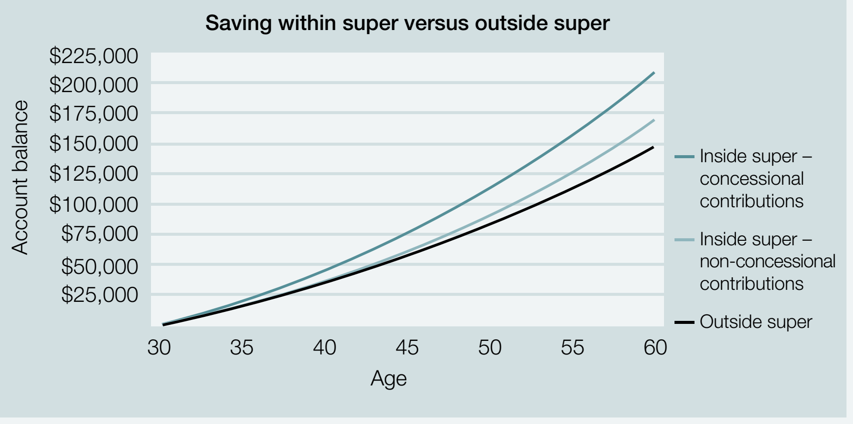
If Alice began contributing $3,000 per year (in today's dollars) as *non-concessional contributions* to her super from age 30, by the time she reaches age 60 she will have $168,505 in her superannuation account. This amount could be higher if Alice qualified for a Government co-contribution.

If she had invested the same contributions outside super, her investment would have grown to $146,750. That's $21,755 higher within super.

If Alice instead made *concessional contributions* (for example, by way of a salary sacrifice arrangement with her employer) up to the pre-tax equivalent of $3,000 into superannuation, her annual contribution would be $4,380 (assuming Alice is on the 31.5% marginal tax rate). These contributions will be taxed at 15% when they are made, instead of her marginal rate.

By the time she reaches age 60, her account balance will have grown to $209,094.

The differences are illustrated in the chart below.



Assumptions:

- the assumed earnings rate in each case is 7.5% and is before tax and net of fees;
- earnings are made up of 50% income (taxed at 15%) and 50% capital growth;
- capital gains qualify for the CGT discount;
- all figures (including annual contributions) are in today's dollars (assuming the Consumer Price Index (CPI) increases at the rate of 2.5% p.a.);
- Alice is on the 31.5% marginal tax rate; and
- contributions are made evenly throughout each year.

When it comes time to draw on your superannuation benefits, recent reforms mean that if you are aged 60 or more you will pay no tax on your benefits (pension or lump sum) if they are paid from a taxed fund. If you draw on your benefits before age 60 you may pay tax, but generally at concessional rates.

2. Investing for the long term

Because super is designed to be a long-term investment, earnings on your money are reinvested. This means you earn interest on your interest, known as the *compounding* effect.

The sooner you start saving through super, the longer you will have to take advantage of the tax concessions and the greater the effect that *compounding* investment earnings will have on the size of your eventual nest egg. But even if you have some catching up to do, it's important to remember that it is better late than never.

Example 2: The power of compounding interest

Brian begins investing $4,000 per year as *non-concessional contributions* into his super from age 25. His investments generate a return of 7.5% per year (before tax). Once he reaches 35, he stops making further contributions (so the total amount he has contributed is $40,000) and leaves his investment in his super fund to accumulate.

Christine, on the other hand, waits until she is 40 before she begins to make *non-concessional contributions* of $4,000 per year to her super. She continues contributing this amount each year until she turns 60 (so the total amount of her contributions is $80,000). She earns the same rate of return as Brian (7.5% per year before tax).

Who do you think will have the bigger retirement nest egg at age 60?

Believe it or not, it is Brian. His nest egg will be worth $121,015. Christine, despite having contributed twice as much as Brian, will have $117,217 by the time she reaches 60.

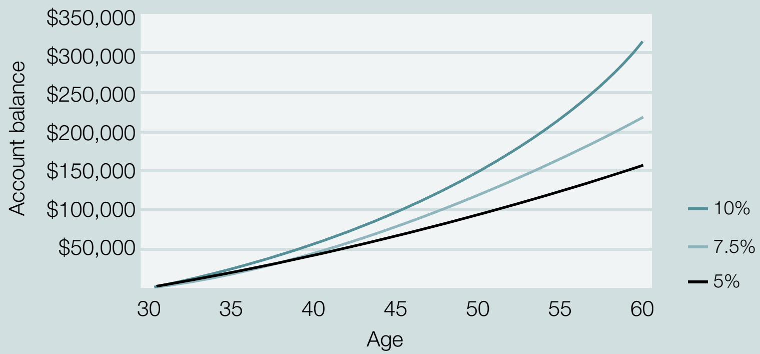
That's the power of *compounding* interest.

Assumptions:

- the earnings rate of 7.5% is before tax and net of fees;
- earnings are 100% income and taxed at 15%;
- all figures (including annual contributions) are in today's dollars (assuming the CPI increases at the rate of 2.5% p.a.); and
- contributions are made evenly throughout each year.

To further illustrate the effects of *compounding*, the chart below shows how your super account balance could grow at investment returns of 10%, 7.5% and 5% per year with *non-concessional contributions* of $4,000 per year.

Example 3: Effect of compounding at different earning rates



Assumptions:

- earnings rates are before tax and net of fees;
- earnings are 100% income and taxed at 15%;
- all figures (including annual contributions) are in today's dollars (assuming the CPI increases at the rate of 2.5% p.a.); and
- contributions are made evenly throughout the year.

3. Superannuation is a convenient and easy way to save

If you are an employee, chances are your employer is making compulsory super contributions on your behalf. It's easy to top up your super by making extra personal contributions. Many employers also offer the option of making extra contributions from your pre-tax salary. These contributions are known as *salary sacrifice contributions*.

4. Other tax concessions and incentives may apply

If you make personal contributions and are self-employed or earn most of your income from non-employment sources, you may be eligible to claim a tax deduction for your contributions.

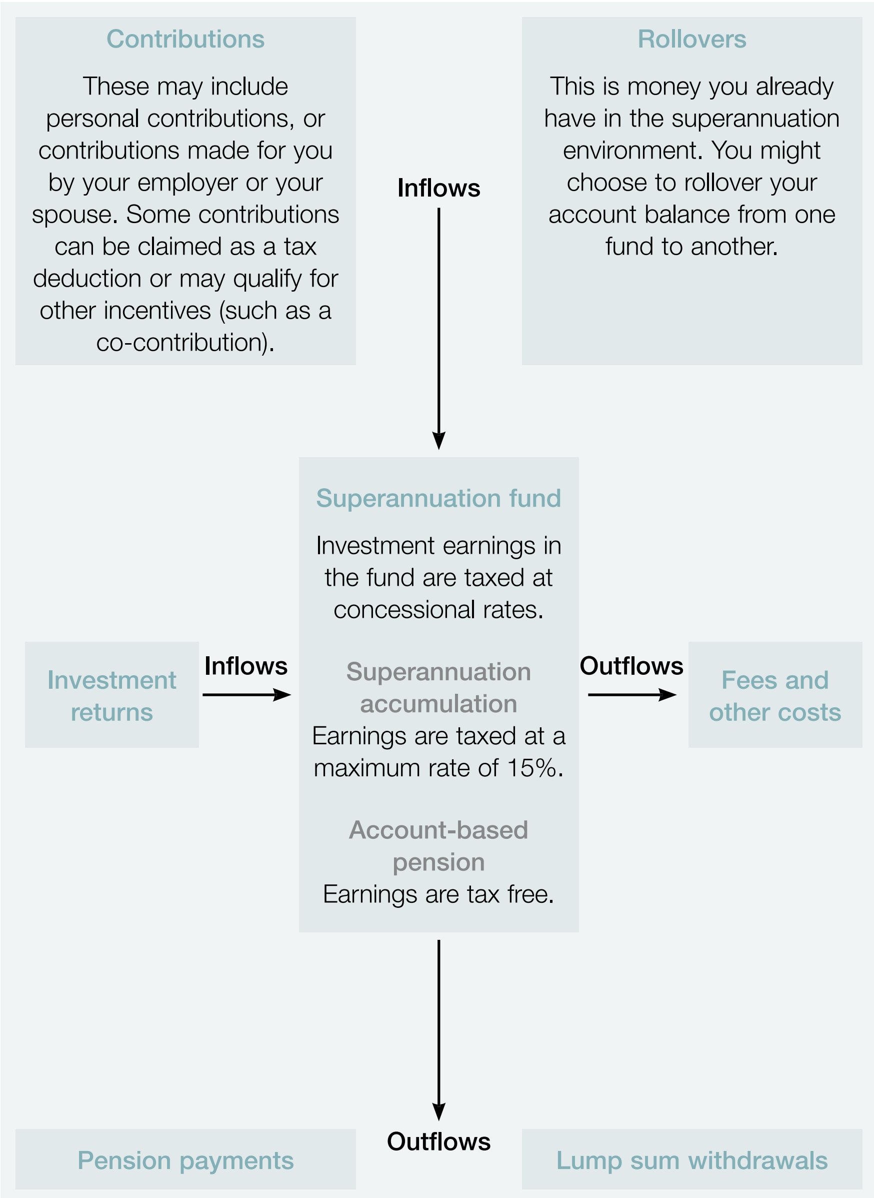
If you don't claim your contribution as a tax deduction and your income is below a particular level, you may qualify for a Government co-contribution.

If you are a low income earner, your spouse may be entitled to a tax rebate for contributions they make on your behalf.

5. Insurance cover through your super

Many super funds can provide members with insurance cover for death and permanent or temporary disability. Insuring through superannuation can be very tax effective compared to holding cover outside superannuation.

How a super fund works



How much should you save?

The amount you need to save for your retirement will depend on how much income you think you will need to enjoy the lifestyle you want in retirement. Obviously, you're going to need a lot more if you want to take an overseas holiday each year, buy a new car or take up new hobbies or interests. Once you've settled on an income figure, your adviser can help you develop a regular savings plan to meet your goal.

If you want to contribute large amounts to your super, the contribution caps mean that it can be important to plan ahead.

Making contributions to your super

Beware of the limits

The Government has recently introduced annual contribution caps which help to keep the superannuation tax arrangements affordable for the Government.

You will incur some significant tax penalties if you exceed the contribution caps.

There are generally two types of super contribution caps:

- The *concessional contributions cap* generally applies to contributions that are taxed in the fund when they are made, for example employer (including *salary sacrifice contributions*), or *personal deductible contributions*. These are known as *concessional contributions*.
- The *non-concessional contributions cap* generally applies to contributions that are not taxed in the fund when they are made, for example non-deductible personal or spouse contributions. These are known as *non-concessional contributions*.

Concessional contributions cap

Concessional contributions are typically employer contributions or *personal deductible contributions*. These contributions are taxed at 15% when they are made.

Concessional contributions are capped at $50,000[1] per financial year (in 2007-08).

However, if you are aged 50 or more at any time in a financial year, your *concessional contributions* cap for that year is $100,000 until the financial year ending 30 June 2012.

Concessional contributions made for you that exceed the cap will be taxed at an additional 31.5%, on top of the 15% tax that the fund already paid when the contributions were made. You will be personally liable for this tax. However, you will have the choice of withdrawing the amount of excess *concessional contributions* tax from your super fund, or paying the tax directly from your non-super funds.

Excess *concessional contributions* will also count towards your *non-concessional contributions cap* (explained on the next page).

[1] The *concessional contributions cap* is indexed annually to Average Weekly Ordinary Time Earnings (AWOTE) in $5,000 increments.

Non-concessional contributions cap

Non-concessional contributions are typically personal contributions for which you do not claim a tax deduction or contributions that are made on your behalf by your spouse. They are not taxed when they are made and count towards your *non-concessional contributions cap*.

The annual *non-concessional contributions cap* is always equal to three times the *concessional contributions cap*, or $150,000 per year (in 2007-08). However, if you are 64 or under at any time in a financial year, you are able to 'bring forward' up to two future years' contribution entitlements so as to contribute a maximum amount of $450,000 over a three-year period.

The $450,000 'bring-forward' cap will trigger automatically in the first year that you contribute more than the annual cap of $150,000. You will then have up to the end of the third year to use up the remainder of your 'bring-forward' cap. When the 'bring-forward' arrangements have been triggered, the cap is fixed and will not increase in the following two years with indexation.

Excess *non-concessional contributions* will be taxed at the highest marginal tax rate (currently 46.5%). If you have an excess *non-concessional contributions* tax liability, the tax must be paid from an amount that you withdraw from your super fund.

Example 4: Non-concessional contributions and the 'bring-forward' arrangements

Dean turns 64 on 20 May 2008 and has recently received an inheritance of $600,000. He wishes to contribute the amount he has inherited to his super fund as *non-concessional contributions*. He speaks with his adviser because he is unsure of how he can do this without exceeding the contribution caps.

To help Dean understand how the *non-concessional contributions cap* works, his adviser shows him what would happen if he contributed the full $600,000 this year.

She explains that if he is under 65 at any time in the year, he can use the 'bring-forward' arrangements so the maximum amount he can contribute is $450,000 over three years without incurring excess contributions tax.

Therefore, if he contributed the full $600,000 this financial year (2007-08), he would incur an excess *non-concessional contributions* tax liability which would be worked out as follows:

Excess contributions tax	= ($600,000 – $450,000) x 46.5%
	= $150,000 x 46.5%
	= $69,750

Dean can see that this is a significant penalty.

Other restrictions on making super contributions

70 and over, but under 75	Your fund can accept *mandated employer contributions* at any time. Your fund can accept *non-mandated employer contributions* provided you have met the *work test*.	Your fund can accept personal contributions provided you have met the *work test*.	Your fund cannot accept spouse contributions.
75 and over	Your fund cannot accept *non-mandated employer contributions* but it can accept *mandated employer contributions.*[2]	Your fund cannot accept personal contributions.[2]	Your fund cannot accept spouse contributions.

Limits on large single contributions

There are limits on the size of *non-concessional contributions* that your fund

Types of contributions explained

Employer contributions

There are two types of employer contributions that can be made to your superannuation: *mandated* and *non-mandated employer contributions*.

Mandated employer contributions are contributions that your employer is required to make on your behalf under the *Superannuation Guarantee* or under an agreement certified, or award made, by an industrial authority.

Under the *Superannuation Guarantee* (SG), if you are aged between 18 and 70 and earning more than $450 per month, your employer is generally required to make superannuation contributions on your behalf of at least 9% of your salary (up to a maximum salary of $36,470[3] per quarter or $145,880 per year in 2007-08). SG contributions are also generally required to be made for employees under 18 who are working full time (at least 30 hours per week).

SG contributions must be made by your employer at least quarterly.

If you work under an award or certified agreement, contributions that your employer is required to make on your behalf under the award or agreement will reduce your employer's SG obligations.

Non-mandated employer contributions are contributions that your employer may make over and above what is required under the SG, industrial award or certified agreement. The most common type of *non-mandated employer contributions* is *salary sacrifice contributions*.

Many employers offer salary sacrifice arrangements to their employees. Under these arrangements, employees have the option of forgoing some of their pre-tax salary in return for additional superannuation contributions. You can often save tax by making *salary sacrifice contributions* as these contributions, like other employer contributions, are generally taxed at 15% in the fund instead of your marginal tax rate.

To be effective, a salary sacrifice arrangement must be entered into before you are entitled to receive payment (normally this would be prior to you performing any work).

[3] This is the maximum earnings base in 2007-08. The maximum earnings base is indexed to Average Weekly Ordinary Time Earnings (AWOTE) annually.

Personal deductible contributions

If you are self-employed or if you earn less than 10% of your income[4] from employment in a financial year, you may be eligible to claim a tax deduction for your super contributions made in that year up until age 75[5].

For example, if you are a sole trader or in a partnership, or an individual who earns most of your income from investments rather than work, you may be eligible to claim a deduction for your contributions.

If you wish to claim a deduction, you must give your fund a notice of intent to claim a deduction. A deduction notice is only valid if it is provided either before the day you lodge your tax return for the year you made the contribution, or the end of the year after you made the contribution (whichever is earlier). If valid, your fund is required to give you an acknowledgement of your notice.

If 10% or more of your income comes from employment, generally you cannot claim a tax deduction for your personal contributions but you may be eligible for a co-contribution.

Personal deductible contributions are taxed at 15% when they enter the fund.

Personal contributions and co-contributions

If you make *personal non-concessional contributions*, you may qualify for a Government co-contribution, depending on whether or not your income falls within a maximum limit.

The co-contribution is a scheme that the Government introduced to reward people who make personal contributions to their super.

To qualify for a co-contribution you need to:

- make personal superannuation contributions to a *complying superannuation fund* or a retirement savings account;
- have assessable income plus reportable fringe benefits of less than $58,980 (in 2007-08);
- receive 10% or more of your income[6] from eligible employment or carrying on a business;
- not hold an eligible temporary resident visa at any time during the year;
- lodge an income tax return for the year of income; and
- be less than 71 years old at the end of the year of income.

[4] Assessable income plus reportable fringe benefits.
[5] You will have until 28 days following the end of the month in which you turn 75.
[6] Assessable income plus reportable fringe benefits.

If you meet the eligibility criteria and your annual income[7] is less than $28,980 (in 2007-08), then you will receive a co-contribution from the Government of $1.50 for every dollar of *personal non-concessional contributions* you make up to the maximum co-contribution of $1,500. The maximum co-contribution reduces by 5 cents for every dollar of annual income[7] you earn over $28,980, phasing out completely at $58,980 or more.

The co-contribution thresholds are indexed each year in line with wages.

Spouse contributions

Your spouse (or de facto spouse) can make *non-concessional contributions* on your behalf. If you are a low income earner, your spouse may be able to claim a spouse contribution rebate.

If your income[8] is less than $10,800, your spouse may claim a rebate of 18% on the first $3,000 they contribute on your behalf, ie. $540. If your income exceeds $10,800, the maximum contribution that attracts a rebate is reduced below $3,000 by $1 for every $1 by which your annual income exceeds $10,800. This means that there is no rebate once your annual income reaches $13,800 per year.

For your spouse to be able to claim any rebate, both you and your spouse must be Australian residents and must be living together at the time the contribution is made.

[7] Assessable income plus reportable fringe benefits less deductions related to carrying on a business.
[8] Assessable income plus reportable fringe benefits.

Transfers from foreign superannuation funds

If you have spent some time living or working overseas, it is possible that you hold benefits in a foreign superannuation or pension scheme. Depending on the rules of the scheme and also the law that applies to the country where your benefits are held, you may be able to transfer your entitlements to an Australian superannuation fund.

For example, many Australians have spent some time working in the United Kingdom and therefore may hold entitlements in a UK pension scheme. To transfer these entitlements to an Australian super fund, the UK law requires that the Australian fund is a *Qualifying Recognised Overseas Pension Scheme* (QROPS). If the receiving fund is not a QROPS, you may incur some significant tax penalties under UK tax law.

The Australian tax arrangements applying to transfers from foreign super funds can vary depending on your residency status and when the benefits are transferred. Whether or not there are advantages in transferring an overseas entitlement to Australia will depend on your individual circumstances and it will be important to seek specialist advice on both the overseas and Australian tax treatment.

When you transfer an amount from a foreign fund, it will be treated as a contribution. This means that you must be eligible to contribute. Foreign transfers are usually counted towards the *non-concessional contributions cap* but an amount representing 'applicable fund earnings' that you elect to have taxed in the fund may be excluded from the caps. Your adviser will be able to give you more information about making a transfer from a foreign superannuation fund.

Share your super contributions with your spouse

Some types of contributions made for you can effectively be split with your spouse (married or de facto). Splitting contributions means allotting contributions to an account for your spouse either in the same fund or another fund of your spouse's choice.

Not all types of contributions can be split. For example, you can't split *personal non-concessional contributions*, co-contributions and rollovers from other funds with your spouse. Generally, only *concessional contributions* (employer contributions or personal contributions for which you can claim a deduction) can be split.

There are limits on amounts that you can split to your spouse in a year. The limit is the lesser of:

- 85% of the total of *concessional contributions* you made in the year; and
- your *concessional contributions cap*.

A contribution split to your spouse can only be processed once each year and your spouse must be under 65 and not retired, or under their *preservation age*. If you wish to split some of your contributions with your spouse, you should talk to your adviser who can check to make sure your fund offers this service and help you apply.

Splitting contributions with your spouse may be a useful strategy if your spouse is likely to reach their *preservation age* or retire before you because they may gain earlier access to their benefits. Splitting can also be effective if your spouse is older as they will become entitled to tax free super benefits (from age 60) before you will.

If you and your spouse expect to receive super benefits before age 60, there can be tax advantages in splitting contributions because you may each qualify for the tax-free threshold on assessable pension income or the *low rate cap* on the *taxable component* of lump sum benefits.

There can also be social security advantages in splitting your contributions with your spouse if they are younger than you. This is because for someone under *age pension age* (65 years for a male and currently 63.5 years for a female), superannuation assets in the *accumulation phase* are not taken into account under the pension means test.

Investing your superannuation

Choosing a fund and consolidating your super

Most employees can choose which fund they would like their employer to use for their compulsory super contributions. If you're eligible, your employer is required to allow you to choose a fund when you start a new job and to make a new choice once each year after that.

If you have more than one superannuation fund, you may want to consider consolidating your existing super accounts together in one fund so you're not receiving several different statements or paying several sets of fees.

For more information about choosing a fund for future employer contributions and consolidating your existing super accounts see *Booklet 2: Superannuation: dealing with life's changes.*

Choosing the right investments

Choosing the right investment mix for your super is important. Many funds offer you a choice of diversified strategies such as growth or balanced, as well as specific asset classes like Australian shares, international shares, fixed interest, cash or property. Some funds also use a wrap service which can offer a very broad range of managed and direct investments, allowing you and your adviser to develop a comprehensive portfolio tailored to your financial goals.

One option that you may consider is setting up your own *Self Managed Superannuation Fund* (SMSF) which can allow considerable flexibility in relation to your super investments. Your adviser will be able to give you more information about setting up your own SMSF. You may also wish to refer to another of Macquarie's booklets called *Self reliance – looking after your self managed super.*

The investment options you select will depend in part on how comfortable you are with risk. As a general rule, the bigger the potential investment return, the higher the investment risk. You might be quite prepared to risk short-term volatility for potentially higher long-term returns. Your tolerance to investment risk is known as your 'risk profile'. Your 'risk profile' can change as you get older and due to other personal factors. While you're young, you can afford to take some risk with your investments, but once you get close to retirement you may want to be more conservative in your approach. However, it's important not to be too conservative as even once you have retired, your retirement savings may still need to last another 20 or 30 years.

Insuring through superannuation

While you are accumulating wealth, it is important to consider the level of insurance cover you may need to ensure that you and your family are looked after in the event of death or disability.

Many super funds offer insurance as an ancillary benefit to members. In many cases, taking out insurance cover through your fund can have some big advantages for you and your beneficiaries. Insuring through super can be very tax effective and with the added cashflow benefits of having premiums automatically deducted from your account, it removes the worry of your cover lapsing.

There are generally three different types of cover available through a superannuation fund. These are:

- life insurance (death cover);
- Total and Permanent Disablement (TPD) cover; and
- income protection or salary continuance cover.

Insurance through super is usually provided by an insurance policy negotiated between the super fund trustee and the insurer.

Life insurance (death cover)

Death cover will provide financial security for your dependants in the event of your death. Upon death, insurance proceeds will be paid to your super fund before being paid out to one or more of your dependants or *legal personal representative* (typically referred to as your estate) along with your accumulated super benefits. Some life insurance policies may also provide cover in the event of terminal illness.

Choosing the right level of cover

It is very important to carefully consider your level of life insurance cover.

The amount of cover you need may depend on a range of factors including:

- your debts;
- the future income needs of your beneficiaries;
- the tax structure of your superannuation and whether your beneficiaries are dependants under superannuation and/or tax law;
- the level of your accumulated superannuation benefits; and
- costs relating to death such as funeral expenses.

Your cover needs are likely to change over time with changes in your circumstances. For example, if you have children who are no longer financially dependent on you, the level of cover you need may be lower than it was previously. As you pay off your mortgage and your level of debt falls, the level of cover you need may also fall.

Paying the premiums

The whole of a premium for death cover can normally be claimed as a tax deduction by your super fund. And often there is little or no tax payable on death benefits paid from superannuation. So holding death cover within super is often much more tax effective compared to insuring outside super, particularly if the premiums are funded from employer or *personal deductible contributions*. It does depend on your circumstances, though.

Payment of benefits on death

There are special rules regarding the payment of superannuation death benefits including life insurance proceeds. Superannuation death benefits do not automatically become part of your estate and there are strict rules regarding who can receive your benefits and in what form. These rules as well as the tax treatment of death benefits are explained in *Booklet 4: Super and estate planning*.

Total and Permanent Disablement (TPD) cover

TPD cover provides benefits in the event of a member's total and permanent disablement that results in them being unlikely to ever return to work. If you hold TPD cover through your super fund and you qualify to make a claim, the insurance proceeds will be paid to the trustee of your superannuation fund. The trustee must distribute the insured benefit in accordance with the governing rules of your superannuation fund and superannuation law.

Choosing the right level of cover

When taking out disability cover through your fund, it's important to think carefully about how much extra money you will need if you become permanently disabled. The amount of cover you need will depend on your age and income needs, debts, and costs such as home alterations and medical expenses. Your cover needs are likely to change over time with changes in your lifestyle so it is important to review your level of cover regularly.

Paying the premiums

Depending on the terms of the policy and the type of cover selected, the whole of the premium for TPD cover may be an allowable deduction for your fund. On the other hand, if you hold TPD cover outside super, premiums are generally not an allowable deduction. Therefore, holding TPD insurance through super is often much more tax effective compared to outside super.

Payment of benefits

Before you can access your insurance proceeds, you must have met a *condition of release* under superannuation legislation, such as the *permanent incapacity* condition.

To be eligible to receive your benefits on *permanent incapacity* grounds, the trustee of your fund must be reasonably satisfied that, as a result of your ill-health, you are unlikely to engage in gainful employment for which you are reasonably qualified by education, training or experience.

If you qualify to make a TPD claim and access your benefits on *permanent incapacity* grounds, you may qualify for special tax concessions that apply to *disability superannuation benefits*. These arrangements are explained in *Booklet 2: Superannuation: dealing with life's changes.*

Income protection cover

Income protection insurance will generally provide you with regular income payments in the event you suffer a disability that prevents you from working. The income payments may replace all or part of your income from working (depending on the policy). Receipt of the income payments may be subject to limits on the period over which the income protection benefit can be paid. For example, some policies may provide income protection benefits over a maximum period of two years or five years, while under other policies, benefits may be payable right up to age 65. There may also be a waiting period that you will need to meet before a claim can be made on your policy.

Paying the premiums

Income protection insurance through super has recently become more attractive than it was previously. Premiums for policies are now typically fully deductible to a super fund. If premiums for income protection insurance are paid using deductible contributions (eg employer or *personal deductible contributions*), they are effectively deductible at your marginal tax rate.

Premiums for income protection cover held outside super are also generally fully deductible to an individual because they are made to replace lost assessable income.

So, if you are unable to have income protection premiums paid from deductible contributions within super, you may want to consider taking out this type of cover outside of your super fund. Your adviser will be able to help work out the best arrangement for your specific circumstances.

Payment of benefits

As with TPD cover, before you can access your income protection benefits, you must have met a *condition of release*. If you qualify under the *temporary incapacity condition of release*, your insurance benefits can only be paid from the fund in the form of an income stream that is subject to certain restrictions (and cannot be paid as a lump sum). *Temporary incapacity* is defined as ill-health (physical or mental) that caused a member to cease to be *gainfully employed* but does not constitute *permanent incapacity*.

Payments from an income stream paid under *temporary incapacity* must be made at least monthly and cannot be indexed by more than the greater of the rate of increase in the Consumer Price Index (CPI), and 5% per year. The income stream must be provided for the purpose of continuing the income you received before suffering the incapacity. It cannot be paid for a period that exceeds the period of incapacity. An income stream that you receive in the event of temporary inability to work is taxed as ordinary income at your marginal rate.

However, if you qualify as permanently disabled, you may be able to have your benefits paid under *permanent incapacity*. If so, the restrictions outlined above on how you can receive your income protection benefits may not apply so that, for example, you could access a lump sum. You may also be able to qualify for the tax concessions that apply to *disability superannuation benefits*.

Accessing your super

Superannuation is subject to strict preservation rules, which generally prevent you from accessing your benefits until you have retired after reaching your *preservation age* (ie. age 55 if you were born before 1 July 1960). Once you have retired, you can access your benefits as either a pension or lump sum, or combination of both. In some circumstances, such as disability, you may be able to access your benefits before retirement.

The rules for accessing your superannuation benefits are explained in *Booklet 2: Superannuation: dealing with life's changes*. If you are nearing retirement and are considering investing your super benefits in a pension, you may wish to read *Booklet 3: Account-based pensions: making your super go further in retirement* which explains in detail the payment rules and tax treatment of account-based pensions.

It is no longer compulsory for you to begin drawing on your super benefits if you have retired and reached a certain age. However, on death, your benefits must be paid as soon as practicable to your dependants or to your *legal personal representative* (typically referred to as your estate). The rules regarding the payment and tax treatment of death benefits are explained in *Booklet 4: Super and estate planning*.

Glossary

Accumulation phase is a term used to describe the period when your superannuation benefits are accumulating in the fund. This is the period of time when you are likely to be working and contributing to your super.

Age pension age is the age when a person may qualify for the age pension. Age pension age for a male is 65. For females, age pension age is being gradually increased from age 60 to age 65 by 2014. Age pension age for females depends on their date of birth. If you are female and were born before 1 July 1944 you have already reached your age pension age.

Date of Birth	Age pension age – female
1 July 1944 to 31 December 1945 (inclusive)	63.5
1 January 1946 to 30 June 1947 (inclusive)	64
1 July 1947 to 31 December 1948 (inclusive)	64.5
1 January 1949 and later	65

Complying superannuation fund is a fund that meets the requirements of the *Superannuation Industry (Supervision) Act 1993*. Only funds that meet these requirements receive concessional tax treatment.

Compounding is when you earn interest on your interest. It occurs when your earnings are reinvested. Compounding is one of the many benefits of saving through superannuation.

Concessional contributions are generally those your employer makes, or that you make and claim as a personal tax deduction. These contributions are taxed at 15% instead of your marginal rate. There is an annual limit on the total amount of concessional contributions that you can make, known as the *concessional contributions cap*.

Concessional contributions cap is an annual limit on the amount of *concessional contributions* that you can make to your superannuation. In 2007-08 the cap is $50,000 per year (indexed annually to wages in $5,000 increments), but if you are aged 50 or more in a year, your annual concessional contributions cap is $100,000 until the financial year ending 30 June 2012.

Condition of release is a condition you must meet before you can access your preserved and restricted non-preserved benefits. The conditions of release are set down in superannuation legislation. Examples are retirement, reaching your *preservation age*, reaching age 65 and *permanent incapacity*. Some conditions of release have restrictions on the amount of, or form in which you can take your benefits, while others (such as retirement) allow unrestricted access.

Disability superannuation benefit is a superannuation benefit that is paid to a person because he or she suffers from ill-health (whether physical or mental); and two legally qualified medical practitioners have certified that, because of the ill-health, it is unlikely that the person can ever be *gainfully employed* in a capacity for which he or she is reasonably qualified because of education, experience or training. These benefits can qualify for additional tax concessions.

Gainfully employed means employed or self-employed for gain or reward in any business, trade, profession, vocation, calling, occupation or employment.

Legal personal representative means:

- an executor or administrator of an estate of a person who has died;
- a trustee of an estate of a person who is under a legal disability; or
- a person who holds a general power of attorney that was granted by another person.

Low rate cap is a limit on the amount of the taxable component of a superannuation lump sum that attracts a lower rate of tax (usually 0%). The low rate cap applies to lump sum benefits paid between *preservation age* and age 60 and is a lifetime limit. This means that the *taxable component* of any previous superannuation lump sum benefits (known as eligible termination payments before 1 July 2007) that you have received since reaching your *preservation age* will generally reduce your low rate cap for an income year. The low rate cap is $140,000 in 2007-08 and indexed annually to wages in $5,000 increments.

Mandated employer contributions are contributions that your employer is required to make on your behalf under the *superannuation guarantee* or under an agreement certified, or award made, by an industrial authority.

Non-concessional contributions are generally contributions that are not tax deductible. They are typically personal contributions for which you do not claim a tax deduction or contributions that are made for a spouse. These contributions are not taxed when they are made. Non-concessional contributions are also subject to an annual contribution limit which is known as the *non-concessional contributions cap*.

Non-concessional contributions cap is a limit on the amount of *non-concessional contributions* that you can make to your superannuation. In 2007-08 the cap is $150,000 per year, but if you are under age 65 at any time in a financial year, you can bring forward up to two future years' entitlement to contribute up to $450,000 (2007-08) for the three-year period. The non-concessional contributions cap will be indexed so that it is always equal to three times the *concessional contributions cap*.

Non-mandated employer contributions are contributions that your employer makes on your behalf other than those that are required under the *superannuation guarantee*, industrial award or certified agreement. The most common type of non-mandated employer contributions is *salary sacrifice contributions*.

Permanent incapacity is a *condition of release* for preserved and restricted non-preserved benefits. To access your benefits on permanent incapacity grounds, the trustee of your fund must be reasonably satisfied that, as a result of your ill-health, you are unlikely to engage in gainful employment for which you are reasonably qualified by education, training or experience.

Personal deductible contributions are contributions that you can claim as a tax deduction. You may be eligible to claim a tax deduction for your superannuation contributions if you earn less than 10% of your income from employment. For example, if you are self-employed, or earning most of your assessable income plus reportable fringe benefits from investments rather than work, you may be eligible to claim a deduction for your contributions. These contributions are taxed at 15% and count towards your *concessional contributions cap*.

Personal non-concessional contributions are personal contributions that you do not claim as a deduction. These are not taxed when they are made. If your income falls within certain limits and you make personal non-concessional contributions, you may be eligible for a government co-contribution.

Preservation age is generally the age when you can access your superannuation benefits after you retire. However, there are some limited circumstances when you may access your benefits before reaching preservation age or retiring (such as under *permanent incapacity*).

Your preservation age depends on when you were born.

If you were born:	Your preservation age is:
before 1 July 1960	55 years
1 July 1960 to 30 June 1961	56 years
1 July 1961 to 30 June 1962	57 years
1 July 1962 to 30 June 1963	58 years
1 July 1963 to 30 June 1964	59 years
after 30 June 1964	60 years

Qualifying Recognised Overseas Pension Scheme (QROPS) is a pension scheme outside the United Kingdom that is recognised under UK legislation and meets certain reporting requirements. A number of Australian *complying superannuation funds* are registered as QROPS.

Salary sacrifice contributions are contributions made by your employer on your behalf under an arrangement where you forgo some of your pre-tax salary in return for additional superannuation contributions. These contributions are taxed at 15% when they are made. To be effective, a salary sacrifice arrangement must be entered into before you are entitled to receive payment (normally this would be prior to you performing any work).

Self managed superannuation fund is a fund that, in general terms, meets the following requirements:

- it has less than five members;
- each member of the fund is a trustee and each trustee is a fund member;
- if the trustee of the fund is a body corporate each director of the body corporate is a member of the fund;
- no member of the fund is an employee of another member of the fund, unless they are related; and
- no trustee of the fund receives any remuneration for their services as trustee.

Superannuation guarantee refers to the legislative requirement for employers to make superannuation contributions on behalf of their employees. If you are aged between 18 and 70 and earning more than $450 per month, generally your employer is required to make super contributions on your behalf of at least 9% of your salary (up to a maximum salary of $36,470 per quarter or $145,880 per year in 2007-08).

Taxed superannuation fund is a fund that pays tax on assessable contributions and investment income while your benefits are accumulating.

Temporary incapacity is a *condition of release* which can allow you to access income protection insurance benefits that are paid through your fund. Temporary incapacity is defined as ill-health (physical or mental) that caused a member to cease to be *gainfully employed* but does not constitute *permanent incapacity*.

Untaxed superannuation fund is one that does not pay tax on contributions or investment income. This can occur because the fund is 'unfunded', where no employer contributions have been made for a member until the member is ready to retire.

Work test is a test you must pass if you have reached age 65 before most types of superannuation contributions can be accepted by your fund. Once you reach 65, you must have worked a minimum of 40 hours in 30 consecutive days in the financial year before your contributions can be accepted. The work test applies to personal contributions, spouse contributions and *non-mandated employer contributions*. In addition to the work test, most types of contributions have a maximum age limit of 75 (for personal and *non-mandated employer contributions*) or 70 (for spouse contributions). *Mandated employer contributions* are not subject to the work test or an age limit.

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