What is an effective way to save for retirement?

For most people, superannuation is the most tax effective way to save for retirement. And, just as importantly, is the most tax effective way to generate a retirement income.

What are the tax advantages of super?

Let's say you decide to invest $10,000 of your salary. If you invest it via your super fund, from your pre-tax salary, this is how your contribution will be taxed (assuming it is part of a salary sacrifice arrangement):

- Firstly you won't have to pay PAYG tax on the $10,000 of salary.
- But once in your super fund, tax of 15 percent will be levied, leaving you with $8,500 invested.

Compare that to investing your $10,000 outside of super. In that case, you'll have to pay PAYG tax, leaving you with just $6,100 (assuming your marginal tax rate is 39 percent including Medicare Levy) for investment wherever you like.

The earnings generated by the investments outside of super will be taxed at 39 percent including Medicare Levy.

However, earnings generated by investments in your super fund will be taxed at only 15 percent.

How much can you invest in super on a tax effective basis?

Because super is tax advantaged, there is a limit on how much you can invest in super and qualify for a tax deduction. This limit is $25,000, and it includes your employer's super guarantee contributions.

No tax for retirees in super and aged 60 plus

Superannuation is even more tax effective for retirees. For most retirees over age 60, there is now no tax on earnings inside the fund and no tax on income or withdrawals (including from account-based pensions).

However, there will be a $1.6 million cap on money you are allowed in to rollover to start account-based pensions (for 2020/21).

All of your superannuation should be invested to generate returns that match your investment timeframe. You need to consider which asset allocation and investments will help you to do that.

Case study

The tax differential between investing in super and non-super adds up over time.

Bob is on a tax rate of 39 percent and invests $10,000 into his super before tax annually, indexed at 3 percent p.a.

If Bob invests his $10,000 as part of a salary sacrifice agreement (i.e. $8,500 after contributions tax) and the fund earns 8 percent p.a. gross, he would accumulate $135,715 after 10 years, and $444,412 after 20 years, see Chart 1.

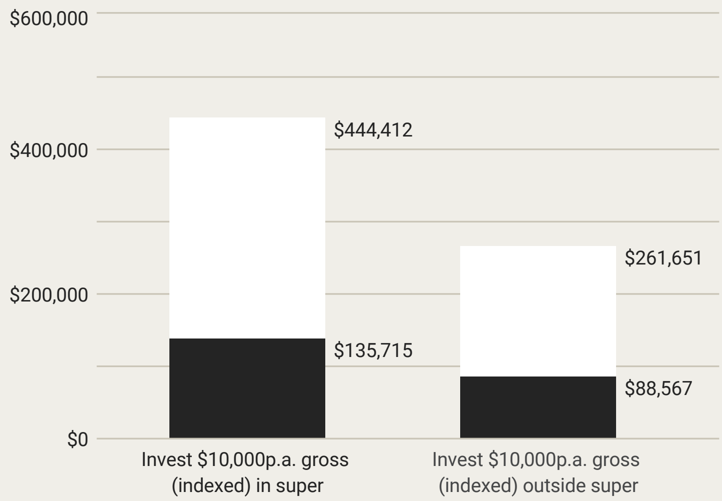
Alternatively, if Bob chooses not to salary sacrifice into his superannuation, he will only have $6,100 p.a. (indexed) to invest after paying PAYG tax, and he will be paying tax on investment income of 39 percent (compared to 15 percent in super). As a result, after 10 years he'll accumulate $88,567 and $261,651 after 20 years, assuming an 8 percent p.a. gross return.* The sole reason for the difference is the preferential tax treatment of superannuation.

Super means you can have more invested^

Salary sacrifice into super	Investing outside of super
You want to invest $10,000 of your salary	You want to invest $10,000 of your salary
No PAYG tax	$3,900 PAYG tax
Contribute to super	
15% tax	
$8,500 invested	$6,100 available for investment
Earnings taxed 15%	Earnings taxed 39%
Nil tax on withdrawals in retirement once aged 60+	Withdrawals subject to capital gains tax

Assumes MTR 37 percent plus Medicare Levy of 2 percent based on 2020/21 tax rates and ignores offsets.

Chart 1: An improvement of $182,760 for retirement*



*Assumes MTR 37 percent plus Medicare Levy of 2 percent, annual pre-tax investment of $10,000 indexed at 3% p.a. and annual gross investment amount of 8% p.a.

Other superannuation strategies

Claiming a tax deduction for personal contributions to superannuation

For similar benefits to salary sacrifice, you may be able to claim a tax deduction for contributions you make to superannuation. This reduces your taxable income and you only pay tax at 15 percent on the contribution, potentially increasing the amount that you have available to invest.

The low-income superannuation tax offset

For low income earners, the low-income superannuation tax offset (LISTO) may refund the 15 percent superannuation contribution tax. You must have an adjusted taxable income less than $37,000 p.a. to qualify. The maximum LISTO paid is $500, equal to 15 percent of concessional contributions up to $3,333. LISTO is paid into your superannuation account.

The ATO's reference for LISTO is: https://www.ato.gov.au/Individuals/Super/In-detail/Growing-your-super/Low-income-super-tax-offset/?page=2#Eligibility_for_the_LISTO

The Government co-contribution

If you are a low to middle income earner and you make a personal after-tax contributions to superannuation you may be eligible for a Government co-contribution. The maximum Government cocontribution is $500, payable at a rate of 50 cents for every $1 of eligible contributions that you make. The co-contribution reduces by 3.333 cents for every dollar that your adjusted taxable income exceeds $39,837, with no co-contribution payable when your income reaches $54,837, (2020/21 figures).

What can't an SMSF do?

There are some restrictions on what SMSFs are allowed to do and invest in. For example, the SMSF cannot lend money to members or relatives and cannot buy residential property from a related party.

Most importantly, the SMSF must be run to meet the sole purpose of providing retirement benefits for members.

An SMSF which contravenes the regulations risks being declared non-complying and losing its concessional tax status. The result would be all concessional contributions and earnings being taxed at 45% instead of at up to 15%.

Who can be in your SMSF?

The fund can include relatives such as your spouse, children and/or parents (up to a total of four members, although the government has proposed an increase to six members). One benefit is that fixed costs are shared by more members, thus creating additional cost savings per member.

What are the costs of running an SMSF?

An SMSF may have to pay fees for investments (e.g. brokerage), trustee services, accounting, administration and audits. An SMSF can be cheaper than a retail fund at higher balances, generally this may be the case if the fund has more than $200,000 invested but it depends on individual circumstances.

Is an SMSF right for you?

An SMSF could be right for you if you and/or your spouse have at least $200,000 to transfer into an SMSF and you think the advantages outweigh the disadvantages.

* As at March 2020, APRA report 'Quarterly Superannuation Performance' (issued 26 May 2020)

Superannuation Pros:

- Low tax on contributions
- Low tax on earnings in the fund
- No tax on earnings and capital gains on assets supporting retirement phase income streams (subject to $1.6 milion transfer balance cap).
- Ability to draw a regular income stream at retirement where pension payments are tax free once you are over age 60 (assuming paid from a taxed superannuation fund).
- If you are in receipt of a Centrelink income support payment, superannuation in accumulation phase is not counted under the Centrelink income and assets test until you are Age Pension age

Superannuation Cons:

- Generally you can't withdraw money until you are at least preservation age (age 57–60 depending on your date of birth) and retired.
- Superannuation in accumulation phase is taxed at maximum rate of 15 percent, which may be lower than your marginal tax rate.
- Limits apply to the contributions you can make and the amount you hold in superannuation
- Rules are complex and subject to change
- Fees would apply to superannuation accounts and vary depending on the fund

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