The Guide to Simpler Super

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Introduction

This article helps explain the basic principles of superannuation.

In summary, the income tax, capital gains tax and asset protection attached to superannuation means that it is often the preferred method of creating wealth for many people.

Disclaimer

Please note that this article should not be construed as legal advice. Readers should refer all specific cases to a qualified legal practitioner for advice.

Introduction

The 2006 year Federal Budget was a watershed event for superannuation. The Federal Government announced a series of changes, the last of which took effect on 20 September 2007, to simplify and de-mystify the superannuation landscape.

What was once remarkably complex and obtuse set of rules has 'morphed' into what is essentially a simple and sensible set of rules that makes super an enticingly rationale and compulsive investment strategy for virtually all clients at all ages.

Interestingly, the rules are still technically complex. For example, all the old rules that bedeviled the taxation of lump sums under age 55 technically still exist, and have to be learnt and understood by the finance professional. But they do not apply in 99% of cases and therefore we will not address them in this special edition. Instead, it makes sense to concentrate on the overwhelming majority of clients who will fund super staggeringly simple from here on, rather than the one or two clients who will run into the old complicated rules.

The Legal E Docs Guide to Simpler Super aims to walk you through these rules and to explain why clients should always consider contributing as much as possible to super for the rest of their working life. The Guide will show how, even if clients do nothing more than this, they will end up much more wealthy than they otherwise would have become.

What this Guide is about

The Legal E Docs Guide to Simpler Super keeps things deliberately short and simple and addresses the following questions:

(i) what is superannuation?

(ii) why is superannuation so important for working Australians?

(iii) who can contribute to a superannuation fund?

(iv) what contributions are deductible?

(v) what are the tax benefits of contributions?

(vi) how are fund earnings taxed?

(vii) what benefits can be paid by a fund? and

(viii) how are benefits taxed?

Part One: The Starting Point

A good starting point for superannuation is that clients at all ages and at all stages of the financial planning process should consider making full use of the concessional super rules as an integral and major part of any investment planning strategy. This is so even for people in their early thirties, even though for these people the ages of 55 and 60, which are the key dates for accessing super benefits, seem a long way off.

The population is aging and the government faces a relatively reduced capacity to support older citizens though a public pension scheme[1]. In fact there is every chance that in thirty years time there will not be an old age pension as we now know it. It's probable that it will regress to its original format of a basic sustenance payment calculated to keep body and soul together, and much less than a minimum income. It's axiomatic that clients should aim to accumulate enough wealth during their working life to support themselves financially through an extended retirement of 25 or more years.

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[1] To get a feel for the information and thoughts being provided to the financial planning profession by the Federal Government, read the speech delivered by the Deputy Governor of the Reserve Bank of Australia at the FPA National Conference on 16 November 2005, which can be downloaded at http://www.rba.gov.au/Speeches/2005/sp_dg_161105.html

What’s the simplest way of making sure you can do this? The answer is “superannuation”.

But there is more to super than ensuring a bleak minimalist standard of living in advanced old age. Superannuation allows clients to accumulate significant wealth in what can become a tax free environment The tax benefits are unbeatable and, with careful planning, will have a significant positive effect on long term wealth accumulation.

In summary, super is super. Super cannot be ignored if you are serious about showing your clients how to build wealth.

What is superannuation?

The basic concept

Superannuation is a form of savings and investment where money is set aside by a member and/or their (ie saved) and used to acquire income producing and capital appreciating assets (ie invested) for the benefit of the member’s retirement. A super fund is an ideal way for people to invest money for retirement.

Most super schemes also provide for ‘ancillary purposes’ such as the payment of death benefits or other benefits if people are seriously injured or become ill and are not able to work.

Tax concessions and other government benefits make super one of the best long-term investments. These concessions occur at each of the three phases of super, being:

> the **contributions** phase, ie when you are in practice and are contributing some of your income to super each year. Tax deductions reduce the after tax cost of these contributions and in effect allow you to invest more than you otherwise could;
>
> the **accumulation** phase, where contributions previously paid in to the fund are invested in income producing and/or value accumulating assets. A low or nil tax rate on earnings means the assets compound in value faster than would otherwise be the case; and
>
> the **benefits** phase, where benefits can be taken out after age 60 without any tax charge (and with only concessional tax charges applying earlier).

As result of the announced changes to superannuation, these three phases now overlap in many circumstances.

What is a "superannuation fund"?

A superannuation fund is a type of trust. The essential characteristics of a trust are all present. These characteristics are: a trustee, a beneficiary (ie a member) and trust property (ie benefits). A super fund is controlled by a trust deed, as well as the various laws and regulations applying specifically to super funds and generally to trusts, under both the general law and each state's Trustee Act.

The trust enjoys significant taxation concessions provided its trust deed complies with certain rules and regulations set out in the Superannuation Industry (Supervision) Act and related legislation and regulations concerning:

i. who can contribute to the fund;
ii. who can receive benefits from the fund, and when;
iii. in what form the benefits are paid, ie as a pension or as a lump sum;
iv. how the fund is run on a day to day basis; and
v. what the fund can invest in.

A fund's trust deed must comply with these requirements if it is to be a complying fund and to be eligible for tax concessions under the Income Tax Assessment Act.

What types of superannuation funds are there?

There are five basic types of super fund. These are:

i. **corporate funds**, which are open to people working for a particular employer or corporation (including public sector funds);
ii. **industry funds**, which were originally formed as part of the Hawke Government/ACTU Accord and were limited to workers in a particular industry or a particular award, but which are now virtually open to the public;
iii. **retail funds** run by financial institutions, which are open to the public;
iv. **self-managed super funds**, which are open to up to four people; and
v. **small APRA funds**, which are actually very rare and use a special trustee and are controlled by the Australian Prudential Regulation Authority.

A superannuation fund is a form of trust and is established and controlled by a trust deed. Trustees run the fund and, by law, the trustees must act honestly and prudently, and make decisions in the best interests of all members[2].

Superannuation funds are often defined by reference to whether they are a "defined benefits fund" or an "accumulation fund". Defined benefits funds are older funds that express a member's benefit as a multiple of their final salary, or a similar measure. They are becoming less and less common and have been largely replaced by accumulation funds, where a member's benefits are determined by their contributions (including employer contributions) and the accumulated earnings on those contributions, much like a conventional bank account.

What is a retirement savings account?

A retirement savings account is an alternative form of superannuation benefit. It is a superannuation account offered by a bank, building society, credit union or a life insurance company. Retirement savings accounts differ from other superannuation funds because they don't have a trust structure and are run like a bank account.

Who regulates superannuation funds?

Three government agencies regulate the superannuation industry. These are:

> the **Australian Securities and Investments Commission**, which regulates what funds tell you about themselves and how they abide by company law;
>
> the **Australian Prudential Regulation Authority**, which regulates how funds other than self managed superannuation funds and makes sure they comply with the superannuation law; and
>
> the **Australian Tax Office**, which regulates self-managed funds and how they comply with the superannuation law as well as employer contributions (the superannuation guarantee), co-contributions and superannuation tax rules.

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[2] A 'Google' search will throw up more expansive discussions of the various types of superannuation funds. Some commentators allow for more than four basic types, and others group in other forms of superannuation investment. One good summary is the South Australian Government's law handbook and it can be accessed at
http://www.lawhandbook.sa.gov.au/ch21s03s04.php

What superannuation is not?

Just as much as thinking about what superannuation is helps clients to understand superannuation, so does thinking about what superannuation is not.

Superannuation is not an investment. Rather, superannuation is a way of investing. You cannot ‘invest in super.’ It is not an asset class like cash, property or shares. Rather super is a medium for investing in assets as cash, property and shares, and is normally constructed as a trust.

The trustee of the trust holds these assets on trust for the beneficiaries, ie the members, and the members are beneficially entitled to both the capital and the income from these assets.

Superannuation is not something that is likely to change for the worse. Clients are constantly asking whether we (ie advisers) can guarantee that superannuation will not change once they have commenced contributing to their fund. Obviously we cannot.

But we can observe that for the last ten years or so the trend in the changes has been to make superannuation better than ever. Virtually each budget has contained an announcement, big or small, to improve the tax efficacy of super. Politics, and the imperative of buying the baby boomers’ votes, undoubtedly influenced the May 2006 super changes. It’s hard to see these forces neutralizing or reversing themselves in our lifetimes. So it is most unlikely that super will change for the worse in the foreseeable future.

Finally, superannuation is not ‘taxed three times.’ This one has been going around for years as a reason to not invest in super. It’s a disingenuous argument that deliberately misleads people to think super is tax inefficient, when it’s actually the most tax efficient investment vehicle available.

Admittedly, up to 30 June 2007 super was taxed three times, but it was still taxed much less than other investments. And since 30 June 2007 super is not taxed three times. It’s just taxed on the way in and along the way until a pension starts at age 60 (or earlier). And benefits are not taxed after age 60.

Why is super so important for Most Clients?

Superannuation has always been important for most clients.

It is a powerful financial planning tool that integrates tax planning with investment strategies producing very powerful long term results.

Part Two: The May 2006 Superannuation Revolution

The May 2006 Budget introduced some of the most far-reaching changes to the superannuation sector that we had seen for years.

Why a revolution?

For most clients the new super rules present a new world of investing where superannuation can become a tax free family investment vehicle. Paying tax can become almost optional for persons over age 60. And that's a large, and increasing, proportion of the population. This is a revolution in taxation jurisprudence. It is the first time we have ever seen Government sanctioned/encouraged tax planning on such a large scale

For example, take a sixty year old married male business owner whose spouse does not work. The business makes $150,000, and the couple has $3,000,000 in assets, comprising a home worth $1,000,000, a residential investment property worth $1,000,000 and shares in a SMSF worth $1,000,000. Assume an average earning rate of 10% per annum on these assets[3].

The couples' total income is $450,000, made up of:

(i) $150,000 per annum of business profit;

(ii) $100,000 per annum net earnings on the property, comprising, say, $20,000 net rent plus $80,000 in un-realized capital gain;

(iii) $100,000 per annum net earnings on the shares in the SMSF.

The client and his wife will face a tax bill of just $28,200, or about 6%, on this income of $450,000. This tax bills is calculated as follows:

Income Component	Amount of Income	Tax on Income
Superannuation contributions	$100,000	$15,000
Un-realized capital gain on home	$100,000	$nil

[3] 10% per annum is a conservative estimate of expected average earnings, and is much less than the historical averages.

Businessman's taxable income	$37,500	$6,600
Spouse's taxable income	$37,000	$6,600
SMSF income (other than contributions)	$100,000	Nil
Un-realized capital gain on investment property	$75,000	Nil
Total	**$450,000**	**$28,200 or 6.2%**

The client and his spouse can take as much cash from the SMSF as they need, on top of their taxable income of $37,500 each. This extra cash is not assessable income and does not affect the amount of tax they pay on their salary and other assessable income. So cash flow is not an issue.

This example is not an extreme example. Advisers are achieving results like this every day with clients. It's simple, safe and has the Federal Government's blessing.

How can a client best use the new superannuation rules?

Careful planning over the years, even the decades, leading up to age 60 is the key. Clients should start superannuation planning as soon as possible.

Certainly paying the maximum deductible contributions each year, if possible for both yourself and your spouse, is a good start. Get your super balls rolling as early as you can and, if you are already over 50, make a big effort to pay the maximum deductible contributions of $100,000 a year whenever applicable.

From 1 July 2007 the age based deductible contribution limits fall to $50,000 irrespective of the member's age (with transitional rules for those over 50: they can pay $100,000 a year each year for 6 years until 30 June 2013).

If clients are already reasonably wealthy and getting closer to age 60 they should consider paying un-deducted contributions up to the limit of $150,000 per person per annum. That's a total of up to $300,000 per annum, or $3,000,000, plus earnings, from age 50 to age 60 (for a couple). Transferring the future income stream to the SMSF is the economic equivalent of extra deductible contributions above and beyond the $50,000 cap.

Contributions

Who can contribute to a superannuation fund?

From 1 July 2007 the rules for who can contribute to super are very simple.

Under age 65

Any person under age 65 can contribute to super. This is so even if they are not working: there is no work test for persons under age 65.

Age 65 to 75

Once you reach age 65 you can contribute to super if you pass the work test. The work requires you to have worked for at least 40 hours over 30 consecutive days at the time the contribution is paid.

“Work” is defined broadly to in effect include time spent administering investments and also includes paid work where the payer cannot claim a tax deduction for the payment, such as baby sitting or private gardening.

Age 75

After age 75 you cannot contribute to super (although you can pay a spouse contribution on behalf of your spouse if the spouse is under age 65.) However, a fund can still accepted mandated contributions made under an industrial award that does not specify an upper age limit. We have heard of clients over age 75 obtaining a “private” industrial award that facilitates such contributions, although we have not arranged this ourselves.

Children under age 18

Contributions can be paid for a child under the age of 18. However, the child must derive eligible employment income or business income before they can claim a tax deduction for the contributions paid for them.

Summary table

Member's Age	Conditions to be met before a fund can accept contributions
Under age 65	No conditions. All contributions can be accepted
Age 65 to age 75	The fund may accept: (i) mandated employer contributions; (ii) employer contributions other than mandated contributions; (iii) member contributions
Age 75	Only mandated contributions can be accepted over age 75

What contributions are deductible?

Contributions by self-employed persons and employers are deductible in the year they are paid to the fund up to the member's deduction limit. From 1 July 2007 100% of the contributions paid by a self-employed person are deductible, whereas previously only the first $5,000 plus 75% of the excess were deductible.

An employer that is a company, including a company that is a trustee of a trust, can superannuate persons who are general law employees and can also superannuate persons who are not general law employees but who are directors. This is because directors are deemed to be employees for superannuation purposes. This is the law and the ATO has recently issued a public ruling In which it accepts that this is the law.[4]

The deduction limits are now $50,000 per member, subject to a special transitional rule that allows persons age 50 and over to claim $100,000 a year until June 2012.

The deduction limit used to apply on a per employer basis. This was great news for some professional groups, such as doctors and dentists, because it meant they could have double or even triple the normal age based deduction limits[5]. But from 1 July 2007 the deduction limit applies on a per member basis, which takes away the opportunity for double or even triple contributions.

[4] The law does require that the income being derived is not personal services income in order for a director to be superannuated.

[5] Our record was five times the aged based limit, achieved for a specialist doctor employed by five different hospitals in the year ending 30 June 2006.

What contributions are not deductible?

Employee contributions are not deductible. However, there is a special concession originally intended for clients who are substantially self-employed but who derive limited salary income from part time employment.

This concession is colloquially known as "the 10% rule". Briefly, provided no more than 10% of a client's assessable income is salary from an employer who is required to superannuate them under the law, the salary is ignored and the client is treated as a self-employed person for super purposes.

When is interest on amounts borrowed to pay contributions deductible?

Interest incurred by an employer on a loan to pay employee contributions is deductible.

Otherwise interest incurred on a loan to pay contributions is not deductible.

For self-employed [eople, this means care is needed when paying contributions other than employer contributions to ensure that borrowings are not directly used to pay contributions. Instead, borrowings should be used for other purposes where the interest on the borrowing is clearly deductible, and debt free cash flow from the business is then used to pay the contributions.

For example, a dentist practising in her own name may choose to borrow to pay all of her non-superannuation expenses, such as staff costs, rather than pay cash. She then uses the cash flow that has been 'freed up' to pay her own superannuation contributions. At the end of the process, she has deductible interest being incurred on the borrowing and has superannuated herself.

What are the tax benefits of large deductible contributions?

Super contributions are usually tax deductible. This means the Government rewards clients for providing for their own financial future. $100,000 of contributions can generate an immediate and certain return of up to $31,500 cash. This makes super the ultimate tax-planning scheme.

From 1 July 2007 the savings depend on the member's age, and hence the maximum amount they are able to contribute, and the member's marginal tax rate.

Single persons under age 50 can be at least $8,250 better off in cash, and married people under age 50 can be as much as $31,500 better off in cash as a result of paying $50,000 of deductible contributions.

Single people over age 50 will be at least $16,500 better off in cash, and married people over age 50 can be as much as $63,000 better off in cash as a result of paying $50,000 of deductible contributions.

The results are summarized in the following table:

Member's Age	Member's age based deduction limit	Member's net tax rate (plus Medicare Levy)	Maximum tax benefit single person	Maximum tax benefit couple
0 to 50	$50,000	31.5% less 15%	$8,250	$16,500
		41.5% less 15%	$13,250	$26,500
		46.5% less 15%	$15,750	$31,500
50 plus	$100,000	31.5% less 15%	$16,500	$33,000
		41.5% less 15%	$26,500	$53,000
		46.5% less 15%	$31,500	$63,000

Bear in mind tax benefits are cash benefits: you have to (up to) almost double it to calculate the effective pre-tax equivalent income. For example, $63,000 tax-free is the same as $114,545 in pre-tax taxable income, for a person with a marginal tax rate of 45%.

Figures for couples are included because self-employed people are typically able to superannuate their spouse out of the business's pre-tax income. This is another reason why super (and self-employment) is so good. And this is just the beginning. The tax benefits go on and on, making sure that super is the most tax efficient investment vehicle available.

Part Three: Earnings within a Superannuation Fund

How are fund earnings taxed?

Once the contributions are received by the fund they are invested. These investments produce earnings in the form of dividends, rents or interest.

These earnings are taxed very concessionally, which means the after tax rate of return on a given investment will usually be greater in a super fund than it would be for the same investment in virtually held by virtually any other investor.

The rules are summarized in tabular form as follows:

Income component	Tax rate in accumulation mode	Tax rate once pension starts
Income (ie rents, dividends and interest)	15%	0%
Realized capital gains on assets held less than 12 months	15%	0%
Realized capital gains on assets held more than 12 months	10%	0%
Unrealized capital gains	0%	0%

These tax rates compare favorably with the personal tax rates and are particularly good for unrealized capital gains: capital gains are only taxed when and if the underlying asset is sold, ie on realization.

Amongst other things, this means 'buy and hold' strategies are very tax efficient for SMSFs. If clients hold the asset for long enough, ie until a pension starts, there will be no tax at all.

Non-arms length investment income in a SMSF

Special rules apply to 'non-arms length investment' income. This income, (for example, private company dividends and distributions from related trusts), is taxed at 47%. This means, as a practical matter, very few super funds derive non-arms length income.

Contributions income

Contributions are taxed at one of three rates:

(i) concessional contributions are taxed at 15%;

(ii) non-concessional contributions are taxed at nil%; and

(iii) concessional contributions above the member's age based limit (Ie $50,000 under age 50 and $100,000 over age 50) are taxed at 47%, and non-concessional contributions above the member's limit (ie $150,000 in a year or $450,000 in a three year period) are taxed at 47%.

A snow ball effect

The concessional rules for taxing contributions and fund earnings mean there is more to invest, and that the amount invested grows faster than otherwise would be the case. We like to think of a bigger snowball and a steeper slope, so that at the end of the slope, ie at the end of a given period of time, the snowball will much bigger than otherwise will be the case. It's a double whammy effect: more at the start plus higher after tax earnings along the way combine to create a much better investment result over time.

Part Four: Benefits Withdrawn from a Superannuation Fund

What benefits can be paid by a superannuation fund?

Most funds pay two types of benefits, being lump sum benefits and pension benefits.

For technical reasons, most trust deeds are drafted with an emphasis on paying pension benefits, with lump sum benefits added in almost as an afterthought. This emphasis is a little duplicitous. It's really there to satisfy various constitutional rules relating to the Federal Government's power to legislate for superannuation funds. The constitution does not allow the government to legislate for superannuation as such, but it does allow it to legislate for pensions. The government therefore made the superannuation tax benefits dependant on whether a fund was set up for the primary purpose of providing members with pensions. Because the fund wants to get these tax benefits, its deed is drafted to reflect a primary purpose of providing members with pensions. This is the case even when the trustees/members never had any intention of drawing a pension and always intended to draw a lump sum benefit.

Lump sum benefits

A lump sum benefit is a simple enough concept to understand. It is a lump sum benefit, ie a benefit paid to a member in one single lump sum. Superannuation lump sum benefits are eligible termination payments ("ETPs") and are taxed under the rules applying to ETPs, which are discussed in the next section.

But it can be confusing. For example, a lump sum benefit can be paid in a series of instalments over time. Each instalment will be treated a single lump sum. So what looks a lot like a pension is actually treated as a lump sum. This is rare these days but can still happen.

Pension benefits

A pension benefit is really a superannuation benefit other than a lump sum benefit. The word "pension" is really a misnomer in this context. A pension is traditionally a series of income payments paid to a person over the life of that person or for a defined period of time. Hence we think of old age pensions, state government super pensions and private life pensions paid by life offices and similar organizations.

But from 1 July 2007, and particularly from 20 September 2007, a pension benefit can be paid to a member over just one year, or an even shorter period of time, and the only real tax condition is that a minimum amount be withdrawn each year, and there is no upper limit. There is no requirement that the pension last for a member's life, expected life or for a defined period of time.

Different types of pension benefits

Pension benefits can be further divided into a bewildering array of different types of pensions. These include complying pensions, allocated pensions, transition to retirement pensions, growth pensions, market linked pensions and so on and so on.

Thankfully, a detailed study of the different types of pensions that were once available is no longer a sensible use of time. This is because from 20 September 2007 only one type of pension can be started, and this pension is already being described as a "Simple Pension".

In tabular form

Type of pension	Where used?	Start date	End date
Allocated pension	To access tax benefits, (ie fund income and pension income both exempt from tax)	Many years ago	30 June 2007
Market linked pension (aka "TAP")	To access tax benefits, and to access old age pension benefits (ie 50% exemption from assets test)	20 September 2004	20 September 2007 (effectively)
New simple pension	To access tax benefits	1 July 2007	On-going

Simplicity, simplicity, simplicity

The new rules make super pensions much simpler than before. For pensions started before 20 September 2007 the rules are actually a bit more complicated than previously. The simplest way to get a handle on the new rules is look at what the position will be come 21 September 2007, ie the position most people will be in, and to then jump back and look at what the position is between now and 30 June 2007, and at what the position will be between 30 June 2007 and 20 September 2007. That is, let's examine the general rule and then consider two minor, and time limited exceptions. This keeps the examination as simple as possible and avoids unnecessary complications.

After 20 September 2007

The position for super pensions after 20 September 2007 is remarkably simple. In summary, allocated pensions and market linked pensions cannot be started after that date and a member can only start a new simple pension.

The new simple pensions must satisfy five basic rules. These are that:

(i) at least one annual payment must be made each year;

(ii) there is no maximum amount that must be paid, but there is a minimum amount. This minimum amounts are aged based as follows:

Age	% of account balance
55 - 64	4%
65 - 74	5%
75 - 84	6%
85 - 94	10%
95 +	14%

(iii) the pension cannot be transferred, except on death;

(iv) the pension's capital value and income stream cannot be used for borrowing; and

(v) the pension can only be commuted in certain circumstances.

What are the tax benefits of a pension?

Once a pension starts, the income on the assets used to pay the pension is tax free in the fund's hands. The pension income is usually tax free in the member's hands provided the member is age 60 or over.

This creates significant tax planning advantages. It makes sense for clients to move as much of their wealth as possible to the super fund before the pension starts to get the maximum benefit from these advantages.

Wealth is moved to a super fund by concessional contributions (ie the old deductible contributions) and non-concessional contributions and these contributions have been discussed extensively in other Dollar Notes newsletters. Let us know if more information is needed.

A summary of the new rules for pensions

From 1 July 2007 only two tax components are relevant: the taxable component and the tax exempt (non-taxable) component.

The tax exempt component includes any un-deducted contributions, CGT exempt amounts and the old pre-1983 service component.

The taxable component is the total benefit less the tax exempt component.

Proportioning rule

From 1 July 2007, when a lump sum is taken, the components of the lump sum are determined by the relative proportions of each of the exempt component and the taxable component at the date of withdrawal. This is known as the 'proportioning rule'. For pension payments and lump sums from a pension account, the proportions are fixed at the date the pension starts and this fixed proportion applies to all pension payments from then on.

Proportioning rule for members under age 60

For members under age 60 the exempt proportion of a withdrawal/pension payment is tax free but the taxable component will be taxed in accordance with the member's tax profile. The rate of tax and the tax offsets depend on whether the withdrawal is a lump sum or pension.

If the pension is a 'pre-retirement' pension or a "transition to retirement" pension, ie where the pensioner is between age 55 and 65 and has not retired, the maximum amount be drawn each year is limited to 10%.

What about pensions on foot at 1 July 2007

Pensions on foot at 1 July 2007 can convert to the new style pension.

The conversion has to be documented correctly, which boils down to the member lodging an application to convert an existing pension and the trustees minuting the decision to accept the application and to convert the member's pension.

Proportioning Rules for members over 60

The proportioning rules are less important for members over age 60 as all lump sum benefits and pension benefits are tax free irrespective of the relative proportions of the exempt component and the taxable component.

But the proportions still need to be calculated and recorded as they will become relevant if the member dies. This is because benefits to dependants are taxed if paid from the taxable component (but not from the tax exempt component)

Proportioning rules for those under 60

The new proportioning rules do not apply to existing pensions being paid to members under age 60 at 1 July 2007. These members may stay under the old pre-30 June 2007 rules. However, if there is a major change in the pension's format, for example if the pension is commuted, is partly commuted or the member turns age 60 the new proportioning rules start automatically.

So the old rules are theoretically still relevant until 1 July 20012, if five years after the start of the new rules by which time all pensioners aged 55 at 1 July 2007 will have turned age 60.

Existing Complying Pensions

The old style "complying pensions" such as "term allocated pensions" (or "TAPs") and defined benefit pensions cannot be converted to the new style of pensions. This is because conversion in effect requires commutation, and non-commutation was a pre-condition to these old complying pensions receiving their tax benefits and Centrelink old age pension benefits.

How are superannuation benefits taxed?

Lump sum benefits

The taxation of lump sum benefits depends on the composition of the benefit and the age of the person receiving the benefits.

Any lump sum benefits received after 1 July 2007 by a person age 60 or more are tax free.

If the person is under age 60 it becomes more complex. Basically the pre-1 July 2007 rules apply and these are summarized in the following table:

Component	Description of component	Tax Payable
Tax-free component	The tax free component at 1 July 2007 plus any non-concessional (ie un-deducted) contributions after 1 July 2007	Nil%
Taxable component	Taxable component (ie the benefit paid less the tax-free component, if any)	Age 60 or older: nil% Between age 55 and preservation age: nil % on the first $140,000 and 16.5% on the remainder Age less than preservation age: 21.5%

Pension benefits

The taxation of pension benefits also depends on the composition of the benefit and the age of the person receiving the benefits.

Any pension benefits received after 1 July 2007 by a person age 60 or more are tax free.

As is the case with lump sum benefits, if the person is under age 60 it becomes more complex. Basically the pre-1 July 2007 rules apply and these are summarized in the following table:

Component	Age/disability status	Tax payable (plus Medicare levy of 1.5%)
Taxable component paid by a taxed fund.	Under age 55 and no disability	Marginal tax rates apply to the whole amount
	Between age 55 and 60 or under a disability	Marginal tax rates apply to the whole amount, less a 15% offset on the whole amount
	Age 60 and above	Tax free
Taxable component paid by an untaxed fund (rare for most clients)	Under age 55	Marginal tax rates apply to the whole amount
	Between age 55 and 60	Marginal tax rates apply to the whole amount
	Age 60 and above	Marginal tax rates apply to the whole amount, less a 15% offset on the whole amount
Tax-free component	Any age	Always tax free