

THE AUSTRALIAN SUPERANNUATION SYSTEM – AN OVERVIEW



In Australia our Superannuation and pension system is very different to the UK but is arguably much simpler to understand.

State and Age Pensions

The UK State Pension System is based upon personal contributions being made over a 30 year period with the level of pension then being a function of how many years contribution have been made. For instance, if you have contributed to the State Pension via your National Insurance Contributions for 15 years you will receive 50% of the entitlement i.e. 15/30 years in retirement.

In Australia we do not make specific contributions to our state or age pension. Our age pension is a non contributory scheme with the benefits being subject to a means test. Essentially, our age pension is meant to provide a base pension for these people without any other means of support. As the level of assessable assets, which excludes the family home, increases the age pension will reduce. For a married home owning couple the pension reduction begins once assets exceed \$252 500 and for a single home owner this figure is \$178 000. Once the assessable assets exceed \$928 000 for a married couple who own their home then no age pension will be paid. This figure is \$626 000 for a single home owner.

Pensions and Superannuation

Australian superannuation funds are now almost entirely contributory schemes, which in UK terms are Money Purchase Schemes. The days of final salary or defined benefit schemes are virtually a thing of the past, as they will also become in the UK. In the early 1980's, the Australian Government introduced the Superannuation Guarantee System under which all Australian employers must now contribute at least 9% of every employee's salary and wages to a superannuation fund. Every person employed in Australia therefore has at least 9% of their salary and wages paid into a superannuation fund for their entire working life. They also have the option of adding further contributions out of their own wages as salary sacrifice contributions, as well as being able to select the types of investments, to determine the level of risk they are prepared to accept, and they can also include life and income protection or salary continuance insurance if they so choose. The flexibility is therefore available to meet the needs of everyone. Changing jobs or employers is also a very simple process for superannuation funds as they are like personal pensions, are fully transportable, and can be used for your working life and then retirement. There is no need to change funds or to buy an annuity at some designated age as there can often be in the UK.

There are now essentially three types of Superannuation Funds that operate in Australia, Industry Funds, Personal or private Funds, and Self Managed Funds, (SMSFs).

Industry Funds are mostly operated by large industry Bodies and are often used as the default option by employers who do not wish to establish their own employer based fund. In this way there can be some economies of scale achieved. Typically, with these funds there is a limited range of investment options and risk profiles to choose from and whilst the fee structures are competitive the limitation on options and the lack of comprehensive financial advice within the funds can be a limiting factor. Just the same, for many Australian workers, these funds offer a reasonable outcome for the members.

Our regulations also stipulate that individuals have the right to opt out of the employer default option and nominate to have their own personal superannuation fund if they wish. This is known as Member choice. In opting out the most common choice is now a superannuation Masterfund or wrap service under which the individual member has the choice to invest their funds in a very broad range of options from direct shares through to wholesale managed funds. Through this structure they can construct a portfolio that meets their personal risk profile and needs. The benefits of using a wrap service include consolidated reporting, direct access to buy and sell shares, as well as the ability to invest in wholesale managed funds and bank cash term deposits.

This option will enable you to have only one Superannuation Fund throughout your entire working life and to simply convert it to a pension internally when you retire. You retain full control but do not have to manage any compliance issues or taxation issues each year.

The third option is a Self Managed Superannuation Fund (SMSF). You would generally choose to have your own SMSF where:-

- Assets are likely to exceed \$500 000 – \$600 000 and
- You wish to include other investment assets such as rental property within your portfolio.

The closest UK equivalent to a SMSF is a SIPP. Having a Self Managed Fund will allow you to include your spouse as a member, plus you may want to include children as members for estate planning purposes.

From an estate planning perspective a self managed fund can give you far greater flexibility which is one reason why they are so popular. From an investment perspective the range of investment options is virtually unlimited as long as the investments are adequately described within the accepted investment strategy documents for the fund. The Administration function is generally provided by an accountant unlike the Industry Fund or the wrap service but the costs of running such

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a fund can also be kept within a very cost effective range and can, for larger funds, be much more cost effective than other options.

The underlying security of superannuation funds is a function of the actual investments held by the funds. Unlike the UK where we are seeing many pension schemes move to voluntary administration, the Australian system is quite different. As long as the assets selected and held within the fund are secure, and the amounts of money being withdrawn have not literally drained the fund of all of its assets, then the fund cannot be placed into administration as can occur in the UK. That does not mean that the fund cannot run out of money, as it can. If the members wish to withdraw all of the fund assets out of super and they are of such an age (currently age 55 and no longer working) they can elect to withdraw the full amount out and do whatever they like with the funds. Similarly, if the members have retired and have converted the fund to a pension then they can still access additional amounts of money over and above the pension which may cause the fund assets to become exhausted. Alternatively, if the investment options nominated are very high risk and the values collapse then the fund is simply wound up or closed. If the fund is UK QROPS accredited and the member has been a non UK resident for less than 5 full UK tax years then there will be significant UK taxation implications if the funds are fully withdrawn. Advice and caution are therefore essential with such a strategy.

Taxation on superannuation funds.

When you, or your employers contribute to your superannuation fund our taxation structure is vastly different to the UK. Typically, when you are employed your employer must contribute a minimum of 9% of your wages to super. At the time the contribution is made the fund is then required to remit 15% of the contribution to the tax office as contributions tax. Similarly, each financial year (July 1 – June 30) the fund is required to remit a further earnings tax of up to 15% on the income earned within the fund less the cost of any fees and expenses incurred within the fund that year. This might seem onerous however if a majority of the assets are held in either tax effective investments or investments that offer more capital growth than income, the tax liability can be kept at very low levels. It is not unusual to have this tax as low as 5% and can often be reduced to nil.

Then when the fund member retires, and elects to draw a pension from his funds the internal tax structure is reduced to zero and if the member is age 60 or more, the pension and or lump sum that they draw will be totally tax exempt. Clearly this is vastly different to the UK where tax relief is given to contributions but then income tax is paid on all pension income and there is generally no ability to draw any one off lump sums to meet expenses, such as

a new car. When the member retires and converts to a pension within the fund the new structure is deemed to be an Account based pension. Under this structure there is a minimum pension that must be paid, but there is no maximum. You can draw periodic lump sums for expenses or to supplement your lifestyle, which will also be drawn tax free. The annual income minimum payment calculation is a function of the account balance at June 30 each year and the members' age at that time. At age 60 the minimum pension will be 4% of the account or fund balance at June 30 of that year. This percentage amount rises over time, in 5 year increments.

If your pension income is paid almost entirely from your Australian superannuation fund you will generally not be required to submit an annual tax return. There should be no need as your pension income is tax exempt.

Death benefits

Finally, the other big difference between UK and Australian pensions becomes apparent when the member dies. In the UK there is typically a reversionary pension paid to the spouse of 50% of the pension amount and then when the spouse dies the balance is often retained within the fund.

In Australia however, when the member dies there is a 100% tax free reversion to the spouse and then when the spouse dies the remaining benefits can be passed onto children or paid out as part of the estate. There may be some tax payable when paid to non dependents but there are ways to minimize any potential liability long before this arises.

Summary

Australian superannuation pension incomes are tax free, and on death pass 100% to the spouse tax free and then onto children or the estate.

British pensions are fully taxed in either the UK and Australia and upon the death of the member there is often a 50% reversion to the spouse but nothing to the children or estate when the spouse dies.

Clearly, there are significant differences between UK pensions and Australian superannuation funds, but what is abundantly clear is the fact that there can be significant benefits to be gained by transferring your UK pension funds across to an approved Australian scheme that is UK QROPS accredited.

Proper advice is essential and so is your understanding of the Australian system and process.

For further information or clarification of any issues raised in this brochure please feel free to contact Global Pension Transfers at www.globalpensiontransfers.com or email us at info@globalpensiontransfers.com or phone +61 7 3369 6211.

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