Cutcher & Neale

Cutcher's Clues to Superannuation

thesupersleuth

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Welcome...

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In this issue, we'll look at the significant superannuation changes from the May 2006 Budget, and 5th September 2006 announcements. We are also holding a free seminar which will be a great avenue for you to raise your issues in an open forum and discuss the important topics and strategies amongst your peers.

If you require any further information or assistance on any of the issues covered please contact us.

in this issue...

Stop Press! 30th June 2007 Deadline

Sweeping changes have been made by the Federal Government to the May 2006 Budget announcements that mean you must act now to take full advantage of concessions before the cut off date of 1 July 2007.

The devil will be in the detail but the main action items in the next eight months will be:

Consider contributing what you can into superannuation!

Got a spare million? Put it into superannuation and receive the benefits down the track with concessionally taxed earnings and NO tax on withdrawal of funds post age 60.

The government has announced that the previous imposition of a $150,000 limit on undeducted contributions will be relaxed until 30 June 2007. Undeducted contributions of up to $1 million can be made prior to 30 June 2007.

After 1 July 2007, the limit on undeducted contributions will generally be $150,000 per year or $450,000 averaged over three years.

Exemptions to this cap will include:

- Certain proceeds from the disposal of assets that qualify for the small business capital gains tax "CGT" exemptions up to a lifetime limit of $1 million (indexed).
- The proceeds from a settlement for an injury resulting in permanent disablement.

Get tax deductions while you can!

The previously announced limit of $50,000 per year in deductible contributions from 1 July 2007 will remain. This figure will be subject to a transitional phase for the over 50s, whereby a deductible contribution of up to $100,000 may be made up until the 2011/2012 financial year.

The opportunity to make double age based contributions and receive double tax deductions will expire on 30 June 2007.

From 1 July 2007, contributions will be assessed on a member basis and not on an employer basis. When the relevant threshold is exceeded, tax on the excess contributions will be applied at 45%.

Time is running out to qualify for the Age Pension!

The assets test exemption for complying income streams (Market Linked pensions) will be removed for income streams purchased on or after 20 September 2007.

Therefore, to receive the current 50% assets test exemption action is needed now!

What else is the Government doing?

- There will be an increased Australian Taxation Office "ATO" compliance focus on self managed superannuation funds (SMSFs).
- From the 2007/08 financial year, the annual supervisory levy of $45 will be increased to $150 per SMSF.

Stop Paying Off The Mortgage?

"Always pay off the mortgage first" has long been standard advice.

With the recent changes to superannuation, many core strategies are changing. In the "new" world of Simpler Super, the best advice may be to pay off the mortgage last, as doing so could substantially increase your wealth.

Changing to an interest-only mortgage repayment, using salary sacrificed superannuation as an alternative way to pay off the home on retirement is just one of the many new strategies.

Under the proposed rules, wage earners will be able to sacrifice up to $50,000 a year into superannuation. It will be taxed at 15%, compared with the new top income tax rate of 45%.

This means that instead of paying off the principal of your home through mortgage payments, which are taken from after-tax monies, retirees can pay off the principal out of low-taxed super savings.

The budget has made this approach more attractive by removing the tax on lump sum super payouts for retirees aged over 60 and allowing them to save as much as they like. Part of the lump sum, "fattened" up using low-taxed super contributions that would have otherwise gone on bigger mortgage repayments, can now be used to pay off the family home. Even after paying off the home loan, the size of retirees' super nest egg should still be bigger using this method of saving for the future.

The financial advantage of this strategy could be eroded if interest rates rise or through poor fund performance and will only be applicable to a certain demographic approaching retirement.

Enhanced Tax Deduction on Death Benefits

The Income Tax Act provides an opportunity for a self managed superannuation fund (SMSF) to potentially increase the amount of a death benefit paid to dependants.

This payment, called an anti-detriment payment, is designed to ensure that the level of death benefits that can be paid by a SMSF are at a level that would have been paid, assuming the same level of contributions and fund earnings, had there been no tax payable by the fund on taxable contributions (which was the case prior to 1 July 1988).

After the death of a taxpayer, an extra payment may be made by the fund as a death benefit payment in addition to the member's balance. This extra payment (subject to a formula calculated under Section 279D of the Income Tax Assessment Act 1936) can result in the fund receiving an income tax deduction for an amount much larger than the actual payment, which may be carried forward to offset any future tax on contributions or earnings for the other members.

Example

James was a member of the James Super Fund and on his death, the trustees paid out his balance of $300,000 as a death benefit to dependants. The trustees have calculated that an anti-detriment payment of $35,000 (a formula calculates this amount) paid as well as the death benefit of $300,000 would give the fund a deduction for approximately $235,000.

Therefore the remaining member/s and future members can have the benefit of this deduction in the fund until fully utilised.

The issue to come out of this is that the fund needs to pay the extra $35,000 from somewhere as this cannot be paid from another members benefit.

The answer is in the establishment of a Reserve within the SMSF so that the capital is there to pay the anti-detriment payment prior to the deduction being claimed.

The fund must also be able to utilise the losses. This could occur through introduction of children into the fund while they are in accumulation (contribution) phase.

The Ultimate

The recent changes to superannuation have opened up a wide variety of strategies that will effectively mean more wealth being passed down the generations through the concessionally taxed self managed superannuation fund (SMSF).

With the tax in an SMSF being only 15%, the use of a SMSF as a wealth creation and estate planning vehicle has never been more prevalent. The effect of the recent changes on estate planning may be seen below:

No compulsory cashing of superannuation

Previously, superannuants had to take their benefits as a lump sum or pension on attaining age 65, or if still in the workforce, at age 75. The government will introduce legislation to scrap the compulsory cashing rules and enable members to maintain their superannuation balance in a concessionally taxed environment. This will mean that if members have assets outside superannuation to live off, the superannuation savings may be used as an efficient wealth creation and estate planning tool.

Tax free withdrawals from superannuation

For members aged over 60 who have met a condition of release, the withdrawal of lump sums or pension payments will be tax free. This opens up opportunities for estate planning.

From 1 July 2007, a member's balance will be made up of two components. One is the "taxable component" which will generally be the current Post June 1983 component and the other being "exempt component" which will generally be made up of undeducted contributions and also any Pre 1 July 1983 component assessed at 30 June 2007. Superannuation funds will have until 30 June 2008 to calculate this amount.

On death, any payments of taxable balance to non-dependants (eg. adult children) will be generally taxed at 15% (+1.5% medicare levy). If your superannuation balance is paid to a dependant (eg. surviving spouse) then the total payment is tax free. However, consider the situation of a sole member or widower with no tax dependants. Their entire taxable balance will be hit with a 16.5% tax bill on the payment to their adult children (as non-tax dependants)! Not a desirable outcome.

One strategy that may be employed is some forward planning in the years that contribution tests are satisfied by the member.

Estate Planning Vehicle!

Example

Jeff is 60 years of age, not working and his spouse Mary had passed away a number of years ago. Jeff is currently the sole member of his SMSF. Jeff has 3 adult children who are financially self sufficient (non-dependants for tax purposes) and wishes all his benefits to be passed equally to the 3 children. Jeff has $650,000 in taxable benefits and $350,000 in undeducted contributions at 30 June 2007. If we assume he has no Pre July 1983 service then at 1 July 2007 his benefits will be $1,000,000, made up of taxable component of $650,000 and exempt component $350,000.

If Jeff were to die on 1 July 2007, his death benefit would be paid equally to his 3 children ($333,333 each). However, the taxable component will be taxed at 16.5%, producing a tax bill of $107,250 and net benefits to each of the children of $297,583 instead of $333,333.

Strategy

From 1 July 2007, Jeff may drawdown his benefits in the form of lump sum or pension and re-contribute any amount back into superannuation prior to attaining age 65 (where he would then have to satisfy work tests).

Therefore, with the new undeducted contribution limits, Jeff may withdraw $150,000 per year and re-contribute this as an undeducted contribution. Please note that the withdrawal must be pro-rated between taxable and exempt component. The table below illustrates this position.

The table does show, however, that the draw-down and re-contribution strategy that Jeff has been able to employ prior to age 65 will mean that the tax payable on a death benefit to non-dependants has decreased from $107,250 to $30,792 ($186,617*16.5%).

You will also note that Jeff has made a $450,000 undeducted contribution while aged 64. The government has relaxed rules and will allow a 64 year old to make an undeducted contribution without the need to pass the work test in the following 2 years. Jeff could have made the $450,000 contribution in the 2007/08 year but this would have been averaged out over the next two years at $150,000 per year. This may become the strategy to safeguard against any unlikely or untimely death.

This strategy is extremely important as the government has also proposed that pensions will not be able to be reverted or be paid to a non-dependant on death and that the death benefit payment must be made as a lump sum.

	2007/08	2008/09	2009/10	2010/11	2011/12
Age	60	61	62	63	64
Draw-down	(150,000)	(150,000)	(150,000)	(150,000)	(450,000)
Taxable	97,500	82,875	70,444	59,877	152,687
Exempt	52,500	67,125	79,556	90,123	297,313
Re-contribution	150,000	150,000	150,000	150,000	450,000
Balance					
Taxable	552,500	469,625	399,181	339,304	186,617
Exempt	447,500	530,375	600,819	660,696	813,383
TOTAL	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000

The above is a basic example that does not take into account required living expenses, earnings in the fund etc which would change the component mix.

How To Maximise Your 'Exempt' Component Before 1 July 2007

Exempt = Tax Free

Do you currently have an old insurance policy or superannuation balance outside of your self managed superannuation fund?

Does that balance include any Pre-July 1983 Service or is there a Pre-July 1983 Service in your self managed superannuation fund?

If you answered yes to both of these questions, there is now a limited time to take advantage of the recent Government announcements. From 1 July 2007, a member's balance will be consolidated and will only comprise of two components – 'taxable' and 'exempt'. The exempt component will include Undeducted, Concessional, Invalidity, CGT Exempt and importantly Pre-July 1983 component. Consideration should now be given to consolidating superannuation benefits in order to maximise the Pre-July 1983 component before it is converted into one exempt component from 1 July 2007.

For example, a fund with $2 million in taxable benefits could have a $200 policy rolled in that establishes a 50/50 pre/post July 1983 service period. This will potentially save $165,000 if paid out to a non dependant after 1 July 2007.

Therefore this strategy is also beneficial for estate planning purposes, because the exempt component will be tax-free in the hands of all eligible beneficiaries (including non-dependants – adult children for example).

Incentives For Life Insurance In Super

In the event of death, 'dependants for tax purposes' can receive accumulated super savings as a tax free lump sum up to the deceased's Pension Reasonable Benefit Limit (RBL), while 'excess benefits' are taxed at up to the highest marginal rate of 45%.

In addition to abolishing RBLs on 1 July 2007, the Government has also proposed that all lump sum death benefits will be tax free when paid to 'dependants for tax purposes'. This has created a great opportunity for clients with tax-dependant beneficiaries to take out life insurance in superannuation or to transfer their current life insurance into the superannuation fund from 1 July 2007.

Dependants for tax purposes include a spouse, minor children, individuals in an interdependent relationship with the deceased and financial dependants.

Does Your SMSF Receive Special Income?

What is special income? There are four types of special income set out under the Income Tax Assessment Act 1936:

1. Dividends paid by a private company, including income derived indirectly from a dividend and non-share dividends;
2. Income from a transaction where the parties are not dealing at arm's length;
3. Income received from a trust in the capacity of a beneficiary other than by virtue of holding a fixed entitlement; and
4. Non-arm's length income received from a trust in the capacity of a beneficiary holding a fixed entitlement.

Tax Ruling 2006/7 outlines the process that trustees must complete in order to assess whether the above income components will be classed as special income.

Example

Does your self managed superannuation fund (SMSF) currently hold units in a related unit trust that owns Business Real Property "BRP"? If so, a market appraisal of the rent obtained from the BRP should be sought to prevent the distribution of this income from the trust to the superannuation fund being classified as special income.

There are unfavourable tax consequences for a superannuation fund that has income assessed as 'Special Income'. Rather than the 15% concessional tax rate that applies to income derived by the superannuation fund, special income is taxed at 45%.

Deadline Approaching

Did your self managed superannuation fund (SMSF) invest in units in a related unit trust prior to 11 August 1999?

If so, time is running out to take advantage of the great opportunities that are available to your SMSF in relation to this investment. The grandfathering provisions that apply allow a superannuation fund to undertake a wider scope of transactions that would generally be caught under the Superannuation Industry (Supervision) Act 1993.

So what does this all mean in a snapshot? Trustees should be implementing strategies now to take advantage of their Pre 11 August 1999 Related Unit Trusts before it's too late!!

Diary Dates

October 2006

28 Last day for superannuation contributions to be paid to a complying superannuation fund for quarter 1.

31 Earliest due date for lodgement of 2006 fund income tax and regulatory return for superannuation entities with more than two years outstanding. The Tax Office will send a Supervisory Levy Payment Advice.

January 2007

1 Superannuation guarantee quarter 3 commences.

29 Last day for superannuation contributions to be paid to a complying superannuation fund for quarter 2

Did you know?

Key Superannuation Thresholds For 2006/07

REASONABLE BENEFITS LIMITS	
Lump Sum	$678,149
Pension	$1,356,291
Post June 1983 Low Rate Threshold	$135,590
SUPERANNUATION GUARANTEE	
Maximum Contribution Base	$35,240 per quarter
AGE BASED LIMITS	
Age	Maximum Deductible Contributions
Under 35	$15,260
35 – 49	$42,385
50 – 70 (& 28 days)	$105,113
(changing to $50,000 per member from 1 July 2007)	
UNDEDUCTED CONTRIBUTIONS	
Maximum (9/5/06 – 30/6/07)	$1,000,000
Subject to applicable work tests, reducing to $150,000 p.a. from 1 July 2007.	
SUPER CO-CONTRIBUTION	
Maximum (For a $1,000 contribution.)	$1,500
When income $28,000 or less; reducing to nil when income is $58,000.	

WorkChoices

From 1 July 2006, corporations who previously did not have to offer choice of fund because they operated under a state award will now have to offer Choice. This is due to the introduction of a Federal Workplace Agreement.

Innovative thinking.
Traditional values.

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