



Welcome...

By Robert Taber, Partner

Welcome to our first newsletter for 2007. We hope you all enjoyed the festive season and are ready for a new year.

In this issue we take a look at how SMSF's can be such a great investment vehicle. We also explain why Allocated Pensions are still tax effective and invite you to a free super seminar we are holding. This will be a great opportunity for you to raise your issues in an open forum and discuss the important topics and strategies amongst your peers.

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Never Pay Tax Again!

The May Federal Budget and subsequent announcements have had an incredible impact on the superannuation landscape. The Self Managed Superannuation Fund (SMSF) is now the premier tool for investment and estate planning and this is reflective in the increase in SMSF registrations since the Budget announcements (3,000 per month up from 2,000).



Why is a SMSF such a great investment vehicle?

From 1 July 2007, there are no Reasonable Benefit Limits (RBL) and there is no tax on monies withdrawn from superannuation post age 60. No other investment vehicle can match this. So it is vital for members to maximise the amount of money in superannuation before the laws limiting contributions come into play.

So what do you need to do before the 30 June 2007 deadline?

Summary of Pre 1 July 2007 Super Strategies

| STRATEGY | BENEFICIARY | KEY BENEFIT |
|--|---|---|
| Boost Pre July 1983 Component | Member's who have a pre July 1983 eligible service date within a super fund. | Boost future tax free super benefits |
| Invest in a complying income stream to boost social security entitlements. | Member's who are receiving or wish to receive social security benefits. | Increase in social security entitlement |
| Top-up Undeducted Contributions up to the temporary \$1 million threshold. | Member's who have available capital to contribute to super and have not reached the \$1 million threshold, particularly those aged 65 and over. | Boost super savings |
| Generate tax efficient income in retirement. | Member's aged between 55 and 59 who do not wish to defer retirement until age 60 and retirees seeking to generate tax-efficient income. | Tax effective income |
| Seek a double deduction while age-based limits apply. | Substantially self employed member's or employees under age 70 with multiple jobs. | Tax savings and boosting retirement savings |

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How do you get money into your SMSF before 1 July 2007?

- \$1 million undeducted contribution.
- In-specie contributions of assets.
- Deductible Contribution (Employer)
 - age based limits for 2006/07 are as follows:

| Age | Maximum Deductible Contribution |
|---------------------|---------------------------------|
| Under 35 | \$15,260 |
| 35 – 49 | \$42,385 |
| 50 – 70 (& 28 days) | \$105,113 |

- Deductible Contribution (Self-employed)
 - contribution required to claim maximum deduction:

| Age | Maximum Contribution (to claim age base limit) |
|---------------------|--|
| Under 35 | \$18,680 |
| 35 – 49 | \$54,847 |
| 50 – 70 (& 28 days) | \$138,484 |

Limited opportunities for over 50's

Members of SMSF's aged over 50 will benefit the least from the budget announcements. With the contributions rules changing from 1 July 2007, those who were planning to maximise their superannuation benefits towards retirement now have less time to do so. Deductible contributions of \$100,000 can only be made from 1 July 2007 for a period of five years before the normal contribution rules apply.

One positive change from the original announcements is that the \$100,000 limit will apply to anyone who is 50 by the end of the relevant year (rather than throughout the year). Effectively, this means that anyone born before 30 June 1962 will have at least one year of \$100,000.

Exceeding the Deductible Contributions caps

One new development that was not specifically covered in the Government's earlier announcements is that employer contributions made between 10 May 2006 and 30 June 2006 or between 1 July 2006 and 30 June 2007 that exceed the relevant age-based limits will also be counted against the non-concessional contributions cap (undeducted contributions cap). This is highly relevant for those employed by non taxpaying entities (eg charities, companies with large tax losses) who may well salary sacrifice beyond their normal age based limits.

Overseas Superannuation transfers

It is not only the undeducted contributions and excess concessional contributions that "count" towards the non-concessional contributions cap. For example, certain parts of overseas transfers are also included.

Further changes to the budget and subsequent announcement

Refinements will continue to be made to the May 2006 Budget announcement until it is legislated some time within the next couple of months. The latest update has also seen a change in the minimum pension drawdown factors for the new pension payable from 1 July 2007. These are as follows:

| Age of Beneficiary | Previous Percentage Factors | Current Percentage Factors (Min. Draw-Down) |
|--------------------|-----------------------------|---|
| Under age 65 | 4% | 4% |
| 65 – 74 | 5% | 5% |
| 75 – 79 | 6% | 6% |
| 80 – 84 | 6% | 7% |
| 85 – 89 | 10% | 9% |
| 90 – 94 | 10% | 11% |
| 95 or more | 14% | 14% |



Roll Back Your Allocated Pensions Now And Save \$\$\$

Allocated Pensions, which have been available for more than a decade, are the easiest type of pension to understand and are efficient in providing a tax effective income stream for a member of a SMSF. As detailed in the May 2006 Budget, benefit withdrawals from 1 July 2007 will be tax free for those over the age of 60 – great news!

So why commute your Allocated Pension now?

Many members originally commenced an Allocated Pension because they had to, not because they wanted to. Due to the compulsory cashing rules, member's who had retired from the workforce had to commence a pension from age 65 together with everyone over the age of 75. This has now changed due to the Government announcements – compulsory cashing has been abolished! This means members can have their superannuation benefits accruing indefinitely without having to draw down on the account (commence a pension).

If you were in this position, you could benefit greatly from commuting your pension.

The catch? By commuting your pension, the fund will become taxable to the extent of the commutation. However, when this is taken into account with the tax saving above, benefits may still be achieved.

Example

John is currently aged 75 and in receipt of an Allocated Pension. For the year ended 30 June 2007, he is required to withdraw a minimum pension of \$60,000. He also has other income of \$90,000. John has a number of decisions to make, including whether to draw the minimum pension (if he requires the money) or to commute his pension.

| Personal Tax Position | Including Allocated Pension | Commutation of Allocated Pension |
|-----------------------|-----------------------------|----------------------------------|
| Allocated Pension | \$60,000 | \$0 |
| Other Income | \$90,000 | \$90,000 |
| Taxable Income | \$150,000 | \$90,000 |
| Gross Tax Payable | \$50,100 | \$25,200 |
| Rebate | (\$9,000) | (\$0) |
| Net Tax Liability | \$41,100 | \$25,200 |
| TAX SAVING | | \$15,900 |

| SMSF Tax Position | Pre-Commutation (Balance Exempt From Tax) | Post-Commutation (Balance Taxable) |
|---------------------------|---|------------------------------------|
| Allocated Pension Balance | \$678,000 | N/A |
| Accumulation Balance | N/A | \$678,000 |
| Total Fund Balance | \$678,000 | \$678,000 |
| Earnings* | \$47,460 | \$47,460 |
| TAX PAYABLE# | \$0 | \$7,120 |

*Note: Earnings have been approximated at 6% per annum. #Note: Tax calculated as 15% of earnings.

The total tax saving achieved by John by commuting his Allocated Pension is \$8,780 (\$15,900 less \$7,120). From 1 July 2007, John can re-commence a pension and it will be tax free.



Superannuation in Australia is about to shift from a system of virtually unlimited contributions and capped concessional benefits to a system of capped contributions and virtually unlimited benefits. With such a change, getting money into superannuation has never been so important or so fruitful.

Double Tax D – Act Now Or

The government proposals will mean the following for contributions into superannuation:

- Allowing a one off undeducted contribution per member from 9 May 2006 to 30 June 2007 of up to \$1 million. From 1 July 2007 the undeducted contribution (after tax) will be decreased to effectively \$150,000 per year.
- Deductible contributions will be on a per member and not per employer basis. The two sections of tax legislation that allow a tax deduction for super contributions for an employer and self-employed persons are independent of each other. This means that it is possible for some individuals to claim a deduction under both sections of the legislation. This double deduction strategy will not be available from 1 July 2007.

This strategy applies to those who are both substantially self employed and an employee. It allows them to:

- 1) Access up to two age-based limits (with non-associated employers);
- 2) Claim a deduction up to the age-based limit for their self-employed earnings and salary sacrifice up to the age-based limit with their employer.

This may be shown in the following example which includes the contribution of commercial property (business real property) from a member into their SMSF. There will of course be stamp duty implications on the transfer.

Deductions Miss Out Forever

Strategy Example

- John, who jointly with his wife Jane, own a commercial premises worth \$2.2m. They purchased the property 10 years ago for \$1.1m.
- Due to the fact they are approaching age 60 they would now like to contribute the property into the fund and eliminate future capital gains as well as potentially pay no tax on the income the property will produce.
- John and Jane are both on a salary package of \$125,000 from their company, XYZ Pty Limited and take this in the form of salary and superannuation. As they only require \$50,000 gross income to live, they take \$25,000 each as salary and \$100,000 as salary sacrificed superannuation.

The effect of contributing the property into the fund is as follows:

John and Jane combined will make contributions of approximately \$2.2 million in the form of \$966,629 each in undeducted contributions and a self employed deductible contribution of \$105,113. In order to achieve this amount of deductible contribution a personal contribution of \$138,484 needs to be made which will be made up of \$105,113 deductible contribution and \$33,371 undeducted contributions. This will take them both up to the \$1 million limit of undeducted contributions.

Their personal situation can be summarised in the following table:

| | John | Jane |
|---|------------------|------------------|
| Salary | \$25,000 | \$25,000 |
| Net Capital gain (after 50% discount) | \$275,000 | \$275,000 |
| Total Income | \$300,000 | \$300,000 |
| Less Self Employed Superannuation Deduction | (\$105,113) | (\$105,113) |
| Taxable Income | \$194,887 | \$194,887 |

John and Jane are able to make a self employed contribution (and receive a deduction) as the income for which they are provided superannuation support from XYZ Pty Limited (\$25,000) is less than 10% of their total income of \$300,000.

Both John and Jane have been able to contribute the following into superannuation prior to 30 June 2007:

| | John | Jane |
|--|--------------------|--------------------|
| Deductible contribution from XYZ Pty Limited | \$100,000 | \$100,000 |
| Self Employed contribution (deductible) | \$105,113 | \$105,113 |
| Self Employed contribution (undeducted) | \$33,371 | \$33,371 |
| Undeducted contribution | \$966,629 | \$966,629 |
| Total Contributions | \$1,205,113 | \$1,205,113 |

John and Jane have been able to contribute more than \$2.4 million into their SMSF. The super fund now owns the commercial property and will pay no more than 15% tax on any income it produces and furthermore will pay \$0 tax once John and Jane enter pension phase on retirement.

However it must be noted that this strategy will lose its effectiveness when the limits on contributions are enforced from 1 July 2007. With the limit of \$150,000 for undeducted contributions and \$50,000 for deductible contributions the opportunities for contributing large amounts into superannuation need to be taken now.



ATO Concerns

The Australian Taxation Office (ATO) is becoming increasingly concerned about SMSF's meeting the residency test and complying with the record keeping rules.

These concerns are explored below.

Residency

There are strict rules which funds must meet in relation to residency. A SMSF that is not a resident fund at all times during the year is not a complying fund for tax purposes. Trustees who will be temporarily

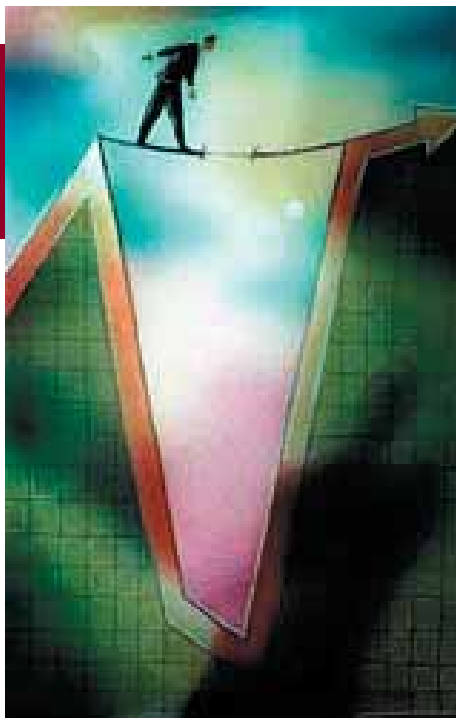
overseas for more than two years need to ensure that the fund does not become a non-resident fund. Steps that trustees should consider include:

- Appointing a Legal Personal Representative (who holds an enduring power of attorney to act on their behalf as a trustee for the period that they will be overseas); and
- Ensuring that, during their absence; the accumulated entitlements of the fund's resident

active members will be more than 50% of the total accumulated entitlements of all active members.

Record Keeping

The ATO have identified poor and inadequate record keeping as a problem for SMSF's. Decisions made by trustees should be recorded properly. This includes minutes of meetings, investment decisions, changes of trustees etc. Furthermore, these records need to be maintained for a period of at least ten years.



The initial aim of Contributions Splitting was to assist low income or non-working spouses to accumulate superannuation benefits in their own name.

Contributions Splitting

It had the further benefit of allowing spouses to utilise two Reasonable Benefits Limits (RBL) and two Eligible Termination Payment "ETP" low-rate thresholds.

Following the changes announced in last year's budget, RBLs will be abolished from 1 July 2007. So is there any need for contributions splitting?

The answer is yes! Under the new rules effective from 1 July 2007, any person aged 60 or over who has met a condition of release will be entitled to commence a tax-free pension or make tax free withdrawals from superannuation.

By utilising Contributions Splitting the older spouse could receive 85% of

deductible contributions or 100% of undeducted contributions from the younger spouse, thereby allowing access to tax free funds earlier.

There are other reasons why continuing to use the Contributions Splitting strategy will be important. These include:

- As the preservation age will be 60 for those born after July 1964 it may be beneficial to split to the older spouse who still has a preservation age of 55;
- Equalise accounts for taxable pensions commenced from age 55-59;
- Protection from creditors;
- Legislative risk.

SASS – Watch As Your Benefit Grows!

The following is a brief outline of the components of a member's balance with SASS.

Benefit Points System

Benefits are usually paid as a lump sum. Certain scheme members prior to 1988 may have the choice of a pension option. The benefit points system is the link between employee contributions and Employer-Financed Benefits. For each 1% of salary you contribute in a year, you accrue one benefit point.

Each benefit point accrued provides an Employer-Financed Benefit of 2.5% of final salary or final average salary depending on your type of exit. You may accrue a maximum average of six benefit points for each year of scheme membership and an overall general maximum of 180 benefit points.

For example, if you accrue 180 benefit points, this would provide an Employer-Financed Benefit of 4.5 times final average salary (ie. $180 \times 2.5\% = 450\%$ or 4.5).

If you have been a contributor to SASS, or the schemes that preceded it, for less than 10 years, you will receive the balance in your personal account. If you have been a contributor for more than 10 years, you will receive your personal account balance, Employer Financed Benefit and Basic Benefit.

Personal Account

This is made up of your personal contributions plus earnings.

Employer Financed Benefit

This is 2.5% of your final average salary for each accrued benefit point.

Basic Benefit

This is additional to the Employer Financed Benefit. It is fully paid by your employer and accrues at a rate up to 3% of final average salary for each year of service after 1 April 1988.

Salary for Superannuation Purposes or “Superable Salary”

Your superable salary is very important because it influences the amount of personal contributions you pay to SASS and the benefits you receive from the scheme, especially the Employer-Financed Benefits. Your Employer-Financed Benefits are calculated using final salary or final average salary. These terms mean:

- Final Salary: the amount of salary for superannuation purposes, paid or payable on your exit date.
- Final Average Salary: the average of the salaries for superannuation purposes, paid on your exit date and the two preceding Annual Review Days (31 December).

It is extremely important that advice is sought on the potential for maximising the components of your benefits in SASS in conjunction with any retirement planning. This may be through strategies to enhance superable salary in the final years of employment or planning to ensure the optimal amount of benefit points are obtained.

SASS benefits may also be salary sacrificed (i.e. before tax contributions) from 1 April 2007, whereby previously the SASS contributions were made from after tax contributions.



The State Authorities Superannuation Scheme (SASS) is a defined benefit scheme, and has a number of different rules to that of a “normal” accumulation fund. Employees of government organisations including hospitals and schools, may fall under the SASS umbrella.

Diary Dates

March 2007

31 Due date for lodgement of Superannuation Member Contribution Statements (MCS) by Self Managed Superannuation Funds (SMSF). An SMSF may lodge its MCS when its Fund income tax and regulatory return is due if this is later than 31 March.

April 2007

- 1** Superannuation guarantee quarter 4 commences.
- 28** Last day for superannuation contributions to be paid to a complying superannuation fund for quarter 3.
- 30** Last date to report lost member information for period 1 July – 31 December 2006 to the Australian Tax Office.

Did you know?

SMSF Statistics

- There are now over 325,700 SMSF's in Australia with over 629,500 members.
- As at 30 June 2006, members of SMSF's, on average, held around \$340,000.
- The ATO completed 4,530 audits on SMSF's during the 2006 financial year.
- The ATO removed the complying status from 12 funds during the 2006 financial year.
- More than \$200 billion worth of assets reside in Australia's SMSF's. Industry researchers predict the SMSF Industry will be worth greater than \$300 billion by 2011.

Advice you can trust

The Self Managed Super Fund Professionals' Association of Australia (SPAA) is the SMSF's self-regulatory body and oversees a stringent accreditation process through which advisors are endorsed as specialists in their field.

Cutcher & Neale are pleased to advise that we currently have four SPAA SMSF Specialists – Partners Robert Taber, Ian Neale and Philip Smith and Client Service Manager Shane Morgan. Shane is also the Chairman of the Hunter Region Chapter of SPAA.



Diary Dates

May 2007

15 Due date for lodgement of SMSF's 2006 Income Tax Return.

June 2007

28 Superannuation contributions need to be paid by this date for a tax deduction in the 2006 – 07 financial year.

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