



The Dust Settles... Strategies from 1 July 2007

Welcome...

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The superannuation deadline of 30 June 2007 has now passed. While there are many fantastic new additions to the superannuation landscape there are also some opportunities lost. In this edition of the Super Sleuth we highlight some of the strategies that are still available as well as focusing on new strategies that have come to light as a result of the Simpler Super changes.



in this issue...

- 1 The Dust Settles – Strategies from July 1 2007
- 2 Taking advantage of the changes? Avoid the potential traps.
- 3 A simple pension at last!
- 4 Transition to retirement pensions – it gets better!
- 6 Easier access to the aged pension – act now!
- 6 Pension Bonus or Age Pension – what should I do?
- 7 Don't leave your children with a tax burden!
- 8 Diary Dates Did You Know?



With the passing of the 30 June 2007 deadline we now have a system of limited contributions and no “RBL’s” (Reasonable Benefit Limits). Has the end of the financial year signalled the end of all the premium strategies?

We have lost RBL's (that's a good thing!) but we have also lost the opportunity to contribute more than \$50,000 per year in deductible contributions (now called concessional contributions) and \$150,000 per year in undeducted contributions (now called non concessional contributions). There will however be a transitional period of 5 years for the over 50's whereby they can contribute \$100,000 in concessional contributions per year.

From 1 July 2007, the over 60's do not pay any tax on their pensions or lump sum withdrawals and those that have commenced or have switched to the new Account Based Pensions are only faced with a minimum percentage to drawdown.

With no maximum drawdown and no tax on withdrawals for the over 60's, will this lead to an exodus of funds from superannuation?

Unlikely!

Not only have contribution limits been imposed meaning less can be siphoned into superannuation but **where else can income tax and capital gains tax on**

investments be quarantined at 0%!

There are many situations where funds worth millions will no longer pay tax on their earnings and all with a minimum % drawdown. Your fund may well be earning 8% when you are only required to drawdown 5% as pension.

The impost of a 16.5% tax on taxable benefits paid out to non financial dependants still stands

however strategies to overcome this will come to the forefront. The amount of monies that will remain in superannuation on the death of members will increase through the effect of the new changes and there will be increased focus on these estate planning strategies.

The conversion of every super fund member balance at 30 June 2007 to either taxable or exempt will mean that only two components will make up each fund members balance. There will be opportunities for creation of different superannuation interests to make the most of the new proportional draw down system.



Taking advantage of the changes?

Avoid the potential traps.

It's interesting how some people are reacting to the super changes. There are some investors that are yet to retire or even reach preservation age who want to give their money to a close relative, typically a parent.

Others are even asking retired friends or associates for assistance. Why?

Their purpose is rather straightforward.

Firstly, the amount you can concessional invest into superannuation is restrictive with the current limits on contributions. There is a \$50,000 limit on concessional and \$150,000 limit on non concessional contributions. Contributions on behalf of someone else gives you more money in super.

Second, there is no longer any compulsory cashing. Retirees are able to leave monies in accumulation account. If these assets are allowed to accumulate, the earnings are taxed at a maximum of 15%. Slightly more palatable than 46.5% for a high salary earner with investments at age 40.

Further, with the abolition of Reasonable Benefit Limits, retirees can have as much in super as they want without penalty.

And finally, if access to these funds is required, the retiree can withdraw the funds tax free, provided they are over age 60.

As you can see, it seems that adult children (by contributing to their parent's account) may be able to access their contributions or leave it there indefinitely to accumulate income.

For most people this seems like a great idea, but as is the case with these strategies there are many issues that need to be considered.

- Would the strategy be considered tax evasion?
- Do you trust the retiree? At law the retiree owns the super assets and can do with them what they wish.
- Do you trust the retiree's relatives? If something happened to the retiree, death, mental incapacity etc. then it may be possible that the retiree's relatives seek to claim the investor's assets
- Estate planning; if the retiree dies and they are not your parent, you may have trouble getting the money.
- Hiding assets from creditors; recent amendments to the bankruptcy rules probably make this unviable.
- Ability to contribute to super; if the retiree is over 65, they have to meet a work test themselves to make the contribution
- Age pension eligibility; additional super assets could have a negative effect on a retiree's age pension or their ability to qualify for the age pension.

How will the government react to this strategy? Don't be surprised if there is some regulatory movements to ban such an arrangement.



A simple pension at last!

The vast changes made to the superannuation environment by the Government will finally bear some fruit from 1 July 2007. Not only are Reasonable Benefit Limits abolished (a blessing for all professionals working in superannuation!) but the Government has also introduced a new simplified pension.

This pension will be known as the 'Account Based Pension'.

Whilst it is a well known fact that in the past when the Government announced any type of simplification, the changes were quite the opposite, in this case the Government is correct – the Account Based Pension is simple!!

So how does the Account Based Pension work?

As the name suggests, the Account Based Pension is a percentage of the member's account balance. The minimum payment is calculated using the balance in the Pension Account at the end of the previous year multiplied by the Pension Percentage Factors. There is no maximum pension.

Age	Per cent of account balance (average)
55 – 64	4%
65 – 74	5%
75 – 79	6%
80 – 84	7%
85 – 89	9%
90 – 94	11%
95+	14%

Have you put in place the relevant steps to commence an Account Based Pension from 1 July 2007?

It is Cutcher & Neale's view that all members aged over 60 in superannuation commence a pension from 1 July 2007.

Why?

As detailed in our previous issues of Super Sleuth, withdrawals from superannuation from 1 July 2007 are tax free – whether taken as lump sums or pensions. Furthermore, the superannuation fund itself becomes exempt from tax to the extent of the pension members balance. No more tax to pay!

This allows numerous strategies to be implemented to maximise a person's wealth and minimise tax. You should contact your licensed advisor for further details.



Trustee Declaration

From 1 July 2007 all new trustees (or directors of a trustee company) of a SMSF will be required to sign a Declaration acknowledging that they (among other things):

- are responsible for the fund complying with all relevant legislation;
- are aware of the consequences for a fund non-compliance, and
- will keep themselves informed of any changes to the legislation, and ensure the trust deed is kept up to date.

The timing of the execution of the Declaration will be the earlier of:

- 21 days of admitting a new Trustee/ Member; or
- lodgement of the Fund's 2007 return.

Please note that this will occur when the fund is established, the deed is amended as well as a change in trustee.



The Transition to Retirement Pension “TRIP” remains one of the best strategies for creation of personal tax savings and to increase accumulated superannuation wealth.

Transition to retirement

This strategy can be used by anyone that has reached preservation age but has not yet met a normal condition of release for access to their benefits. For example, permanent retirement.

To revisit, in simple terms the strategy for the member is as follows:

- A TRIP is commenced with the member’s balance in their superannuation fund.
- The earnings in the fund are then tax free to the extent of the TRIP balance.
- As the member is receiving an income stream via the TRIP, they are able to salary sacrifice more of their wage into superannuation, thereby maximizing available contribution limits while maintaining disposable income.
- As they are salary sacrificing their wage down to a lower level, they are paying less personal income tax due to the lower tax rate.

Why is it bigger and better under the new super rules?

There are a number of changes that have made the TRIP strategy one that every person over preservation age should explore. Briefly these include:

- The conversion of any pre July 1983 component to exempt component will mean a greater exempt amount for the pension (the TRIP is still taxable for the 55 to 59 year olds).
- Those that were not able to contribute up to their age based limit may now do so.
- Members over age 60 will now not be taxable on the pension payment.

The last one is the big one. You may be drawing down a pension from your superannuation fund which is not shown in any taxation return. You could then sacrifice a large proportion of your salary and pay tax only on the remaining amount.

Bear in mind however that unlike the non TRIP pensions, the TRIP has a maximum drawdown of 10%.

Let us consider some case studies:

ement pensions – it gets better!

Case Study 1 (age 55)

- John is aged 55
- Salary is \$130,000
- John only has Super Guarantee paid on his behalf (\$11,700 approx.)
- John has a super fund balance of \$850,000 (\$600,000 taxable and \$250,000 exempt)
- Assume super fund earning rate of 6%

TAX POSITION		
	BEFORE	AFTER
Salary	\$141,700	\$141,700
Deductible Contributions	\$11,700	\$99,247
Undeducted Contributions	\$0	\$0
Pensions	\$0	\$63,000
Deductible Amount	\$0	\$18,528
Gross Income	\$130,000	\$86,924
Tax Payable	\$41,799	\$23,923
Tax Rebate	\$0	\$6,671
Income Tax	\$41,799	\$17,252
Contribution Tax	\$1,755	\$14,887
Total Tax	\$43,554	\$32,139
Net Income	\$88,201	\$88,201
Superannuation Fund Tax Position	\$7,171	\$266
Total Tax Savings		
Income Tax	\$24,547	
Contribution Tax	– \$13,132	
Total Tax On Income Saved	\$11,415	
Plus Superannuation Fund	\$6,906	
Total Saved	\$18,321	

Case Study 2 (age 60)

- Bill is aged 60
- Salary is \$130,000
- Bill only has Super Guarantee paid on his behalf (\$11,700 approx.)
- Bill has a super fund balance of \$850,000 (\$600,000 taxable and \$250,000 exempt)
- Assume super fund earning rate of 6%

TAX POSITION		
	BEFORE	AFTER
Salary	\$141,700	\$141,700
Deductible Contributions	\$11,700	\$100,000
Undeducted Contributions	\$0	\$14
Pensions	\$0	\$55,000
Deductible Amount	\$0	\$16,176
Gross Income	\$130,000	\$80,524
Tax Payable	\$41,799	\$8,485
Tax Rebate	\$0	\$0
Income Tax	\$41,799	\$8,485
Contribution Tax	\$1,755	\$15,000
Total Tax	\$43,554	\$23,485
Net Income	\$88,201	\$88,201
Superannuation Fund Tax Position	\$7,171	\$268
Total Tax Savings		
Income Tax	\$33,314	
Contribution Tax	– \$13,245	
Total Tax On Income Saved	\$20,069	
Plus Superannuation Fund	\$6,904	
Total Saved	\$26,973	

As you can see from the above examples, the TRIP strategy is extremely effective in personal and fund tax savings and the creation of wealth through superannuation. Everyone over age 55 that has a superannuation balance and salary should be exploring this strategy.



Easier access to the age pension – act now!

The 20 September 2007 deadline for commencing a Market-Linked Pension (also known as a Term Allocated Pension – ‘TAP’) is fast approaching. TAPs attract favourable social security treatment as they benefit from the 50% assets test exemption.

Furthermore, the Government will be reducing the Assets Test taper rate from \$3 to \$1.50 per fortnight for every \$1,000 of assets above the threshold from 20 September 2007. There has never been a better time for retirees to access or increase their social security benefits.

For example, a couple who are homeowners will now only lose entitlement to a pension when their Centrelink tested assets surpass approximately \$825,500 compared to the existing \$531,000.

Beware – whilst obtaining the age pension and social security benefits is favourable, it should be noted that a TAP is less flexible than an Allocated or Account Based Pension. The assets backing a TAP are non-commutable – that is, there is no opportunity for lump sum withdrawals.

Pension Bonus or Age Pension – what should I do?

The pension bonus scheme was introduced in 1998 to encourage people to stay in the workforce. For every year beyond retirement age that you stay in the workforce, you will be eligible for a tax free lump sum bonus based on a multiple of the retirement income you would have received up to a maximum of five years.

The eligibility for the Pension Bonus is based on similar criteria as the age pension.

To qualify you must have reached retirement age (65 for men and between 60 and 65 for women, depending on year of birth), be eligible to receive payments under the Income/Assets tests and still be working at least 960 hours a year. This equates to an average 20 hour week over a 48 week working year.

So is it better to stay in the workforce and receive the pension bonus or retire and receive the age pension?

The amount you would receive as a lump sum bonus is significantly less than the amount you might receive if on the full age pension.

The maximum lump sum for staying in the workforce is \$32,083 for a single person, while the maximum pension for that same period would be \$68,263. However, this comparison does not take into account the money derived from working 960 hours per year for five years.

As a result, it would be worthwhile to register for the bonus once you reach retirement age and enjoy a little bit of Government generosity!

Don't leave your children with a tax burden!



From 1 July 2007, member's benefits in the superannuation environment will be consolidated into two components – taxable and exempt. Death benefits paid from superannuation will be taxed at 16.5% to the extent of the taxable component when paid to non-dependants (eg. adult children). However, this tax burden can be minimised or even extinguished through a couple of easy strategies!

A new proportional system applies to the withdrawal of benefits from 1 July 2007. This is explained in the following example – if your superannuation balance is 50% exempt and 50% taxable, then any withdrawal taken from that balance must be divided in the same proportions.

What strategies can be implemented to minimise the taxable component if the proportional system now applies?

When the above concept was first legislated, many advisors wondered if it was possible to structure a client's superannuation so that they had more than one balance ("superannuation interest" is the term used in the legislation) in a single superannuation fund. The latest Regulations confirm that as a general rule each member will only have one superannuation interest within a single superannuation fund, **with one exception – pensions.**

The Regulations specifically state that pensions are always considered a unique superannuation interest. Our first estate planning opportunity therefore arises. If at 30 June 2007 a member had exempt component (undeducted contributions) and taxable component, a strategy of locking in the exempt component into one stand alone pension may have been implemented. The components of a pension at commencement are maintained throughout the entire pension, therefore this pension will always remain exempt – even with allocations of earnings. The member can then address the taxable component of the fund and draw that down more aggressively while preserving the exempt component.

The second opportunity for minimising the tax burden on death has been addressed in previous editions of the Super Sleuth and is the 'recycling' of benefits strategy. This strategy is particularly beneficial for members with high taxable component in superannuation.

A pension is drawn by the member and re-contributed back into the fund as a non-concessional contribution up to the relevant contribution threshold. This therefore reduces the taxable component on a proportional basis and increases the exempt component.

Example (assuming \$50,000 required for personal needs)

	2007	2007/08	2008/09	2009/10	2010/2011
Age	60	61	62	63	64
Draw-down (Pension)	N/A	\$200,000	\$200,000	\$200,000	\$500,000
Taxable	\$1,000,000	\$800,000	\$631,579	\$491,228	\$202,270
Exempt	\$0	\$0	\$118,421	\$208,772	\$147,730
Re-Contribution		\$150,000	\$150,000	\$150,000	\$450,000
Balance		\$950,000	\$900,000	\$850,000	\$800,000
Taxable		\$800,000	\$631,579	\$491,228	\$202,270
Exempt		\$150,000	\$268,421	\$358,772	\$597,730
TOTAL		\$950,000	\$900,000	\$850,000	\$800,000

If the above member was to pass on 1 July 2007, death tax of \$165,000 may apply. However, if the member were to pass on 1 July 2011, the liability would only be \$33,375. A tax saving of \$131,625 has been achieved through this strategy.

You should speak to your licensed advisor to ensure that the right strategies have been implemented for you and a large tax burden isn't passed on to your beneficiaries.

Diary Dates

July 2007

- 1** Superannuation Guarantee quarter 1 commences.
- 14** Pay As You Go (PAYG) withholding payers must issue payment summaries to payees.
- 28** Last date for superannuation guarantee contributions to be made to a complying superannuation fund for quarter 4.
- 28** Final Date for Lodgement and payment of June 2007 Activity Statement.

October 2007

- 1** Superannuation Guarantee quarter 2 commences
- 21** Final date for payment and lodgement of Annual PAYG instalment notice.
- 28** Last date for superannuation guarantee contributions to be made to a complying superannuation fund for quarter 4.

Did you know?



Co-contributions

Effective 1 July 2007 self employed people may now make personal superannuation contributions that will be eligible for the Government's Co-contribution.

To be eligible they must meet the following criteria:

- contribution to a complying superannuation fund;
- total income (assessable income plus reportable fringe benefits) is less than \$58,000;
- 10% or more of total income is from eligible employment;
- lodge an income tax return for the year of income; and
- be less than 71 years old at the end of the year of income.

In the 2007 Commonwealth Budget the Government announced a one-off additional super co-contribution payment for people who were, or will be eligible to receive a co-contribution for the 2005-06 financial year, which will effectively double the payment.

Bankruptcy

Previously, protection of a bankrupt member's interest in a regulated superannuation fund was limited to their Pension Reasonable Benefit Limit (RBL). With the abolition of RBLs from 1 July 2007 The Bankruptcy Act has been amended so that there is now unlimited protection for a bankrupt in terms of their superannuation benefits in the fund.

Contributions are protected so long as they were not made to prevent creditors from access. Factors looked at to determine purpose of contribution include:

- Timing of contribution, for example if made when a person was or was about to become insolvent; and
- The pattern and history of the person making the contributions.

For Superannuation Benefit Payments, the Bankruptcy Act has been further amended so that Lump Sums are protected from creditors, whereas income streams that are in excess of a certain amount (pension and annuities) are protected from creditors, whereas income streams that are in excess of a certain amount (pension and annuities) are not protected.

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