



Welcome...

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In this issue we take a look at the new rules allowing SMSFs to borrow to purchase an asset. We also explain super death benefits and the estate planning issues within your super 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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A gear change in Super – hold on to your seats!

From September 24, 2007, the general prohibition on superannuation funds borrowing has been relaxed to allow super funds, including Self Managed Superannuation Funds (SMSFs), to borrow to purchase any asset they would otherwise be permitted to acquire subject to certain strict instalment warrant like conditions.



It not only confirms a super fund's ability to invest in current commercial instalment warrants, but also allows SMSFs to put in place their own private instalment warrant arrangements in order to borrow to purchase an asset.

How does it work?

An instalment warrant allows the buyer to pay an initial fee to acquire an underlying asset with an option to pay a second fee to acquire the legal title of that asset.

They allow a super fund trustee to borrow money or maintain a borrowing of money under an arrangement where:

- the borrowing is applied for the acquisition of an asset other than one the super fund trustee would be prohibited from acquiring;
- the asset is held on trust for the super fund so that the trustee acquires the beneficial interest in the asset (that is, a security trust is established over the asset);
- the super fund trustee has the right to acquire legal ownership of the asset after making one or more payments; and
- must be a limited recourse loan.

How good is it?

The new rules may allow super fund trustees to invest into asset classes they were previously locked out of because of insufficient funds eg. residential property.

Alternatively, trustees could use these new rules to enable their SMSF to purchase commercial property, which they could then lease to a related party to use in their business.

There is no limitation on who the lender may be, conceivably the superannuation fund member could be the lender to their own superannuation fund. Thus, a member may be able to get much more of their wealth working for them in their superannuation fund, more than the recent superannuation contribution caps allow, the excess will just be a borrowing that will enable the income and capital gains to be earned in a concessional tax environment. (*Continued on page two >>*)



A gear change in Super – hold on to your seats!

Is it too good to be true?

Investment rules still apply!

The asset purchased must still comply with investment rules such as the Sole Purpose Test; the fund's governing rules (Trust Deed); arm's length dealings; acquisition of assets from related parties; and in-house asset rules.

Borrowing issues

From a practical perspective, the requirement for a limited recourse loan will effectively limit the amount a SMSF trustee can borrow eg. a bank may only be willing to lend on a limited recourse basis up to a certain loan to value ratio (LVR) such as 60:40 LVR. There is also conjecture concerning personal guarantees.

Capital Gains Tax (CGT) and Stamp Duty

When putting a private instalment warrant arrangement in place trustees should consider the potential impact of CGT and stamp duty on the transfer of the asset to the SMSF. Care is needed to avoid double stamp duty on the first purchase of the asset by the instalment trust and the second purchase of it under the instalment arrangement.

Trustees should seek specialist advice when putting in place any arrangements to ensure they qualify for those exemptions.

The arrangements are more complex than normal gearing and are likely to be more expensive, involve more parties and be subject to more fees. Trustees need to understand the costs or legal structures of the arrangements and could face a capital loss on their investment.

But will the gearing opportunity last?

As recent as the end of January, the Australian Financial Review has reported that "Super Industry representatives" have expressed concerns to the new Superannuation Minister, Senator Nick Sherry, as to the width of the recently enacted gearing exception.

It seems that the "representatives" are concerned that SMSFs may use the exception to invest, on a geared basis, and acquire assets of various classes and not simply listed securities. The report mentioned that geared investments could extend to residential and commercial real estate, cars and antiques.

SMSF trustees who are considering entering geared investments using the new exception may wish to expedite their investment proposals to lock in the exception.

If there is any tightening of the exception, it will likely, going on past experience, not be retrospective, but only limit investment thereafter.

Beware excessive contributions!



With the abolition of Reasonable Benefit Limits, the Government has introduced contribution ‘caps’ to limit the amount of superannuation a member can accumulate. The two contribution caps relate to concessional (taxable contributions) and non-concessional contributions (the former “undeducted contributions”).

What is the concessional contributions cap?

The concessional contribution cap for the 2007/08 financial year is \$50,000. A transitional cap of \$100,000 applies to members over age 50 for a 5 year period. After 2011/12 all members will have the same concessional contributions cap.

What is the non-concessional contributions cap?

The non-concessional contribution cap for the 2007/08 financial year is \$150,000 or \$450,000 over a three year period for the under 65s.

Assessing excess concessional contributions tax

Excess concessional contributions tax is payable on excess concessional contributions at a rate of 31.5% – this is on top of the 15% paid by the fund on its taxable income.

Watch out! Your excess concessional contributions also count toward your non concessional contributions cap!

Assessing excess non-concessional contributions tax

Excess non-concessional contributions tax is payable on excess non-concessional contributions at a rate of 46.5%.

So be careful! If your contributions exceed both the concessional and non-concessional contribution caps in an income year **you could end up paying 93% tax on the excess amount.**



Marriage breakdown

– tax relief at a difficult time

The Government has amended the Law to extend the Capital Gains Tax (CGT) rollover relief for superannuation funds on marriage breakdown. In the past the rollover relief concession was only available to the relevant amount split under divorce. This often left members having to pay a portion of CGT on the transfer of their balance to a new super fund.

From 1 July 2007, the CGT rollover relief on marriage breakdown extends the rollover relief concession to the entire amount rolled out of a SMSF.



With the Simpler Super reforms commencing 1 July 2007, few could find reason to sustain any cynicism towards using super as a wealth creation vehicle.

Who gets your super

The abolition of Reasonable Benefit Limits and compulsory retirement age cashing provisions will mean more people will have more money in super at the time of their death.

There are some general principles when discussing Simpler Super and estate planning:

1. Super death benefits are a non-estate asset. You can't leave super in a will.
2. There are limits on who can receive a pension on death under the new laws.
3. Death benefits paid to tax dependants will be tax free.
4. Death benefits paid to non tax dependants will generally be taxed at 15% + Medicare on the taxable component.

Case Study

John is a widower with two adult children. He is over 60 and has started a superannuation pension. He has \$2 million in superannuation, which is comprised of taxable component only. The assets in his super fund are comprised of commercial property and a share portfolio and there is \$1 million in unrealised gains. Let's assume John dies after July 1:

1. Capital gains tax on the sale of the assets –
 $\$1\text{m} * 10\%$ tax (assuming assets were held for more than one year) = \$100,000
2. \$2m paid out to non tax dependants is taxed at 16.5%
= \$330,000
3. Total tax is \$430,000 or 21.5%

If half of the super benefit was comprised of non-taxable elements, then the death benefit tax would have been halved. However, if John had withdrawn all of the money when he was alive, there would have been no tax at all!

Superannuation benefit when you die?

The five main estate planning issues within Super

1 Who is going to get control of the superannuation on your death or incapacity?

On the death or incapacity of a trustee of an SMSF, the legal personal representative (LPR) of the incapacitated or deceased person stands in that person's place.

On death, the LPR is the executor of the estate of the deceased member. On incapacity, the LPR is the holder of an enduring power of attorney. The member needs to choose their executor carefully as their appointee will be put in a position of control of their super interest.

The appointment of a corporate trustee can also alleviate a number of the control issues that surround the death of a member.

2 What can be done to reduce or eliminate superannuation death benefit taxes?

There are many strategies that may be considered and these include:

- a) Withdrawal and re-contribution strategies (subject to non concessional contribution limits);
- b) Crystallising unrealised gains while in pension phase (however transaction costs should be considered);
- c) Drawing down on the taxable part of superannuation or maximising segregation of interests between taxable and tax free component where possible;
- d) Establishing financial dependency or interdependency relationships.

3 Which is better – a pension or lump sum?

The answer depends on the circumstances of the beneficiaries at the date of death.

The new rules mean that pensions may not be available from all super funds and in all circumstances. For example, a pension paid to a child of the deceased member under age 18 can be a very tax effective income stream. However, once the child is 18, they can effectively call for the payment of the income stream to them. Also, the income stream must be paid out to them at age 25, which may not be the desired result in all circumstances.

4 What can be done to assist vulnerable beneficiaries?

The last thing a fund member would normally want to see is a lump sum death benefit paid to a vulnerable beneficiary, say a bankrupt, drug addict, chronic gambler or intellectually disabled person.

In any of these circumstances, it may be more effective for the superannuation death benefit payments to be paid into a testamentary trust established in the will of the member in order to safeguard the capital.

5 Which is more appropriate – binding or non binding nominations?

It is important to understand that while a member is alive, it is very difficult to predict what amount of money will be retained on death; the circumstances of the beneficiaries at death; the taxation components of the member's balance on death.

Binding nominations provide certainty on the payment of the death benefit however a non-binding nomination may provide flexibility in certain circumstances.

Estate planning advice is a highly specialised area, yet one that will become extremely important as a result of the recent Simpler Super legislation.



Caution – are you planning an extended overseas stay?

The Tax Office has recently issued notices of non-compliance to a number of SMSFs on the grounds that they ceased being “resident” funds.

The Residency Tests

Broadly, a fund must satisfy two tests in order to be an Australian Superannuation Fund in any given income year.

Firstly, the central management and control (CMC) of the fund must ordinarily be in Australia. This test generally looks at where the strategic and important decisions of the trustees have been made.

The second residency test requires that where the fund has active members at least 50% of the total assets are attributable to interests held by resident active members. The penalty if the above is not adhered to – you could lose 45% of the value of your fund.



With all the recent changes to the superannuation environment, there are a lot of myths being circulated in relation to what you can and can not do. Here are the most common myths and their clarification.

Fact or myth?

Myth: Everybody over 60 can take their money out of their super fund tax free and keep working.

Fact: Although superannuation benefits for people aged 60 or more are tax-free if the benefit is from a taxed source, an individual will still need to satisfy a condition of release to access their superannuation benefit before age 65.

Myth: I am over 60 and on a pension so I don't have to lodge a tax return.

Fact: People receiving a pension from taxed funds and who have no other source of income will not need to lodge a tax return.

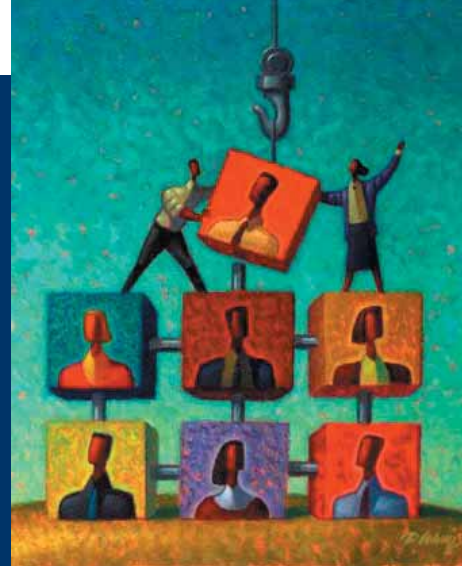
Myth: I'm turning 50 soon after 1 July 2007 so I miss out on making the \$100,000 contribution to my super fund until after June 2008.

Fact: You can contribute \$100,000 in the year you turn 50 and future years until 30 June 2012.

Myth: SMSFs can acquire residential property from a fund member.

Fact: Trustees are prohibited from acquiring assets for the Fund from a related party of the Fund, with some limited exceptions. Residential property does not fall within one of the exceptions and is therefore prohibited.

Super contributions and directors of passive/family companies



The issue of whether or not a family/passive investment company can make a tax deductible contribution on behalf of the directors of the company has been a contentious one for some time. However, a recent Australian Taxation Office Interpretive Decision has clarified the issue and brought with it great opportunities.

It has long been held that directors of a company are not entitled to payment for the services they provide as directors unless it is specifically provided for in the company's constitution or approved by shareholders. Therefore a great opportunity exists – as long as the company's constitution states that the directors are to be paid such remuneration as is determined by the company in a general meeting,

a general meeting can be held declaring a directors fee be paid in accordance with the constitution. This fee can be as small as \$100.

As the directors are 'entitled to payment' they qualify as employees for SGAA purposes. In making a superannuation contribution, the company and director should consider contribution caps in determining what contribution should be paid.



While SMSFs have been a popular wealth creation vehicle for some time, the May 2006 and 2007 Budget's convinced all Australian's that it is the premier wealth creation vehicle. Below are recent SMSF statistics which show the incredible growth in the industry.

SMSF statistics

SMSF Population

	June 2004	June 2005	June 2006	June 2007
Net Establishments	25,613	17,734	19,621	43,323
Total number of SMSFs	280,065	297,799	317,420	360,743
Total members of SMSFs	541,237	575,147	611,618	693,697

SMSF Average Assets

	June 2004	June 2005	June 2006	June 2007
Average assets per member	\$247,642	\$295,266	\$361,999	\$417,694
Average assets per SMSF	\$478,401	\$569,704	\$694,907	\$800,651

Increase in Superannuation Assets – SMSF vs Industry

	Increase (\$B) Year to 30 Sept 2007	Total Assets (\$B) As at 30 Sept 2007
Corporate	\$20.1	\$74.0
Industry	\$47.9	\$204.9
Public Sector	\$22.5	\$181.4
Retail	\$69.1	\$379.9
SMSF	\$72.1	\$299.7

Diary Dates

May 2008

- 15** Due Date for superannuation funds income tax return for tax agents clients and not allocated to other categories
- 15** SMSFs – if you lodge your fund income tax return, you also must lodge your regulatory return and MCS form.

Did you know?



Seniors Health Care

To qualify for a Commonwealth Seniors Health Care, you must:

1. be an Australian resident, living in Australia; and
2. have reached age pension age but do not qualify for Age Pension; and
3. have an annual adjusted taxable income of:
 - (a) less than \$50,000 (singles)
 - (b) \$80,000 (couples combined)
 - (c) \$100,000 (couples combined who are separated due to ill health)

Pensions drawn by members over age 60 are not included in the assessment of their annual adjusted taxable income as the pension is no longer required to be included in their income tax return.

Example

A 65 year old male has \$3m in his super fund and is drawing a pension. The pension is his only source of income. From 1 July 2007, this pension income is no longer assessable, therefore allowing the member to become eligible for the Commonwealth Seniors Health Card.

Trust deed upgrade

Over the next 6 months Cutcher & Neale will be doing a mass deed upgrade. This will ensure that all of our Self Managed Superannuation Funds are not limited in what they can do with the introduction of the recent Simpler Super reforms.

Once the upgrade has occurred, all SMSF Trust Deeds will be online and will be upgraded automatically on an annual basis.

Specific information in relation to the upgrade and Trust Deed provider will be provided before this exercise commences.

Terminally ill members

Terminally ill members of a superannuation fund are now afforded the same tax treatment as members attaining age 60 (who have met a condition of release). Benefits can be drawn from the fund without the implication of tax.

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