



The Super Sleuth

Cutcher's Clues to Superannuation

DETECTION • ANALYSIS • SOLUTIONS

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AUGUST 2003

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Joint Venture Investments – How Do They Work?

The truth is Superannuation Funds cannot borrow, but they can achieve "Indirect Gearing" by way of a Joint Venture with a related company or trust.

Benefits?

- Indirect gearing for superannuation funds.
- 15% tax on profits.
- No direct exposure for superannuation funds.
- Compliance with the SIS legislation.

How?

- A related company or trust can acquire an investment asset.
- The superannuation fund will "put on the table" whatever amount of money it wishes to venture into the deal as a contribution to the Joint Venture.
- The company or trust undertakes any necessary borrowings.
- The essence of the Joint Venture Agreement will be that the superannuation fund and the company or trust split the "gross" receipts from the enterprise whether the receipts be income or capital.
- The company or trust repays the borrowings from its share of the gross proceeds, as well as any expenses of the project, while the superannuation fund receives its share of the gross proceeds.

Rules?

- The split of gross proceeds needs to be on a commercial basis.
- Documentation is critical to prescribe that the superannuation fund does not have an interest in the company or trust, nor an interest in the asset.

Outcome...

- The Joint Venture process allows participation in a project by a superannuation fund not otherwise available without breaching the law surrounding geared investments and/or acquisitions from related parties.



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Special Income – Don't Let Your Super Fund Pay 47% Income Tax

This can happen to your super fund if **it invests in or receives certain income streams**.

Essentially there are 3 types of special income:

1. Dividends received from private companies are taxed at 47% **unless** the ATO exercises its discretion to the contrary. Generally, if collectively more than 13% of shares in a Private Company are held by related parties the ATO will not exercise its discretion.
2. Income from a 'non-arms length' transaction. This is where **income the fund has earned** may be greater than what could have been received in an open market due to the super fund and another party not acting at arms length. A good example of this is where the super fund may receive excessive interest from a loan to an associated entity.
3. From 25 November 1997 distributions from discretionary trusts (eg. Family Trust) are treated as special income - there is no exemption. However, distributions from fixed trusts (eg. Unit Trust) in general do not attract the 47% tax rate.

Bankruptcy – What Happens To Your Superannuation Benefits???

Under the Bankruptcy Act interests in a regulated superannuation fund are retained by the bankruptee provided the combined value of such assets does not exceed the bankruptee's **Pension Reasonable Benefit Limit** (for 2003/2004 – \$1,176,106). Any amount over this limit vests in the trustee and will be available for divisions amongst the creditors.

Contributing to superannuation is therefore not only a means of wealth creation but is also an effective **asset protection** mechanism as generally the benefits are protected from potential creditor claims.

Segregation Of Assets – A Valuable Tax Planning Tool

For the purpose of efficiently running your SMSF, the assets of the fund are generally not deemed to be owned by any member in particular.

That is, they are treated as being in a "pot" of assets, of which each member has an entitlement. This entitlement being determined by the amount credited to each member's account in proportion to the total balance of the fund.

But this approach may not always produce the best result. In some cases, it may be more beneficial to actually segregate the assets and assign different assets to different members.

Take the situation where a SMSF has significant capital gains in an asset, and where one member has commenced an allocated pension and the other has not.

Here, the asset with the capital gain could be segregated from the other assets and assigned to the allocated pension member. **Given no tax is applied to the allocated pensioner's assets, subsequent Capital Gains Tax liabilities would be avoided!**

Approaching 65??? Think Contributions!!!

If you have already retired and are approaching 65, your chance to make contributions is fast drawing to a close.

With laws stating you are not permitted to make contributions once you turn 65 unless you are 'gainfully employed', it may be worthwhile considering contributing any cash you have on hand to your SMSF before your 65th birthday.

The effectiveness of this strategy is **lump sum withdrawals** can be made from the fund after you turn 65, if cash is needed. Hence, it's better to have made too greater a contribution than not enough.



Additional Tax Free Amounts – Don't Miss Out!

As a super fund moves from accumulation phase (building up cash/investments for retirement) to retirement phase, consideration of allocated pensions, complying pensions and Eligible Termination Payments (ETP) from the super fund become foremost in a retiree's mind.

Leaving aside pension payments, an ETP from a super fund has several components which are affected by whether there has been any super accumulated before 30 June 1983.

Most people with super miss out on any pre 30 June 1983 component unless they have been careful about super rollovers or job termination payments prior to 30 June 1983. **This leaves the Post June 1983 component.**

For those people who have reached retirement age (or had an event that releases access to their super fund) there is a two tiered system for taxing this component:

1. A Tax Free component up to \$117,576 (2003/2004)
2. Balance taxed at 15%

The main feature of the tax free component (other than being tax free) is that it is indexed each year by the rate of wage inflation.

The advantage of this is if you have taken the tax free component in an earlier year, you can still access the increase in the threshold in the current year. This is best illustrated by the example below where an ETP was taken in the 1994 financial year.

Tax Free ETP 1994	\$77,796
2004 Threshold	<u>\$117,576</u>
Difference	<u>\$39,780</u>

This means that there is an additional **\$39,780** that can be taken **TAX FREE** from the super fund!

Benefit Payments "In Specie"...

Direct Transfer Of Assets

Most people think that withdrawals from their SMSF must only be in the form of cash. This is not the case.

The SMSF can transfer to the member any asset it owns and treat that transfer as a 'withdrawal of benefit'. **This applies equally to lump sum withdrawals and allocated pension payments.**

The amount of tax payable on the withdrawal is dependent on the value of the asset transferred.

For example, a SMSF may have listed shares as its only assets. If the member needs to draw an allocated pension, but doesn't require all of the payment in the form of cash, they could transfer a number of shares equal to the value of the payment required.

By doing so:

- Cash is not accumulating in their own name and being taxed at their marginal rate.
- If the shares are fully franked, the effect of their imputation credits may have a positive impact on the amount of tax paid when held personally.
- The shares have not been disposed of unnecessarily in order to create cash.
- Capital losses could be created for the member's benefit.



Superannuation & Divorce!

Prior to 28 December 2002 superannuation was not treated as 'property' of the marriage under the Family Law Act 1975.

As such, it could not be divided on the breakdown of the marriage, which often led to an unjust or inequitable outcome for the parties involved.

Typically, the court would decide to give the family home to the non-working spouse and leave the superannuation to the working spouse. This left one party with housing and no retirement benefits, and the other with no housing but benefits they couldn't access until retirement.

However from 28 December, couples who have legally separated or divorced can split their superannuation in the same way as their assets.

The key points to note are:

- Must be a fair split.
 - To be split superannuation benefits must be greater than \$5,000.
 - Superannuation payments for financial hardship and certain disability payments cannot be split.
 - Superannuation funds **are not** allowed to notify a member if their spouse has requested information in regards to their superannuation interests.
 - Superannuation can be split via a 'superannuation agreement' (in a financial agreement) or by 'court order'.
 - Divorcees have an entitlement to 'flag' until a property settlement is finalised or split a superannuation interest.
 - If superannuation is in the accumulation phase, **once it is split it will be asset and income test exempt** if the client who owns the fund is under pension age. Once the client reaches pension age superannuation assets are subject to the assets test and deeming under the income test.
 - If superannuation is in the pension phase, it can be split by either of the following:
 - (a) Commutation to provide for the non-member spouse entitlement whereby an amount is specified in the superannuation agreement; or by court order, which may be commuted from the income stream; or
 - (b) Pension Percentage Payments split, where the superannuation agreement or court order specifies a percentage of future income stream payments be paid to the spouse.
- The new rules apply to **pensions but not annuities**.
 - The new rules do not apply to **de facto or same gender partners**.

Things To Consider:

Partners both under age pension age:

- If one client is closer to pension age, it may be beneficial to limit the amount of superannuation in their name and split other assets such as the exempt family home.
- Clients can only access superannuation in accumulation phase if they meet a condition of release and they may require access to funds following a divorce.
- If they require a regular income stream to supplement social security benefits, their superannuation monies may lose their exempt status as most income streams are income and asset test exempt.

One Partner under pension age and the other over pension age:

- A common strategy is to place superannuation monies in the partners name that is under pension age to take advantage of the assets and income exemption.
- But once superannuation is split it will cause the funds split to the partner over pension age to become assessable.



Estate Planning – Allocated Pensions For Children

A 'child allocated pension' is an **allocated pension paid to a child upon the death of a parent**. The deceased parent's superannuation benefit is converted into an allocated pension account from which the income stream is paid.

There are many **benefits** of incorporating a child allocated pension into your Estate Planning strategies, such as:

- The **child is restricted from gaining access to what could be a significant lump sum of cash**. Instead, income is distributed to the child to pay for their education and living expenses, in effect, protecting the capital and the child from excessive or reckless spending.
- The lump sum may be accessed when a pre-determined age is reached, say 25.
- The amount of capital designated to the child's allocated pension is **not counted for Reasonable Benefit Limits (RBL)**. It therefore becomes a very effective tool in the management of the parent's superannuation benefits in excess of their RBL.
- The earnings and growth on the capital invested in the child's allocated pension is **tax free**.
- The allocated pension income, when received in the hands of the child, is **taxed at adult rates**, meaning the adult tax free threshold of \$6,000 applies in contrast to the normal child tax free threshold of \$416.
- Like normal allocated pensions, a **15% tax rebate** applies on the assessable income when received by the child. Assuming the child allocated pension is the sole source of income, then effectively each child can receive a pension of up to approximately \$24,200 per annum, tax free!



Find Out More...

ABOUT: Income Streams Via Allocated Pensions
Death Benefits – Estate Planning Fundamentals & Strategies

WHEN: Thursday 4 September 2003
6pm – 8pm

WHERE: Newcastle City Hall – Mulubinba Room
290 King Street, Newcastle

AVAILABLE: Finger Food and Refreshments

RSVP: Wednesday 27 August 2003
Nancye or Virginia on (02) 4928 8500

**FURTHER
INFO:** Refer to enclosed flyer



Redundancy Strategy – If You're Over 55, Rollover Then Cashout!

Redundancy payments in excess of the bona-fide tax free amounts need to be treated carefully so as to minimise Eligible Termination Payment (ETP) tax, particularly if payment is required in the form of cash.

In general, to minimise ETP tax it's best to wait until you turn 55 before you cash out and for added advantages it is wise to rollover to superannuation before cashing funds.

By waiting until you are 55 the tax on cashing out falls from 21.50% to 16.50%, but by rolling over the ETP

then cashing out only a 15% 'contributions tax' is payable, as the withdrawal from superannuation forms part of the 'post 1983 tax free' component.

There is therefore a saving of \$1,763 being the Medicare rate on the first \$117,576 cashed out of super.

Note: It is always important to check directly with the ATO to determine whether any of your 'post 83 tax free' threshold has previously been used, as tax on the excess is 16.50%!!

Lump Sum Super Withdrawals – Tax Traps!

Care should be taken when making lump sum withdrawals from a superannuation fund, with tax payable on the lump sum dependent on which component of the fund the money is deemed to have been taken from.

In summary, this table applies for the 2003 - 2004 financial year:

By understanding these components and their application constructive tax planning strategies are available!

COMPONENT	TAX
Concessional component.	5% of this component is added to your assessable income and taxed at your marginal rate.
Post June 1994 invalidity component.	Not subject to tax.
Pre 1 July 1983 component.	5% of this component is added to your assessable income and taxed at your marginal rate.
Post 30 June 1983 taxed component.	Included in assessable income, but subject to maximum tax rates as follows: <ul style="list-style-type: none"> • Under age 55 - 20% • Age 55 or over: <ul style="list-style-type: none"> • first \$117,576 - nil • excess over \$117,576 - 15%
Post 30 June 1983 untaxed component.	Included in assessable income, but subject to maximum tax rates as follows: <ul style="list-style-type: none"> • Under age 55 - 30% • Age 55 or over: <ul style="list-style-type: none"> • first \$117,576 - 15% • excess over \$117,576 - 30%
Undeducted contributions.	Not subject to tax.
Excessive component.	Tax at highest marginal rate.
CGT exempt component.	Tax free (within RBL's)

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