



## SMSF Sector Update

The total number of SMSFs in the market at the end of March stood at 378,656, serving the interests of 729,851 members. Over the three-month term there were 6272 new funds established compared to 5959 SMSFs set up in the 2007 December quarter.

Like the rest of the superannuation sector, SMSFs experienced a drop in total asset values from just over \$300 billion in December 2007 to just above \$286 billion at the end of March 2008.

In regard to asset allocation the March quarter saw an increase in cash, debt securities and term deposits to \$58.6 billion compared to \$56.8 billion in the previous quarter. On the flipside, investments in listed shares and equities fell from \$107.4 billion in December 2007 to \$93.7 billion at the March quarter's end.

As at June 2007, 48.8% of members of SMSFs were in the over 55 age group, with a further 28.6% being in the 45-55 age range.

This indicates that a large proportion of SMSF members are approaching their retirement in the short to medium term and are using a SMSF to control investments and facilitate their retirement planning strategies.

Rice Warner Actuaries ([www.ricewarner.com.au](http://www.ricewarner.com.au)) have projected that the assets in superannuation in the 15 years to 2022 will rise to \$3.202 trillion (in 2007 dollars), of which \$1.256 trillion (or 39%) will be in post retirement benefits.

This Rice Warner report also estimates that the superannuation market will increase by 60% over what it would have, had the May 2006 budget pension changes not occurred.

Over the past financial year we've seen many of our clients capitalise on the changes to superannuation announced in last year's budget – and highlight some of the strategies in this newsletter.

## Transition to retirement

By far the most popular strategy we have seen being used since 1 July 2007 is the transition to retirement strategy for those over 60 years old.

This involves salary sacrificing as much remuneration into superannuation as personal cash flow permits (of course within

the \$100k concessional cap which applies to those over 50) and concurrently drawing a pension income stream from the super fund.

This strategy was available before 1 July 2007, however the tax benefit has been increased dramatically for those over 60 who now pay **no tax** on pension draw downs from their SMSF.

The tax benefit arises because personal income can be funnelled into the super fund and is therefore subject to 15% superannuation contributions tax rather than personal marginal tax rates.

Personal cash flow is then supplemented by the tax free pension drawn from the super fund (or concessional tax pension for those aged 55 to 60).

Effectively, tax is capped at a maximum rate of 15%, rather than the higher personal marginal tax rates. Furthermore, the income and capital gains earned from the investments of the superannuation fund which support the pension are not subject to tax either. A fantastic outcome!

The following example highlights how this strategy can be tax effective in the right circumstances - a tax saving of at least \$14k in year one alone:

### 60 year old - 2007/08 tax rates

	No Salary Sacrifice	Salary Sacrifice
Gross wages	100,000	100,000
less salary sacrifice	-	70,000
Taxable income	100,000	30,000
less tax on taxable income	28,600	4,050
Net salary income	71,400	25,950
add tax free pension	-	45,450
<b>Total net income</b>	<b>71,400</b>	<b>71,400</b>
Personal income tax	28,600	4,050
Super fund tax	-	10,500
<b>Total tax</b>	<b>28,600</b>	<b>14,550</b>

### Therefore a tax saving of at least \$14,000

#### Note:

- does not include tax benefit of nil tax on super fund pension account's investment earnings
- assumes adequate superannuation balance to support \$45,450 pension payment

## Allocating contributions to the spouse who is closer to 60

The new super rules permit tax free withdrawals to those over the age of 60. Therefore, if a couple is considering making non-concessional (or after tax) contributions to superannuation, or if they are self employed and are considering making concessional (or pre tax) contributions to superannuation, we have seen these contributions often allocated to the older spouse.

Superannuation contributions splitting may also facilitate the allocation of concessional (pre-tax) contributions to the older spouse for salary and wage earners, however this is subject to other criteria being met and this may not be available if the splittee is already 55 or over.

The allocation of contributions to the older spouse is attractive because they will reach the age of 60 sooner, therefore be in a position to draw down their super benefits tax free sooner and take advantage of strategies such as the transition to retirement strategy mentioned above.

However, this strategy can be hampered by the concessional contributions cap of \$50k per person per annum (or \$100k for those over 50 under transitional rules which expire in 2012) and the \$150k non-concessional contributions cap per person per annum. For the non-concessional contributions cap, the following two years entitlement may be brought forward under an averaging rule which is available to those under the age of 65.

## Recontribution

Although superannuation draw downs are tax free to those over 60, they generally are not tax free for those under 60. Furthermore, if a death benefit is paid to an adult child, this will generally not be tax free (even if the deceased was over 60).

For payments to those under 60 and the death benefits paid to adult children, the portion which will be tax free is generally determined by the proportion of the balance of the superannuation fund interest which represents 'non-concessional' contributions (contributions made to the super fund from after tax money).

Therefore a common strategy we have seen since 1/7/07 is for members to take a withdrawal from superannuation (which will be tax free for those over 60 and concessionally taxed for those between 55 and 60) and re-contribute the amount back into super as a non-concessional (after tax) contribution.

Although the initial withdrawal needs to be taken from the tax free and taxable components of the super fund on a proportionate basis, the re-contribution of this money back into super of non-concessional contributions will then increase the overall proportion of the tax free component which is based on these non-concessional (after tax) contributions. A very popular estate planning strategy.

*(This will be subject to the \$150k non-concessional contributions cap per person per annum, of which the following two years entitlement may be brought forward under an averaging rule which is available to those under 65, meaning \$450k may be contributed in one year using the next two years' entitlement. This strategy will also be subject to the individual being eligible to draw benefits from the super fund and meet the work test to re-contribute if member is aged 65 – 75.)*

## Co-contribution

We have seen circumstances where the self employed are now eligible for the government co-contribution, where they would not have been before 30/6/07. There have been changes to the rules which permit someone with at least 10% of their income from business to be eligible, whereas they would not have been eligible under the previous employment related criteria.

Therefore, this is a strategy we are seeing more of for the self employed with net business income of less than \$58,980.

If your total income for co-contribution purposes is \$28,980 or less, then you may be eligible for the government to match a \$1 after tax contribution with \$1.50, up to a maximum of \$1,000 matched by \$1,500. This reduces by 5c for every additional \$1 earned and therefore phases out at the income level of \$58,980.

## Defer pension payment until after age 60

A popular strategy is for a pension to commence for a member of a super fund on 1 July for the financial year in which the member is to turn 60.

The reason is that the income and capital gains derived from the assets supporting the pension will be tax free for the full financial year. However, the required pension payment can be taken *after* the member's 60th birthday, meaning it is completely tax free. This is even the case if the member turns 60 in June, 11 months after the pension commenced.

We have seen many examples where a pension was commenced on 1 July 2007 for a member who turned 60 in June 2008. The investment income and capital gains from the assets supporting the pension are tax free. The minimum pension payment is taken after the 60th birthday in June 2008 and is therefore tax free.

## Contributions to constitutionally protected funds

Concessional (pre-tax) contributions made to a 'constitutionally protected fund' are not subject to the annual concessional contributions cap (the cap is generally \$50k, or \$100k for those over 50 until 2012).

A constitutionally protected fund is usually a government super fund, which is 'untaxed', meaning more tax is paid at the time of withdrawal from the fund, rather than the 15% tax at the time of the contribution and on earnings. Therefore, those in the public sector may have the opportunity to salary sacrifice amounts in excess of the usual concessional contributions cap to the constitutionally protected fund.

These balances within the constitutionally protected fund however are subject to an overall lifetime limit of \$1m (similar to the old Reasonable Benefit Limits), which if exceeded means the balance will be taxed at 46.5%, regardless of whether it is rolled over or withdrawn from super altogether.

We are seeing those in the public sector take advantage of this (particularly medical professionals), whilst keeping an eye on the total balance to ensure it doesn't exceed \$1m. Doctors therefore may be eligible to salary sacrifice all of their hospital salary and then also be eligible to claim another superannuation tax deduction against self employment private practice income, which would be subject to the concessional contribution cap.

## SMSF Audits

With the growing number of SMSFs in Australia, the ATO is concerned that Trustees are meeting the stringent rules and regulations surrounding a SMSF so as to protect their superannuation savings.

The role of the SMSF Auditor is therefore increasing in its importance to ensure Trustees fulfill their legal obligations.

There are approximately 14,000 SMSF Auditors throughout Australia, with 95% of these auditing fewer than 5 funds per year. The ATO is concerned that a large number of these Auditors may lack the necessary skills and expertise to adequately carry out an audit.

As a result, the ATO will target what it considers to be 'high risk' SMSF Auditors with a focus on:

- A lack of independence of SMSF auditors where the accounts of the SMSF were prepared by the same person carrying out the audit
- Funds identified with contraventions with the Auditor did not lodge a qualified audit report
- Funds with loan arrangements
- Non complying funds.

From 1 July, the ATO have imposed stricter rules and regulations surrounding SMSF Auditors.

It is mandatory for Auditors who sign an SMSF audit report to meet the following requirements:

- Hold a practicing certificate issued by the professional accounting body of which they are a member
- Have relevant professional indemnity cover
- Undertake training and development as set out in the requirements
- Ensure those who perform work on their behalf have appropriate knowledge and experience and are properly supervised in the conduct of the audit
- Have an understanding of the SIS Act and Regulations as they apply to self managed super funds

SMSF Auditors must also meet a minimum level of continuing professional development which involves:

- 8 hours of superannuation training
- 8 hours of financial statement training or compliance audit training
- 4 hours of financial accounting training

In the past, audits have been often been conducted after the lodgement of the tax return and financial statements.

It is now a legal requirement that the audit of the self managed superannuation fund is completed prior to the lodgement of the fund's annual return with penalties applied if this is not met.

The downside of the changes to audit standards are with the role of the Auditor increasing in importance and the audit of SMSFs a specialist area, Trustees are likely to see some sort of increase in audit fees in the future.

*SuperGuardian engages the services of independent approved Auditors to audit our work.*

## Summary

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