SuperGuardian™

Superannuation administration made simple!

YOUR GUARDIAN

Issue: June 2006

Super – The New Tax Haven!

Analysis of 2006 Federal Budget on Superannuation

On May 9, Treasurer Peter Costello announced what we believe to be the most significant changes to superannuation in nearly two decades.

The impact of the proposed measures are extraordinary, and, although superannuation was already a very good, low tax structure, it is now even better.

We have set out below the main proposals, and strategies to consider to maximise super or minimise tax under these proposals.

Please note that Treasury is seeking comment prior to finalisation of the proposals, but the Treasurer is on record saying he does not expect that there will be any significant alterations to the plan announced on budget night.

Beware that the law has not been passed – so you should not take actions without seeking professional advice and an update on the status of the proposed changes. Most (but not all) of the changes are planned to commence from 1 July 2007.

Limit to Undeducted Contributions

This change, which if passed will apply from 9th May 2006, restricts the amount that can be contributed to a super fund as an undeducted contribution (i.e. no claim for a tax deduction is being made by the entity making the contribution) to $150,000 per annum, per member.

On 13th June 2006, Treasury announced that a 3 year averaging rule will apply, where $450,000 may be contributed in one year representing the current year limit and the following two year's limits.

If this is utilised, no undeducted contributions may be made in the following two years.

The averaging is prospective only – if a contribution is missed for a year, this amount cannot be credited to future years.

This will impact mostly those that were over 50 and who had been planning on contributing a large amount to super, or those who have inherited a lump sum that wanted to invest it in a low tax environment.

Individual Tax Rates

The good news for everyone, especially those on higher incomes, is that personal income tax rates will fall. It is predicted that only 2% of the population will face a marginal tax rate in excess of 45%.

From 1 July 2006, the top marginal tax rate of 45% will only apply on income above $150,000 per annum.

RBL's Abolished

With super being so attractive in the past, the Government limited the extent to which it could be used with the application of Reasonable Benefit Limits. These are indexed, and for the year ended 30 June 2006 are $648,946 if you intend to take a lump sum, or $1,297,886 if you will use your super to pay a pension. Any more than that, and the benefit you receive in excess of the limits were subject to tax at higher rates.

So for most of the last decade, a lot of effort has gone into strategies to get around these RBL rules. Contribution splitting is a recent example – instead of becoming subject to excess benefits tax because you exceed your RBL, split part of your super contributions to your spouse, so that as a couple you would make use of two limits.

With RBL's abolished from 1 July 2007, these plans and strategies will soon become defunct.

You can now have as much money in super as you like, and not pay tax when it comes out, either as a lump sum or a pension, provided you have retired or met another condition of release and have passed the age of 60.

The catch is – there are now new limits to how much you can put in.


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Contributions

Aged based limits – that is, the amount you could contribute based on age bands – will be scrapped and replaced by a limit of $50,000 per person regardless of age. This applies from 1 July 2007.

So someone young who has the cash to be able to contribute to super will be better off than previously because they can start building up more super earlier.

But what about someone who is in their early 50's who had just begun putting large amounts into super to cover for their retirement? The government has those people covered via transitional rules which will allow them to still contribute up to $100,000 per year until 2012.

As previously mentioned, there is a new limit however on non-deductible contributions.

Contributions Measured on basis of Fund Receipts

If you have two employers, both contributing to your fund, you can until 30 June 2007 have effectively twice the aged based limit contributed to the fund. From 1 July 2007, there will be a total limit of $50k that can be paid in as tax deductible amounts. Any amounts in excess of this will be subject to 45% tax, payable by the fund. We presume that this figure will be increased to $100,000 for a person over 50, for the years until 2012, when the transitional rule referred to earlier comes to an end.

Self employed people are currently able to only claim the first $5,000 of contributions into a fund, and 75% of the amount paid in excess of $5,000. They will, from 1 July 2007, be entitled to a deduction on the whole lot, up to the $50,000 maximum, which will be indexed.

And capital gains from the sale of a small business can still be contributed tax free into a fund, subject to a lifetime limit of $500,000, and subject to the other rules associated with the Small Business CGT Concessions. With an ageing population, this is expected to be quite popular as people in business sell their businesses over the next few years.

Taxes on Pensions after Age 60

For most people, they were not likely to be paying much tax anyway, if they were within their RBL's, especially if they chose to take their super money by way of a regular pension payment.

So most of the impact of the changes to taxing rules are about simplifying the tax regime. It will of course also benefit those with larger super balances.

If you are over 60, and retired, the amounts that you will receive from a super fund, whether by way of a lump sum payment or a pension, will be exempt from tax. And if the fund is paying pensions, the income from the assets being used to pay the pension will be exempt from income tax – hence potentially an entirely tax free environment for the retiree.

There will be minimum pensions that need to be drawn each year, but in fact there is no need to start a pension or to take money out of your fund until you wish to. If you have other income you could just let it build up at a low rate of tax and leave it to your children as a nice inheritance.

Taxes on Pensions before Age 60

For those who choose to retire between the ages of 55 and 60, their lump sums or pensions will still be subject to tax, in a similar way that exists currently. There is a tax rebate on payments made, so in reality the tax burden should be nil or low, unless they have an excessive amount in their super fund, or significant other income.

Taxes on Pensions before Age 60 – still working

Since 1 July 2005, it has been possible for people over 55 to draw a pension from their super fund even though they are still working. Apart from supplementing their income, they could in fact reduce their personal income tax by salary sacrificing into super, then drawing it out again with a tax rebate.

The new changes do not prohibit this strategy.

This is known as a Transition to Retirement Pension, and can be very effective for some people to reduce their overall tax. It can also cause their fund to obtain tax free status – not only for income and capital gains in the future, but on all unrealised capital gains to date.

This is one area where professional advice is needed, and calculations performed to identify the tax savings available.

Strategies

- With the new limits to amounts than can be contributed, there is an increased focus and urgency on dealing with superannuation. For many, the sooner one contributes to super, the better, subject of course to other cash flow needs.
- For those over 50, they are limited to how much they can contribute. One strategy for someone who has a lump sum is to contribute as follows:
  - $150,000 non deductible amount before 30 June 2006
    $100,587 tax deductible amount before 30 June 2006
    Repeat this in July 2006 and again in July 2007.
  - This represents a total of around $750,000 in 14 months, which if also made for the spouse would enable you to contribute up to $1.5 million within the next 14 months.

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- Under the 3 year averaging rule for undeducted contributions, consider the possibility of a contribution of $450,000 as soon as possible, rather than contributing $150,000 a year for the next three years.
- Commence a pre-retirement pension – there are still benefits with this if you are over 55 – as a way of reducing income tax and reducing or eliminating tax within your super fund.
- Small business CGT concessions – you can structure your affairs to maximise your chances of obtaining this, which could reduce your taxable gain by $500,000 for both you and your spouse. If you have a client in a small business that is in their late 40's or 50's, they should be planning on how to achieve this now. Putting money into super actually helps to achieve this as money in super is ignored in terms of the wealth test that applies to this tax concession.
- Move shares to super – if you are of the view that the market will keep rising in the long term, this should seriously be considered.
- Start young – gain the benefits of compounding. Use salary sacrifice if necessary to build up your super.
- Encourage your parents! Their wealth will grow much more strongly if they hold their investments via a super fund – and to that extent you will probably get a bigger inheritance. You will only pay 15% tax on the lump sum received when they die.

Strategies and Actions List

- Review whether you may now get the government aged pension due to a change in the assets test taper rate.
- Consider super splitting where one spouse is much older than another, in order to be able to access the money sooner, if needed.
- Consider maximizing super contributions and deductions before 30 June 2006 regardless of age.
- If you have benefits in excess of the lump sum RBL, consider deferring pension commencement until after 1 July 2007. In meantime draw down the tax free lump sum component within the super fund and live off that if you need to retire before 60.
- Re-evaluate life insurance within super now that payouts will not be subject to RBL limits. Lump sum payments to non dependents would be taxed at 15%.
- Consider changing employment contracts if existing contracts include a large lump sum termination payment, as from 1 July 2007 these cannot be rolled over into super and hence tax will be greater.

Please note these strategies are not recommendations – they are merely examples of the sorts of actions that can be considered. In every case, a person's overall financial situation needs to be carefully considered before implementing any of the strategies set out above. The examples above are not intended and should not be taken as advice.

Summary

As you can see there are many strategies that can be applied to minimise tax or maximise super before and after the new rules are planned to commence.

For those over 50, specialist advice may be necessary to optimise your superannuation, especially if you were planning to contribute large amounts in the next few years.

Once the Government's proposals become law, we will prepare another newsletter to our clients to advise any material changes to the proposals as outlined in the 2006 Federal Budget.

If you have any questions or would like some advice please phone **Phil Jaquillard** on **1300 787 576**.

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