



Changes that affect Pension clients on 1 July

Under the 'simplified superannuation' reforms, the nature of pensions and the underlying tax components are set to change substantially on 1 July 2007.

This will affect people who currently draw a pension who will need to make decisions as to how their arrangements are structured from this date.

We explain what these changes are, the timing of such and how they will affect SMSF members currently drawing a pension.

The new style pension

From 1 July 2007, those who qualify to draw a pension from their superannuation fund may elect to receive a pension with new style pension rules. The new style pension is attractive to many because, although there is still a minimum balance that must be drawn each year, there is no maximum limit on what you can withdraw out of your pension account. Significantly more flexible than under the previous allocated pension rules.

The new style pension rules stipulate a minimum amount which must be drawn each financial year. This is calculated by applying a percentage which is determined by the age of the recipient at 1 July, against the recipient's pension account balance at 1 July or age and account balance at the date of commencement of the first pension. Where a pension commences part way through a year, the % factor is calculated on a pro-rata basis.

eg Minimum pension = Account balance @ 1 July x % factor

The relevant percentage factors:

Age of beneficiary	Minimum annual drawdown (% factor)
Under 65	4%
65 - 74	5%
75 - 79	6%
80 - 84	7%
85 - 89	9%
90 - 94	11%
95 or more	14%

Example: Mr Smith is 68 years of age and has \$150,000 in his account balance as at 1 July.

Therefore $\$150,000 \times 5\% = \$7,500$. This minimum amount must be drawn out as a pension payment during the 2007/08 financial year.

Special Note

If the pension is a 'pre-retirement' pension, that is generally when the pensioner is over 55 but under 65 and has commenced the pension before retirement, there is a maximum amount they can draw out each year which is capped at 10%.

The new tax components

Currently there are an array of different tax components which determine the tax on lump sums and pensions. From 1 July 2007 these tax components will generally be converted into one of two different components – taxable and tax exempt (non taxable).

The tax exempt component will include any undeducted contributions members have made, Capital Gains Tax exempt amounts and the pre 1983 component.

The taxable component will include the post 1983 component.

Proportioning rule

As of 1 July 2007, when a lump sum is taken, the components of the lump sum will be determined by the proportion of the exempt component and the taxable component at the date of withdrawal. This is referred to as the 'proportioning rule'.

For pension payments and lump sums from a pension account, this proportion will be locked in at the date of commencement of the pension and this fixed proportion will apply to all payments from the pension balance thereafter.

For those under 60 and therefore still subject to tax on withdrawals from superannuation from 1 July 2007, the exempt proportion of a withdrawal/pension payment will remain tax free but the taxable component may be taxed. The rate of tax and the tax offsets available will depend on whether the withdrawal is a lump sum or pension.

So what does this mean for existing pensions?

For those with existing allocated pensions at 30 June 2007, the pension can convert to a new style pension. If clients want to convert to the new style pension they will need to notify their Accountant as there will need to be a minute to evidence the conversion.

Special Note

Before converting, it is important to check that the fund's Trust Deed permits the new style of pensions.

Proportioning Rules for those over 60

Those over the age of 60 will need to automatically convert to the new proportioning rules to determine the tax component breakdown of each pension payment.

The tax exempt and taxable components will be tracked during the pension's existence, even though the payments are tax free to the pension recipient.

The tax exempt and taxable components are important for SMSF Members for estate planning purposes, as the taxable component will be taxed when a member dies if the death benefit is not paid to a financial dependant.

Proportioning rules for those under 60

Those under 60 who are in receipt of a pension do not automatically convert to the new proportioning rules. In this case, it may be possible for the pension recipient to remain under the pre 30 June 2007 component rules and existing tax deductible amount calculation. However when they either a) stop the pension; b) draw a lump sum from the pension balance (ie partial commutation); or c) turn 60, then they will convert to the new proportioning rules.

This means that the existing ETP component regime may still apply until 2012 in some cases.

Whether it is more tax effective to remain under the old system or convert to the new proportioning system will depend on each pension recipient's individual circumstances – and this is an area we strongly recommend SMSF members seek the advice of a qualified financial adviser.

Existing Term Allocated Pensions (TAPs) / Defined Benefit Pensions

Unfortunately, non-commutable complying pensions such as TAPs and Defined Benefit Pensions cannot be converted to the new style of pensions.

However, it may be possible for the defined benefit pensions to be converted to a TAP. This process will need to be carefully considered as it may result in 'reserves' being created within the fund, or may impact on asset test exemption for Centrelink purposes.

Again – we recommend financial advice is sought on this matter.

In-Specie Transfers

With the flurry of activity in June, a lot of people are leaving their off-market transfers until the last minute.

Whilst the stamp duty office may allow a period of time to lodge standard transfer forms, we do not recommend back dating of in-specie transfers. One key reason is that the share transfer must take place after the date of establishment of the fund. The second is that back-dating in-specie transfers may be viewed by the ATO as tax avoidance.

For further clarification on this issue, please call our office.

Confirm your contributions

If you have made undeducted contributions since 10 May 06 that total more than the \$1 million maximum, the amount over \$1 million is subject to Excess Contributions Tax which is charged at 46.5%.

Those that fall in this category may apply to the ATO to release the excess contribution – however you can only do this for a contribution made between 10 May 06 and 6 December 06 and the **application must be made to the ATO before 30 June 07**.

For more information please contact us or refer to the ATO Fact Sheet at:

www.ato.gov.au/super/content.asp?doc=/content/00094536.htm

We're on the move...

On Monday 9th July SuperGuardian will be operating out of new premises. Our contact details will remain the same, however our street address will be:

65 Gilbert Street, Adelaide

For more information relating to this edition of Your Guardian, call **Brendan Daw** or **Ed Bernard** of our office on **1300 787 576**.



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