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YOUR GUARDIAN

Issue: December 2005

Superannuation Contributions Splitting

From 1 January 2006, a member's superannuation contributions may be able to be allocated to his or her spouse. Draft regulations state that up to 85% of deductible contributions may be allocated to a spouse, and up to 100% of personal contributions (or undeducted contributions) may be allocated. The 85% limit exists to allow for the 15% contributions tax which must apply to the deductible contributions.

Currently, subject to contribution rules, a spouse may already make unlimited undeducted contributions to the other spouse – this change in the law should not attract too much interest.

However, the ability to allocate deductible contributions to a spouse will provide some great tax incentives. Firstly, this effectively means that a couple will have the opportunity to access two Reasonable Benefit Limits (RBLs). Once retired, this will also enable both husband and wife to receive the post June 1983 tax free limit for lump sum withdrawals (currently $129,751 for 2005/2006), and the use of two marginal tax rates once in pension phase.

These advantages of using such a strategy are highlighted in the following example:

Mr & Mrs Fox

(For the purpose of these calculations we assume the post June 1983 threshold and lump sum RBL threshold remain at the 2005/2006 levels of $129,751 and $648,946 respectively, and we have used the 2005/2006 income tax rates. The existing allocated pension factors have also been used)

Scenario 1:

Mr Fox receives (net of contributions tax) $1,000,000 in deductible contributions, until he turns 60 and retires. At this point he withdraws his tax free amount of post June 1983 benefits (being $129,751) and re–contributes this into superannuation as an undeducted contribution (which provides the benefit of a tax free portion on a pension income stream). He then commences an allocated pension with his entire balance, the pension being reversionary to his wife who is aged 60 (this means the pension will continue to his spouse in the event of his death).

Of his account balance, $351,054 is in excess of his lump sum RBL (ie $1,000,000 – $648,946) – he will not be entitled to a 15% tax rebate on this portion of the taxable amount of his pension payments. He has $129,751 in undeducted contributions resulting from the withdrawal and recontribution.

Scenario 2:

Mr Fox receives (net of contributions tax) $1,000,000 in deductible contributions, yet for the past few years he decided to split the contributions (net of contributions tax) entirely to his spouse which resulted in both having $500,000 in their accounts. At age 60 and retired, both Mr & Mrs Fox withdraw their tax free amounts on the post June 1983 component and re-contribute these amounts as undeducted contributions (total of $129,751 x 2 = $259,502). They both then commence allocated pensions with their entire balances, both reversionary to one another.

Both Mr and Mrs Fox are below their RBLs of $648,946. Therefore, their taxable portions of their pension payments will be entitled to a full 15% tax rebate. Both Mr and Mrs Fox have $129,751 each in undeducted contributions in their fund (ie. a combined total of $259,502) resulting from the withdrawals and recontributions.

Summary

Assuming the minimum pension is drawn, the differences in the net after tax income between the two scenarios are as follows:

	Scenario 1	Scenario 2
Gross Combined Pensions	$56,180	$56,180
Tax Deductible Amounts	$5,100	$10,201
Taxable Amounts	$51,080	$45,979
Rebatable Amount	$30,474	$45,979
Tax Payable	$12,262	$6,827
less rebate	($4,571)	($6,897)
Net Tax Payable	$7,691	–

In other words, in year one of receiving the pension, there is already a substantial tax saving of $7,691. This shows the benefit from the use of two RBLs, two post June 1983 tax free thresholds, and two marginal tax brackets.

Please be aware that the above calculations are based on a number of assumptions. It should be noted that once a contribution has been split, the amount will then be actually owned by the receiving spouse!

The draft regulations also state that the receiving spouse must be aged less than the relevant preservation age (which is currently age 55) or is aged between the relevant preservation age and 65 years, but does not consider themself to be permanently retired (therefore cannot immediately access the amount if transferred to them).

The fund's trust deed must also allow for superannuation splitting.

For more information on the tax benefits of superannuation splitting, please do not hesitate to contact **Ed Bernard** or **Phil Jaquillard** on **1300 787 576**.

Section 279D
Clawing Back Contributions Tax

A deduction may be available to Trustees of a Self Managed Superannuation Fund when a death benefit is paid in the form of a lump sum, the deduction representing a 'claw back' of the total amount of contributions tax paid by the deceased in the past.

The deduction can only be claimed if the lump sum death benefit is increased by an amount equal to the full benefit which will accrue to the superannuation fund as a result of the deduction being claimed. If the death benefit is not "grossed up" to include the amount of this benefit which will accrue, no deduction is available.

There are two methods which can be used in order to calculate the amount of this deduction – there is nothing to say you cannot choose between the two to obtain a larger deduction:

Firstly, you can calculate the total amount of contributions tax which had ever been paid by the deceased member. To use this method, you must know the total amount of contributions tax ever paid – in other words, only using the previous few years, as prior year records have not been maintained, is not allowable.

Considering contributions tax has existed since 1 July 1988, it would be rare that these records would be readily available in most cases.

Under the second method, an actuary or an accountant can calculate the amount of contributions tax using an ATO approved formula. This is a much simpler and commonly used procedure – in fact it can also generate a generous deduction.

The deduction is allowable in the year that the grossed up death benefit is paid. Should the deduction create a tax loss, this loss can be carried forward to future years.

Some important issues to consider when deciding whether to apply the 279D deduction are:

- The deduction cannot be claimed if the death benefit is paid as a pension;
- The superannuation fund must be a continuously complying superannuation fund;
- If the remaining member of the fund is in pension mode, hence a 0% fund tax rate, there may be no benefit in creating a large tax deduction;
- Always ensure that the payment of the additional death benefit does not compromise the solvency of the fund and that the result is equitable between the members of the fund;
- Finally, always check the fund's trust deed to ensure this procedure is allowed.

For more information on the practical steps in implementing this strategy, or for a copy of the ATO approved formula for calculating the deduction, please contact **Ed Bernard** or **Phil Jaquillard** on **1300 787 576**.

Merry Christmas

On behalf of the SuperGuardian team, we wish all of our clients a very Merry Christmas and a Happy New Year.

Please note our office will be closed between Christmas and New Year, though we will be available by phone for any urgent queries.

Happy Holidays, **Olivia Molina** General Manager

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