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www.afr.com The Weekend Australian Financial Review October 7-8, 2006 41

DIY SUPER JOHN WASILIEV

Tax-free money there for the taking

Generous pension allowances are coming in but you need to follow the rules.

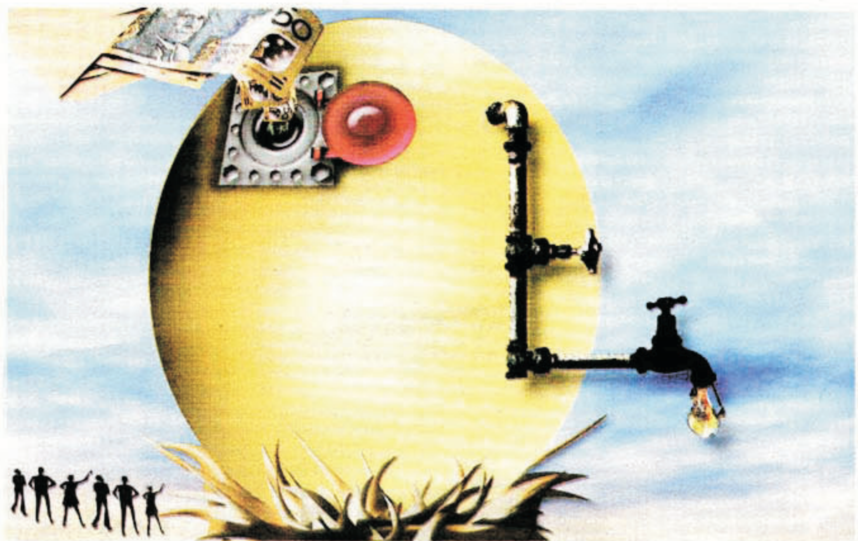

Photo-illustration Peter Riches

Last weekend's column on the transition-to-retirement superannuation pensions attracted a number of questions from readers with a common theme: surprise bordering on disbelief about the apparent generosity these arrangements offer under the government's super reforms.

The fundamentals of a transition-to-retirement pension are that you sacrifice as much of your salary income as the super contribution rules permit – paying less income tax on your earnings – and supplement your income by starting a tax concessional pre-retirement pension, which from next year will be tax free if you are over 60.

One reader wanted confirmation that pre-retirement super pensions are able to pay tax-free income to those over 60 from next July.

While he accepted that super benefits – either pension income or lump sums – paid to retirees will enjoy tax-free income status, he wanted to be sure this will also apply to transition-to-retirement pensions.

Another reader wanted confirmation the Tax Office will pay dividend imputation credits on share investments as income to funds paying either pre-retirement or retirement superannuation pensions because these funds are entitled to tax-free investment earnings.

Director of Adelaide-based SuperGuardian Phil Jaquillard says it is very common for people not to realise until they take a pension that the fund's investment earnings become tax free. Even though this entitlement has been available for years, many people think this is too good to be true, he says.

As far as those over the age of 60 being entitled from next year to tax-free income on the pensions, Jaquillard says the way this is expected to work is that members of DIY funds who receive a retirement pension from their fund won't have to include these amounts in their tax returns. "It will be genuinely tax-free income," he says.

Funds will still need to keep a record of pension income payments for the fund auditor who will check to see that payment rules have been satisfied. With all retirement pensions, a fund must pay a minimum level of income on a pension. Under the rules that will apply from next July, the minimum is at least 4 per cent of the fund's July 1 balance if you are aged between 55 and 64.

The maximum transition-to-retirement pension from next July will be 10 per cent of the account balance. Presently anyone who starts a transition-to-retirement pension must comply with the minimum and maximum requirements set down for the pension they choose.

If it is an allocated pension, for example, and you are 60, the minimum income you must take is 5.6 per cent of the July 1 account balance and the maximum is just over 11 per cent.

The big restriction as far as allocated pensions taken as transition-to-retirement pensions is concerned is that you can't withdraw any additional lump sum amounts.

A fund will still need to detail income payments so that an accurate picture of the account balance can be determined.

"Even though there is no tax, the accounting still has to be done," says Jaquillard.

As well, a fund may be asked to show its accounts to a tax office auditor if they have been selected for a random audit.

Deutsche Asset Management technical adviser David Giltrap says many people don't fully appreciate the difference between a fund earning tax-free income on super investment portfolios that pay an income stream and the taxation of the actual pension income stream, such as an allocated pension.

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It is the entitlement to tax-free earnings once you start a pension that give the extra zing to dividend imputation tax credits.

Where a fund does not have to pay tax on investment earnings, it has been the case since July 2000 that the Tax Office will refund imputation tax credits. Previously, imputation credits could be used only to offset any other income tax liability.

Where a fund had excess imputation credits, these were disregarded and not refunded.

The refund measures were introduced from 2000 to ensure that funds pay tax on the share dividends in their investment portfolios at the fund's tax rate rather than at the company tax rate. Where the fund's tax rate is zero, the full value of the credits will be refunded in the form of a cheque from the taxman.

One important pre-retirement pension issue to be mindful of if you are working for an employer, says Jaquillard, is whether this will reduce the 9 per cent super guarantee contribution employers must make on your behalf.

Employers are required to base the SG contribution only on your salary so if this is dramatically reduced by a bigger contribution to super, any benefit could be offset by a lower SG payment.

Jaquillard says, from his experience, people with a good relationship with their employer have been able to negotiate an SG payment based on the total employment income before any salary sacrifice.

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