Major super announcements from the Treasurer

By David Shirlow Head of Technical Services, Macquarie Adviser Services

Essentially, the plan remains as previously announced, but the new details do indicate a change of position on some proposals as well as a welcome clarification of other proposals (albeit in some cases with an unwelcome result).

The announcement is supported by a 31 page document entitled “A Plan to Simplify and Streamline Superannuation – Outcomes of Consultation”, which is available at www.simplersuper.treasury.gov.au/decision/decision.pdf. The press release from the Treasurer and Assistant Treasurer is available at www.treasurer.gov.au/tsr/content/pressreleases/2006/093.asp.

Key elements of the package, including abolition of Reasonable Benefits Limits (RBLs) from 1 July 2007, removal of tax on all benefits paid to members aged 60 or more and removal of compulsory cashing requirements, will remain (the latter has already been legislated for the period before 1 July 2007).

The following is a description of our understanding of the key developments, together with examples in some cases, to assist you to digest them. Bear in mind that none of these proposals have been legislated.

UNDEDUCTED CONTRIBUTION LIMITS

Pre 1 July 2007 limit lifted to $1 million. Perhaps the most positive change with immediate impact is that the undeducted contributions cap for the period 10 May 2006 to 30 June 2007 inclusive will be $1m (provided the fund is or was eligible to accept contributions for the client in the relevant year). This replaces the proposal to impose a $150,000 per annum cap for the 2005/06 and 2006/07 income years. This will certainly provide greater scope to contribute amounts representing proceeds from the sale of real estate or other non-superannuation assets.

From 1 July 2007 the $150,000 per annum cap will apply for the 2007/08 and later income years. The government has confirmed that the limit applies in relation to the beneficiary of the contribution, not the contributor. So, for example, contributions made by a husband for the benefit of his wife would count towards the wife’s limit, as would contributions she made for her own benefit.

Three year rule changed. The ability to bring forward two years of contributions (so as to make a contribution of up to $450,000) will be available from 1 July 2007 in respect of people aged 64 or less. This will be the case with respect to 63 and 64 year olds even if they intend to retire at age 65.
However, there will be no scope to bring forward future years’ contributions for those aged 65 to 74 inclusive, even if they do continue to work the necessary hours in future years. Undeducted contributions for this age group will be limited to $150,000 per annum.

**Examples**: In tandem with the transitional provisions leading up to 1 July 2007, the following table illustrates acceptable contribution patterns for an individual trying to maximise their contributions as they approach age 65, assuming they will not meet the work test after this age. We will provide further analysis of contribution patterns in due course.

**Excess undeducted contributions taxed, not refunded.** Contrary to the original proposal, contributions in excess of the cap will not have to be refunded to the individual. Instead they will be effectively taxed at the top marginal tax rate plus Medicare Levy which in typical circumstances is a powerful incentive not to over-contribute. The individual will be liable for this tax and will be able to nominate a superannuation fund to release money to pay that tax. The balance of the excess contributions may remain in the fund.

**Excess contributions made before 1 July 2007.** Undeducted contributions in excess of the $1million cap will be able to be withdrawn without penalty before 1 July 2007 (subject to legislation enabling funds to release these amounts on this basis).

**Exemption – small business.** In June the Treasurer announced that small business CGT exempt component amounts (arising under the $500,000 CGT retirement exemption) would not be counted towards the undeducted contribution limit. On 5 September 2006 the Treasurer announced instead that the exemption would be broadened to cover not only those amounts but also proceeds from the disposal of assets which qualify for CGT exemption under the 15 year rule. (Presumably this applies to the whole of the proceeds, not just the part for which an exemption has been necessary, but we await the details). It will also extend to assets that would have qualified for these CGT exemptions but for the fact that they are pre-CGT assets, or if disposed of after permanent disablement of the owner including where the asset had not been owned for 15 years. The overall limit for this exemption will be a lifetime limit of $1million (indexed).

**Exemption – injury settlement proceeds.** The Treasurer announced that proceeds from the settlement for an injury resulting in permanent disablement would be exempt. No limit on the exemption was announced.

**Exemption – co-contributions.** Government co-contributions will not count towards the undeducted contributions cap.

**Exemption and non-exemption for transfers from overseas funds.** If a benefit is transferred from an overseas fund to an Australian fund and the relevant client elects for the taxable part of the benefit to be taxed in the hands of the receiving fund, that taxable amount will not be counted towards any contribution limit. However, the balance of the amount transferred will be counted towards the undeducted contributions limit.

**Indexation in $15,000 lumps.** The undeducted contributions limit will always be three times the concessional deductible contributions limit, so in effect it will be indexed whenever that limit is indexed (see below).

### DEDUCTIBLE CONTRIBUTION LIMITS

**$50,000 limit as announced.** The proposed $50,000 per annum limit (or $100,000 per annum for any income year during which the relevant client attains age 50 or more, up to and including 2011/12) remains, and will apply in relation to employees up to and including age 74, as announced.

**Indexation in $5,000 lumps.** The $50,000 limit will be indexed to AWOTE and it will be increased once the increased amount exceeds $5,000. In other words, it will be indexed in $5,000 lumps. This should make thresholds easier to remember.

**Individual pays tax on excess deductible contributions.** While all employer contributions will be deductible, the amount above the limit for each person will be taxed in the fund at 15 per cent and an additional tax at 31.5 per cent will be levied on the individual (who may elect for their superannuation fund to release money to pay that tax). The ATO will be able to reduce the amount of excess contributions in the event of inadvertent breaches (but examples of this have not been provided).

**Excess deductible contributions potentially taxed again.** Not only will excess deductible contributions be taxed at a total rate of 46.5 per cent, but also they will be counted towards the undeducted contributions cap. To the extent they were to exceed that cap as well (which could occur, for example, if that cap had already been used up with an undeducted contribution of $450,000) then they would be subject to further tax at the top marginal rate. Presumably it is only the net contribution

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<th>TABLE 1. CONTRIBUTION LIMITS</th>
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<tr>
<td>Client age</td>
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<tr>
<td>Tax year</td>
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<tr>
<td>Post tax contributions</td>
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* Less any undeducted contributions already made on or after 10 May 2006
after the first 46.5 per cent tax has been deducted which counts towards the undeducted contributions cap and only the net amount which could attract the top rate of tax again, but that is not entirely clear. It seems clear that this treatment is only potentially relevant for deductible contributions made from 1 July 2007.

**Defined benefit funds — transitional relief.** A concept of “notional taxable contributions” will be developed for the purpose of applying the limit in relation to defined benefit arrangements. However, as a transitional measure, defined benefit fund members as at 5 September 2006 with notional taxable contributions above the limit will be deemed as having contributions made at the limit (unless the fund rules are amended to increase benefits).

**SELF-EMPLOYED PERSONAL CONTRIBUTION INCENTIVES**

**Full deductibility for unsupported personal contributions to age 75, subject to concessional limits.** The government has confirmed that, from 1 July 2007, the size and age limits for concessional deductible personal contributions will reflect those limits applicable to employer contributions (as described previously).

**82AAT notices.** The notice process will change so that a person who wishes to claim a tax deduction for a personal contribution will need to notify their superannuation fund by the time they lodge their income tax return, or the end of the following financial year after the contribution was made, whichever is earlier. This will provide certainty at an earlier point in time for contribution limit purposes.

**Co-contributions.** The government has confirmed it will extend the government co-contribution to the self-employed from 1 July 2007.

**BENEFITS — TAX COMPONENTS**

**Pre–July 1983 component crystallisation.** It has now been confirmed that the pre–July 1983 component will be crystallised as at 30 June 2007 and funds have until 30 June 2008 to implement this. The pre–July 1983 component will now be fixed and form part of the new ‘exempt component’ along with concessional, invalidity and undeducted components.

**Pensions and pre–July 1983 components.**

Pensions commenced on or after 1 July 2007 which would qualify for a pre–July 1983 component will have this included in the exempt component of the pension income. However, pensions before that date will continue to have the deductible amount calculated under the current method.

Therefore from 1 July 2007 when any part payment of a superannuation benefit is made the benefit received (whether a lump sum or pension) will be taken to include the relevant proportion of the exempt and taxable components. We assume the government has accepted industry suggestions so that earnings would also be allocated to the exempt and taxable components of pension accounts on a proportional basis, so that the proportions do not need to be recalculated every time there is a further benefit payment. If so, this new proportional system will alleviate the need for superannuation funds to track individual components into the future.

Example: This may lead to some interesting alternative results for clients depending on how much income they intend to draw from their pension. Consider a client at 1 July next year with a $612,000 allocated pension of which the current components are as follows:

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<thead>
<tr>
<th></th>
<th>Pre 07 DA</th>
<th>Post 07 exempt</th>
<th>Pre 07 DA</th>
<th>Post 07 exempt</th>
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<tbody>
<tr>
<td>Pre $204,000</td>
<td>$29,500</td>
<td>$29,500</td>
<td>$40,000</td>
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</tr>
<tr>
<td>Post $258,000</td>
<td>$12,437</td>
<td>$17,063</td>
<td>$6,019</td>
<td>$23,138</td>
</tr>
<tr>
<td>UDC $150,000</td>
<td></td>
<td></td>
<td>$33,981</td>
<td>$16,864</td>
</tr>
<tr>
<td>Total</td>
<td>$612,000</td>
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Let’s assume his life expectancy was 25.92 years when he commenced the AP and his current annual deductible amount is only based on the original UDC component and is $6,019 per annum (ie $156,000/25.92). If he was to commute this pension and commence a new pension the pre–July 1983 component would now form part of the exempt income and 57.84 per cent of the pension payment will be considered to be exempt. This is likely to be advantageous depending on the level of income he takes, though this will be less relevant from age 60. In the table below we look at two alternative levels of income.

<table>
<thead>
<tr>
<th>Level of income</th>
<th>Pre 07 DA</th>
<th>Post 07 exempt</th>
<th>Pre 07 DA</th>
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<tr>
<td>$29,500</td>
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For those clients who already have the pre–July 83 component included in their deductible amount via the pre–July 1994 grandfathering rules there should generally be no tax impact on them in combining their pre and post–July 1994 income streams from 1 July 2007. Nevertheless, these clients may find it administratively convenient to consolidate their income streams from this date.

**Proportional lump sums.** The requirement for lump sum payments to be drawn proportionally from the tax components will also lead to some interesting outcomes. This requirement we assume will also apply to rollovers. Therefore it appears that clients aged 55–59 inclusive will not be able to only draw from the exempt tax component.
PENSION RULES

**No fresh opportunity to commute.** The government has noted the concerns of various annuity providing institutions about the detrimental impacts on annuitants and annuity providers of allowing commutation of complying guaranteed annuities. As a result it has been decided not to allow commutation of any complying income stream, including SMSF complying pensions and term allocated pensions. In Macquarie’s view this is unfortunate, although the ongoing social security advantages of these pensions will extend to a broader range of complying pension recipients than before (see below). It is worth noting, however, that the legislation currently allows these pensions to be commenced in limited circumstances including where the proceeds are applied to commence another complying income stream. Presumably such a commutation would need to be before 1 July 2007. This may be worth considering in circumstances where the term of a client’s complying pension has become less desirable than alternative possible terms. It may also be appealing to commence a new term allocated pension for those seeking release of capital backing SMSF complying lifetime pensions in light of the impending removal of RBLs, or perhaps for the purpose of improving estate planning arrangements.

**Term allocated pensions and new payment levels.** It is not clear whether the government will accept industry arguments to relax the pension payment requirements for term allocated pensions so that the minimum drawdowns match the proposed new pension minima, with a parallel relaxation of maximum drawdown and term requirements. If this proposal is accepted it may go some way to alleviating concerns for those who have commenced term allocated pensions for RBL purposes. They will reap no benefit from the dilution of the assets test for age pension purposes and are stuck in an income stream which they entered for a reason which is no longer relevant.

**Allocated pensions and new payment levels.** The government has, however, indicated that existing allocated pensioners will be able to adopt the payment levels which are to apply to the new type of account-based pension (ie generally lower minima, no maxima). It will not be possible to fully evaluate the pros and cons of adopting the new payment levels until the legislation is finalised. (See also earlier comments about commuting pensions after 1 July 2007 to achieve a different deductible amount for tax purposes).

**AGE PENSION ENTITLEMENTS**

**Assets test proposals unchanged.** The government has confirmed that the assets test phase-out will be extended as originally proposed and that complying income streams commenced prior to 20 September 2007 (in effect we assume this means 1 July 2007 for superannuation pensions) will retain their current level of assets test exemption. The extended phase-out will apply in respect of age and service pensions, disability support pensions, carer payments, wife pensions, widow B pensions and bereavement allowances.

**Income test for super pensions.** The government states that the current income test of superannuation pensions will remain unchanged. This presumably means that the new simplified pension will have income test treatment consistent with the current treatment of allocated pensions, that is there will be a social security deduction amount calculated as purchase price divided by the relevant life expectancy factor.

The appeal of complying pensions for certain clients remains the preferential assets test treatment and potentially more clients will find this beneficial.

EMPLOYER ETPs

**Transitional relief for existing service agreements.** Transitional rules will be put in place for situations where an employer ETP is specified in existing employment contracts as at 9 May 2006, provided that payment is made prior to 1 July 2012. Presumably these rules will not be applicable until 1 July 2007, as it is expected that the current tax and RBL treatment of employer ETPs will remain in place until then. The transitional rules are as follows:

- Employer ETPs can be rolled into superannuation until 1 July 2012. Amounts of less than $1 million will be treated as a taxable contribution to the fund (but will not count against the $50,000 cap on concessional deductible contributions). Amounts rolled over above $1 million will be taxed at the top marginal tax rate plus Medicare Levy. In circumstances where the benefit is ultimately withdrawn tax free, this approach will often be the more appealing.
- If taken in cash, amounts up to $140,000 will be taxed at 15 per cent (or 30 per cent if under age 55), 30 per cent tax will apply for amounts over $140,000 and below $1 million, and amounts over $1 million will be taxed at the top marginal rate. All amounts will presumably be subject to the Medicare Levy.

We presume these rules are intended to apply only to the taxable part of an employer ETP (and that the part representing pre July 83 component and post-June 1994 invalidity component will not be taxed). The pre-July 1983 component would be calculated at the date of termination of employment (rather than at 30 June 2007).

**SMSFs AND OTHER FUND RULES**

SMSFs, as with all superannuation funds, will be prohibited from accepting greater than the maximum allowable undeducted contributions in a year (ie $450,000 for members under age 65 from 1 July 2007).

Interestingly, FBT will be removed from in specie employer contributions to superannuation funds. Typically this will be most relevant in relation to SMSF arrangements. Combined with the extension of the undeducted contribution limit to $1 million before 1 July 2007 (and the removal of the compulsory cashing requirements), it is possible we will see an increase in transfers of business real real property or listed securities into funds in circumstances where it makes sense to do so.
New proposals specifically regarding the regulation of SMSFs include:

- from the 2007/08 year, an increase in the supervisory levy from $45 to $150 per annum;
- a single new annual return covering the annual regulatory return, income tax return and member contributions statement, with which the supervisory levy will be collected;
- new administrative penalties for late returns and false statements;
- additional resources to be provided to the ATO to better regulate self-managed superannuation funds (with increased funding of $112 million over the forward estimates period);
- clarification of obligations to ensure independent auditors are properly informed of what they are required to report to the ATO. At this stage we assume that the reference to “independent” auditors does not flag an intention to legislate as to the meaning of that term.

DEATH BENEFITS

Meaning of dependant. For the purposes of the commentary on death benefits the government appears to indicate that the tax (not the SIS) definition of dependant applies. This means that adult non-financially dependent children are generally regarded as non-dependants.

Benefits to dependants generally. The government has confirmed that lump sum death benefit payments (including, we presume, benefits arising from insurance proceeds) are tax free if paid to a dependant. It has also confirmed the original proposals for tax treatment of pensions paid to dependants on the death of a pensioner.

Benefits paid in accumulation phase. Death benefits will be able to be paid as a pension to a dependant if the member dies before commencing a pension.

Child pensions. Death benefits will be able to be paid as a pension to a dependant child, but when the child reaches the age of 25 the balance in the fund will have to be paid as a lump sum (tax free) unless the child was permanently disabled. It is not clear whether transitional rules will apply to existing child pensions.

Benefits to non-dependants. The government has confirmed that death benefits will only be able to be paid to a non-dependant in lump sum form and it has now stated that the taxed element of the taxable component of a lump sum paid to a non-dependant will be taxed at 15 per cent. While not entirely clear it is possible that an untaxed element may arise where the benefit has been funded by insurance (the premiums for which a deduction has been claimed). If so, it may be taxed in the same way as a benefit paid from an untaxed fund. That is, the untaxed element may be taxed at the rate of 30 per cent up to $1 million and at the top marginal rate for amounts in excess of that. It is also not entirely clear whether there will be any transitional relief from the restriction on paying pensions to non-dependants. We assume at this stage that existing arrangements will be disrupted.

Non-dependants and untaxed schemes. For death benefits paid from untaxed schemes to non-dependants, the post-June 1983 untaxed element will be taxed at 30 per cent up to $1 million and the top marginal tax rate above than amount.

DISABILITY BENEFITS

Self-employed tax relief. The government will extend eligibility for a post-June 1994 invalidity component to self-employed persons from 1 July 2007.

Temporary income benefits taxed. The government has confirmed that temporary invalidity income payments from superannuation funds will continue to be treated as assessable income of the member regardless of age.

UNTAXED SUPER SCHEMES

Increased thresholds for lump sum payments from an untaxed source:

- The thresholds that will apply to the tax treatment of lump sum benefit payments made from an untaxed source are to be increased.
- For individuals aged 60 or more, a tax rate of 15 per cent will apply to the total of all payments from an untaxed source up to $1 million (an increase on the original proposed threshold of $700,000) and the top marginal tax rate will apply on amounts above $1 million. The upper threshold amount is to apply on a lifetime basis to each member of the fund. As with various other thresholds described above, the upper threshold amount of $1 million applying to those aged 60 or more will be indexed to AWOTE and increase in amounts of $5,000.
- For individuals aged 55–59, amounts up to a low-rate threshold of $140,000 will be taxed at 15 per cent. Amounts over $140,000 but less than an upper threshold of $1 million will be taxed at 30 per cent. Amounts in excess of $1 million (presumably also indexed and on a lifetime basis, although that is not stated) will be taxed at the top marginal rate. Presumably all amounts will be subject to the Medicare Levy.
- No change for payment of pensions paid from untaxed funds: The government confirmed that from age 60 the pension payments are to be taxed at marginal rates with a 10 per cent tax offset. Pensions paid to those under age 60 are to be taxed at marginal rates with no tax offset.

TFNs

Taxable contributions will be subject to the top marginal tax rate where a TFN is not quoted, however a $1,000 threshold will be available for accounts opened prior to 1 July 2007.
Late quoting of TFN. Where a TFN has not been quoted, funds will not be required to apply the higher tax on contributions until 30 June each year. This will allow clients until 30 June 2008 to quote their TFN. The additional tax can be refunded if the TFN is subsequently provided within the period that a fund can amend its own assessment (generally four years).

Employer empowered to use TFNs for super purposes. Legislation will be amended so that where an employee quotes a TFN for employment purposes it is automatically taken to be quoted for superannuation purposes.

Components taxed. If a TFN is not quoted and a benefit is paid out under the new arrangements, only the post-June 1983 component (the taxable element) will be subject to withholding at the top marginal tax rate. The pre-July 1983 component will be classed as an exempt component which is tax-free.

PORTABILITY CHANGES

30 day limit change. The original proposal to reduce the maximum time limit in which a superannuation fund must transfer a benefit after a request is received from 90 days to 30 days remains. However, the 30 day time limit will commence after the person has provided all the necessary information and not from the date of the initial request, as was originally proposed.

Standard form to be used. To make it easier for members to provide the necessary information, all funds will be required to accept a standard form for portability requests. The government will consult on the development of the form.

LOST MEMBERS REGISTER

As originally proposed, the government considers that there is scope to further improve the operation and effectiveness of the current lost member arrangements and that the ATO should be given a more active role in facilitating the consolidation of lost accounts. The government now proposes the introduction of a phased approach to reduce the number of people who are on the lost members register, which will include:

- rationalising existing processes to identify actual lost members including redefining lost members to exclude inactive accounts and more comprehensive reporting from funds;
- allowing accounts of less than $200 to be paid tax free;
- an extensive letter campaign to lost members in 2007-08 and 2008-09 with lost account reviews to be conducted over a four year period through a combination of outbound phone calls and letters;
- establishing a web-based tool through which members can locate their lost accounts using their TFN and generate a pre-populated portability form; and
- enabling members by 2009-2010 to electronically request consolidation of their accounts through the ATO website.

As stated, this is an overview of some of the key points from this latest announcement. And while the announcement provides further clarity to the operation of some of the proposals, we await the legislation itself (which the government has advised would be produced by the end of the year) to gain a full understanding of the impact of all of these measures.