APRIL 2007

# SPECIAL NEWSLETTER

## SIMPLER SUPER UPDATE

The Federal Government's superannuation and retirement income stream reforms were recently passed through Parliament. The reforms have changed the superannuation landscape dramatically and are generally favourable to most people. In this newsletter, we have outlined the main changes and the potential impact they may have, grouping them into three main categories:

1. Contributions to Superannuation,
2. Withdrawals from Superannuation and
3. Centrelink Changes.

## 1. Contributions to Superannuation

**Non-concessional (formerly undeducted contributions) capped**

- Non-concessional contributions are contributions to a superannuation fund where no tax deduction is claimed. From 10 May 2006 the government has placed a cap on the amount of non-concessional contributions that an individual can make to a superannuation fund. Transitional measures limit non-concessional contributions to a maximum amount of $1,000,000 for the period 10 May 2006 to 30 June 2007.
- After 1 July 2007, non-concessional contributions will be limited to a maximum amount $150,000 per year per person.
- For those under the age of 65, the limit can also be brought forward by contributing up to $450,000 in a given year and not making any further non-concessional contributions in the following two years.
- Owners of small businesses are allowed to contribute additional amounts in excess of the limits stated above in certain circumstances surrounding the sale of their business or assets used within their business.

**Concessional contributions (employer contributions and personal contributions for which a tax deduction will be claimed) will also be capped.**

- Under existing superannuation rules, the tax deductibility of superannuation contributions made by employers and self-employed persons has been governed by aged based limits. These limits will be removed effective 1 July 2007.
- From 1 July 2007, there will be a limit of $50,000 on concessional contributions made to superannuation. This limit applies on a per person per year basis and will be indexed in lots of $5,000 in future years. A five year transitional measure applies for people who are 50 years or over which will limit concessional contributions to $100,000 per year until the 2011/12 financial year. This amount will not be indexed during the five year period.
- The superannuation reforms have also removed an anomaly for self-employed persons. Current rules enable a self-employed person to claim the first $5,000 plus 75% of the amount in excess of $5,000 contributed to superannuation (up to their age based limit) as a tax deduction. This results in the contribution required to claim the maximum deduction

being slightly higher than the tax deduction obtained. From 1 July 2007, a self-employed person will be entitled to claim the full amount of their contributions to superannuation (up to the limits mentioned above).

- The table below outlines the new limits to tax deductible (concessional) contributions that will apply from 1 July 2007.

| Age | Age Based Limit 2006/2007 | Contribution limits after 1/7/07 |
|---|---|---|
| < 35 | $15,260 | $50,000 |
| 35 – 49 | $42,385 | $50,000 |
| 50 and over | $105,113 | $100,000* |

* $100,000 limit will apply until the 2011/12 year. From 1/7/2012 all age groups will be limited to $50,000 per year for concessional contributions.

- Penalties have been introduced to discourage people from breaching the new contribution limits. Generally, the penalties will result in the top marginal tax rate of 46.5% applying to contributions in excess of the limits.

## Co-Contribution scheme

The government has extended the co-contribution scheme to include self employed persons from 1 July 2007.

## How do the contribution rules affect you?

| Age | Rules that apply between 10 May 2006 and 30 June 2007 | Rules that apply after 1 July 2007 |
|---|---|---|
| 18-49 | • Age based limits govern the maximum amount that can be contributed and claimed as a tax deduction. Age based limit applied per employer.<br>• A limit of $1 million on personal contributions made to superannuation whereby no tax deduction is claimed. | • Employer and personal contributions for which a tax deduction is claimed limited to $50,000 per year per person in total.<br>• Non-concessional contributions (undeducted contributions) limited to $150,000 per year or $450,000 per three year period. |
| 50-64 | • Age based limits govern the maximum amount that can be contributed and claimed as a tax deduction. Age based limit applied per employer.<br>• A limit of $1 million on personal contributions made to superannuation whereby no tax deduction is claimed. | • Employer and personal contribution for which a tax deduction is claimed limited to $100,000 per year per person in total until year ending 30 June 2012. Will then revert to limit of $50,000 per year per person in total.<br>• Non-concessional contributions (undeducted contributions) limited to $150,000 per year or $450,000 per three year period |
| 65-69 | • Age based limits govern the maximum amount that can be contributed and claimed as a tax deduction. Age based limit applied per employer.<br>• A limit of $1 million on personal contributions made to superannuation whereby no tax deduction is claimed.<br>• Individual must satisfy a work test to enable contribution to be made (40 hours in 30 days) | • Employer and personal contribution for which a tax deduction is claimed limited to $100,000 per year per person in total until year ending 30 June 2012. Will then revert to limit of $50,000 per year per person in total.<br>• Non-concessional contributions (undeducted contributions) limited to $150,000 per year.<br>• Individual must satisfy a work test to enable contribution to be made. |
| 70-74 | • Employer contributions can only be made in limited circumstances.<br>• No ability to claim a tax deduction for personal contributions.<br>• A limit of $1 million on personal contributions.<br>• Individual must satisfy a work test to enable contribution to be made (40 hours in 30 days). | • Employer and personal contribution for which a tax deduction is claimed limited to $100,000 per year per person in total until year ending 30 June 2012. Will then revert to limit of $50,000 per year per person in total.<br>• Non-concessional contributions (undeducted contributions) limited to $150,000 per year.<br>• Individual must satisfy a work test to enable contribution to be made. |
| 75+ | • Unable to contribute to superannuation | • Unable to contribute to superannuation |

# 2. Withdrawals from Superannuation

### Compulsory cashing of benefits removed

From 1 July 2007 the rules which required members of superannuation funds to commence withdrawing their superannuation as a lump sum or an income stream at age 65 (or 75 if gainfully employed), have been abolished. Superannuants can now leave their superannuation in accumulation phase indefinitely.

### New Account Based Pension

- These will be very similar to existing allocated pensions whereby the minimum annual pension will be based on the account balance of the pension. The major difference will be the removal of a maximum withdrawal limit. The factors for drawdown of a members pension account are as follows and generally result in a slower draw down of superannuation capital than the previous allocated pension factors.

| Age | % of Account Balance |
|---|---|
| Under 65 | 4% |
| 65-74 | 5% |
| 75-79 | 6% |
| 80-84 | 7% |
| 85-89 | 9% |
| 90-94 | 11% |
| 95+ | 14% |

- From 1 July 2007, an account based pension is the only type of income stream that a self managed superannuation fund will be able to establish.

### Abolition of Reasonable Benefit Limits (RBL)

One of the significant changes in the superannuation reforms was the abolition of RBLs which placed a limit on the amount of superannuation a person could withdraw over their lifetime in a concessionally taxed manner. This reform provides significant tax savings for those people with large superannuation balances. It also helps to explain why there is now a cap on contributions to superannuation fund.

### Abolition of tax on withdrawals for people aged 60 and over

- Possibly the most publicised of all the superannuation reforms is the abolition of tax on withdrawals from superannuation for those people age 60 and over. Excluding un-taxed public sector superannuation funds, where a person aged 60 or over withdraws some of their superannuation, either in the form of an income stream or in the form of a lump sum, that payment will not be taxable.

- The implications of this reform are significant. Currently, superannuation funds pay no tax on earnings within the fund where 100% of the fund's assets are used to meet pension liabilities. Given that no changes have been made to the taxation of superannuation funds, a 60 year old person in receipt of an income stream from their superannuation fund will essentially pay no income tax.

- For those people under 60, benefits will be taxed in a similar way as they are currently taxed, whereby tax is dependent on the components of a members superannuation fund (discussed on following page).

## Simplification of components within superannuation accounts

- From a taxation perspective, the contributions to an account within a superannuation fund are classified primarily in accordance with their original source and whether or not a tax deduction has been claimed for the contribution. Typical components of a members existing superannuation account may include some or all of the following:
    - Undeducted Component
    - Concessional Component
    - CGT Exempt Component
    - Post 94 Invalidity Component
    - Pre 1 July 1983 Component
    - Post 30 June 1983 Component

- As at 1 July 2007, the components within a members superannuation account will be "crystallized" into the following two components:
    1. a Concessional "Taxable" Component and,
    2. a Non-Concessional "Tax Free" Component.

- In addition, the components will now be defined as a % of a members account, as opposed to the current $ value placed on each component under existing rules. This % allocation will not change unless additional contributions are made to the account.

- The importance of the different components is in their tax treatment, which is dependent on whether the accumulated benefits are taken as a lump sum or as an income stream. The table below summarises and compares the tax treatment of the above components when taken as either an income stream or as a lump sum from 1 July 2007.

| | **Lump Sums** | | **Pensions** | |
|---|---|---|---|---|
| **Age** | **Non-Concessional "Tax Free" component** | **Concessional "Taxable" Component** | **Non-Concessional "Tax Free" component** | **Concessional "Taxable" Component** |
| Under preservation age (currently 55 increasing to age 60) | Nil Tax. | 21.5% | Nil Tax. Reduces assessable amount of pension. | Taxed as normal income at marginal rates with no 15% tax rebate |
| Under 60 and greater than preservation age | Nil Tax. | First $140,000 – nil tax<br><br>Over $140,000 – 16.5% tax | Nil Tax. | Taxed as normal income at marginal rates, but attracts a 15% tax rebate |
| Over age 60 | Nil Tax | Nil Tax | Nil Tax | Nil Tax |

- One effect of crystallizing a members components from 1 July 2007 is that members will no longer have the ability to withdraw the components separately. As such, for those under 60 and those in receipt of a superannuation death benefit (discussed below), any withdrawal from superannuation will consist of a proportion of the members tax free component and a portion of the taxable component.

- The amalgamation of the various components as at 1 July 2007 presents some one-off planning opportunities for clients with Pre 1 July 1983 service periods. Specifically, the following should be considered as a means to maximising the tax free element within a superannuation fund post 1 July 2007:

  - Amalgamating multiple superannuation fund balances to ensure the earliest Eligible Service Period date is recorded against all their superannuation account balances.
  - Contributing undeducted contributions prior to 30 June 2007 to maximise the Pre July 1983 component within their superannuation fund.
  - Lump sum withdrawals and re-contribution strategies prior to 30 June 2007.
  - Account segregation / separation to optimise "crystalised" benefits at 1 July 2007.

## Taxation on death benefits paid from superannuation accounts

- Death and taxes – the two certainties of life. The superannuation reforms have not dramatically changed the taxation treatment of superannuation payments on the death of a superannuation member. Taxation of the "taxable" component of death benefits will be dependent on the recipient of the death benefit and whether it is being paid in the form of an income stream or lump sum as illustrated below:

| Type of Death Benefit | Recipient | Tax on taxable component |
|---|---|---|
| Lump Sum (Death Benefit ETP) | Tax dependent | Exempt |
| | Non-tax dependent | 16.5% |
| Death Benefit Pension – reversionary pension paid to a tax dependant (RB) of primary beneficiary (PB) | If PB < 60 at date of death and RB < 60 | Marginal Tax Rate on pension income less 15% rebate |
| | If PB < 60 at date of death and RB 60+ | Income is Exempt |
| | If PB 60+ at date of death and RB < 60 | Income is Exempt |
| Death benefit pension | Non-Tax Dependent | Cannot be paid to non-tax dependent. |

- Although the taxation of death benefits has not changed dramatically, there have been significant changes in the way in which benefits can be paid. Specifically, it is only dependents for *tax purposes* of a deceased person which can receive death benefits as an income stream, ie surviving spouse, children under age 18, financial dependents. This would therefore preclude an adult child from being nominated as a reversionary pensioner.

- Significantly, from 1 July 2007, there will be no ability to stream components of a superannuation balance to specific beneficiaries of the deceased, eg direct "undeducted contributions" to a non-tax dependent and the Post 1 July 1983 component to a tax dependent, thereby minimising the ability to distribute death benefits in a tax effective manner.

# 3. Centrelink Changes

### Assets Test treatment of Complying Income Streams

- Currently, income streams that meet the definition of complying, eg. payable for at least the recipients life expectancy and no entitlement to access the capital, receive a 50% exemption from the Assets Test when determining an individual's entitlement to an Age Pension.

- From 20 September 2007, complying income streams purchased after 20 September 2007 will no longer receive an exemption from the Assets Test and will be 100% assessable under the Assets Test.

- An opportunity therefore exists before 20 September 2007 to purchase a complying income stream to permanently reduce assessable assets under the Assets Test. However, the reduced accessibility of these income streams needs to be weighed up against the benefits that will arise from an increase in the upper limit for the Assets Test as outlined below.

### Changes to Assets Test maximum limit

- From 20 September 2007, the upper limit for qualifying for an Age Pension under the Assets Test will increase. The table below shows the new cut-off limits for eligibility to the Age Pension under the Assets Test that will apply from 20 September 2007.

| | **Cut-off limits for eligibility to Age Pension under Assets Test** | | | |
|---|---|---|---|---|
| **Period** | **Couple, Homeowners** | **Couple Non-Homeowners** | **Single, Homeowner** | **Single, Non-Homeowner** |
| **Before 20/9/2007** | $523,500 | $640,500 | $338,500 | $455,500 |
| **After 20/9/2007** | $818,000 | $935,000 | $515,500 | $632,500 |

- The above changes to the Assets Test are likely to result in:
    - Existing Assets Test assessed recipients of the Age Pension automatically receiving an increase in their Age Pension payment from 20 September 2007.
    - An increase in the number of retirees who are eligible for the Age Pension under the Assets Test. Individuals who fall into this category will need to apply for the Age Pension post 20 September 2007 to receive their entitlement.