

SUPERANNUATION UPDATE

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In this Update ...

The recent extensive proposed changes to the superannuation system are still being digested (and this will probably continue for some time to come). In this Update, we discuss some specific items included in the proposed superannuation changes, along with other principal recent developments.

If you require assistance in relation to any matter set out in this Update, or require assistance or advice in relation to any other tax or superannuation matter, please contact either Arthur Athanasiou or James Shattock – contact details appear below.



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Budget 2006 – Superannuation proposals revisited

The proposed changes to the superannuation system as outlined in the recent budget announcement were summarised and discussed in our May 2006 Superannuation Update.

Since then there has been much discussion of these proposed changes, and while they have generally been well received, there is still some uncertainty and confusion as to what the actual effect of these changes will be.

In this Update, we discuss three specific items included in the proposed changes that we believe particularly require clarification.

1. Benefits of members aged 65 or over between 10 May 2006 and 30 June 2007 do not have to be cashed

As noted in the May update, one of the proposed changes is to remove the requirement that member's superannuation benefits must be cashed on attaining age 65 or 75 unless specified employment tests are satisfied. In other words, it is proposed that from 1 July 2007, there would be no requirement to access superannuation on attaining a certain age.

Transitional relief has now been granted so that members who turn 65 or older between 10 May 2006 and 30 June 2007 are not required to cash their benefits, irrespective of whether they satisfy the existing employment tests.

Superannuation Industry (Supervision) modification declaration No. 3 of 2006 (registered on 30 June 2006) adds new regulations to the relevant legislation which remove the compulsory cashing requirement during this period for members aged 65 or older who do not meet the work test.

Importantly, this modification declaration does not remove the obligation to compulsorily cash benefits after the death of a member.

2. Transitional superannuation contribution measures announced

As we stated in our last update, another of the proposed changes was for there to be a cap of \$150,000 a year to apply on the amount of post-tax superannuation contributions a person can make. The Government was to consider whether the cap should be averaged over three years to allow people to accommodate larger one-off payments.

It has now been confirmed that the above cap is to be averaged over three years. In a press release issued on 13 June 2006, the Treasurer Peter Costello announced transitional provisions

to apply to the proposed \$150,000 annual cap on post-tax (i.e., undeducted) superannuation contributions. The Government has decided that it will allow the cap to be averaged over three years to allow people to accommodate larger one-off payments. Undeducted contributions made between 1 July 2005 and Budget night 9 May 2006 would not count towards the cap. This means that the 2005/2006 cap of \$150,000 will only apply for contributions made between 10 May 2006 and 30 June 2006.

The changes mean people will be able to contribute up to \$450,000 of undeducted contributions in a year, but will then be unable to make further undeducted contributions for another two years.

The Treasurer confirmed that the cap would exclude the CGT exempt component from the sale of a small business. This will allow a small business owner to contribute up to \$500,000 of capital gains into a superannuation fund in addition to contributions allowed under the cap.

3. Existing long-term pensions cannot be cashed before 1 July 2007

In Treasury press release No. 5 of 2006 issued on 26 May 2006, the Treasury noted that the Australian Financial Review of the same date refers to comments reportedly made by Treasury to the superannuation industry that retirees would be allowed to cash in long-term pensions and annuities.

Treasury states that this is incorrect. Treasury has not indicated that existing non-commutable pensions can be cancelled as part of the Government's plan to simplify and streamline superannuation. The Government has said that it will consult on aspects of the proposed superannuation reforms until 9 August 2006, after which it will make final decisions on the reforms.

It is proposed that pensions commenced before 1 July 2007 that meet existing rules would be deemed to meet the new minimum standards that are to apply to pensions as from 1 July 2007.

The new minimum standards for pensions commencing on or after 1 July 2007 would require payments of a minimum amount to be made at least annually, allowing pensioners to take out as much as they wish above the minimum (including cashing out the whole amount). Also, if the recipient of the pension is aged 60 or over after 1 July 2007, then he/she could receive the pension tax free.

New thresholds and limits for superannuation amounts in 2006-2007

The new thresholds and limits for superannuation amounts for the year ending 30 June 2007 are set out in Taxation Determination TD 2006/42, which was issued on 31 May 2006.

In accordance with the *Income Tax Assessment Act 1936* (ITAA 1936), there are a number of thresholds and limits that require indexation each year by movements in full-time adult average weekly ordinary time earnings (AWOTE).

The AWOTE amount is an estimate by the Australian Statistician of the full-time adult average weekly ordinary time earnings for persons in Australia. The estimate for February 2006 was \$1037.50 and the estimate for February 2005 was \$992.90. This produces an indexation factor of 1.045.

This factor is applied against the 2005-2006 thresholds and limits. The new thresholds and limits that apply from 1 July 2006 are set out in the following paragraphs.

For the purposes of subsection 27A(20) of the ITAA 1936, the **tax free amounts** of a bona fide redundancy payment or of an approved early retirement scheme payment are:

- **\$6,783** (formerly \$6,491); and
- **\$3,392** (formerly \$3,246).

For the purposes of subsections 82AAC(2B) and 82AAT(2B) of the ITAA 1936, the **age based deduction limits** for superannuation contributions by employers and eligible persons are:

- **\$15,260** (formerly \$14,603);
- **\$42,385** (formerly \$40,560); and
- **\$105,113** (formerly \$100,587).

For the purposes of subsection 140ZD(3) of the ITAA 1936, the **RBL limits** are:

- Lump sum RBL **\$678,149** (formerly \$648,946); and
- Pension RBL **\$1,356,291** (formerly \$1,297,886).

The **upper limit for determining the residual amount** for the purposes of section 159SG of the ITAA 1936, that is the [tax free provided the recipient is over 55] threshold on the post-June 1983 component of an eligible termination payment is:

- **\$135,590** (formerly \$129,751).

This Determination applies to the 2006-2007 income year.

We note that the age based deduction limits and the RBL limits (referred to above) are to be abolished as from 1 July 2007 pursuant to the proposed changes to superannuation. Also, from 1 July 2007, the tax free threshold (referred to above) would only be applicable if the member was aged below 60, since it is proposed that after 1 July 2007—if you are aged over 60—the entire benefit may be received tax free.

Superannuation Guarantee: payments of salary or wages to former employees

In **ATO ID 2006/153**, the issue was whether an employer would have an individual superannuation guarantee shortfall under subsection 19(1) of the *Superannuation Guarantee (Administration) Act 1992* ("SGAA") in respect of a payment of salary or wages to a former employee if the employer does not make sufficient superannuation contributions in respect of the payment by the cut off date for the quarter.

In this case, the taxpayer ceased employment with the entity (the former employer) on 30 June 2005. The entity paid the taxpayer a bonus payment in September 2005. The bonus is performance based and relates to the taxpayer's employment with the entity in the 2004-2005 income year.

For periods up until 1 January 2006, there were conflicting views as to whether the formula in subsection 19(1) of the SGAA applied to capture payments of salary or wages by an employer to a former employee.

It was argued by some that subsection 19(1) had no operation in relation to former employees as the provision required the existence of a current employment relationship at the time of the payment. The Tax Office view is that, having regard to the context, scope and purpose of subsection 19(1), the better view of the law is that the provision did apply to payments of salary or wages by an employer to a former employee.

Provided it is established that the payment arises from and has a clear link to an employer/employee relationship and has the character of salary or wages (as defined in the SGAA), subsection 19(1) will apply notwithstanding the fact that a current employment relationship does not exist at the time of the payment.

In the circumstances of this case, the taxpayer ceased work as an employee with the entity on 30 June 2005. The taxpayer received a performance based bonus payment from the entity in September

Superannuation Guarantee *cont*

2005 which related to the taxpayer's employment with the entity in the 2004/2005 income year. A bonus that relates to employment constitutes salary or wages for the purposes of the SGAA. Because the bonus arises from and is clearly linked to the former employee's employment, the entity was therefore required to make sufficient superannuation contributions in respect of the payment to avoid having an individual superannuation guarantee shortfall under subsection 19(1) of the SGAA.

For payments of salary or wages by an employer to a former employee on or after 1 January 2006, section

15B of the SGAA operates to put beyond doubt that the employer will have an individual superannuation guarantee shortfall in respect of the former employee under subsection 19(1) of the SGAA if they do not make sufficient contributions in respect of the payment by the cut off date for the quarter.

Ensuring appropriate use of pre-1 July 1988 funding credits

In Treasury press release number 36 of 2006, it was announced that the Australian Government will protect the integrity of the taxation system by ensuring that pre-1 July 1988 Funding Credits ('funding credits') can be used only in accordance with the original policy intent. The measure is expected to only affect some public sector superannuation schemes.

The Government has become aware of arrangements under which some public sector superannuation schemes are inappropriately applying funding credits to reduce tax on contributions made to fund benefits that accrued after 1 July 1988. This measure will remove this anomaly and ensure consistent treatment between funded and unfunded schemes.

Pre-1 July 1988 funding credits will be able to be used by superannuation schemes to reduce their taxation liability on contributions made after 1 July 1988, only if those contributions were made to fund benefits that accrued before 1 July 1988. The measure will take effect from 9 May 2006.

Since 1 July 1988 most contributions to superannuation schemes have been subject to a 15 per cent tax. Unfunded superannuation schemes have access to pre-1 July 1988 funding credits so that contributions made after 1 July 1988 in order to fund benefits that accrued prior to 1 July 1988 are not taxed. This ensures equity with funded superannuation schemes which pay tax on contributions from 1 July 1988.

Any new or outstanding objections or requests for amendment to past assessments will only be able to amend funding credit use for that year/s up to the amount that can be claimed under the new law. This is designed to ensure that the new law cannot be avoided by superannuation schemes adjusting previous years' returns.