

SUPERANNUATION UPDATE

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In this month's Update ...

Well, we didn't see that coming! The extensive proposed changes to the superannuation system outlined in the recent budget announcement are quite a surprise. We have now carefully examined and considered these proposed changes, and they are outlined and discussed in this update, 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 – their contact details appear below.



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Budget 2006 – Superannuation proposals

The proposed changes to the superannuation system as outlined in the budget announcement on 9 May 2006 are far-reaching and should be considered carefully. It appears most likely that the proposed changes will take effect with little or no modifications, and for the most part they are intended to take effect from 1 July 2007.

We have already carefully considered the proposed changes to the superannuation system and examined the detailed outline released by Treasury. We can now say that the proposed changes are not as simple and clear-cut as they might at first sight appear to be.

It is beyond the scope of this paper to outline the proposed changes, and their likely effect, in detail. (The outline released by Treasury referred to above is about 80 pages long!) However, the principal proposed changes can be outlined as follows:

- no tax on superannuation benefits (both lump sums and pensions) when they are paid for members aged over 60;
- benefits paid before age 60 would be taxed under rules similar to current arrangements (but simplified by reducing the number of components in a benefit);
- reasonable benefit limits (“RBLs”) to be abolished;
- all lump sum death benefit payments would be tax free if paid to a dependant (currently they are only tax free up to the deceased’s pension RBL if paid to a dependant);
- if death benefit is paid as a reversionary pension, the taxation of that death benefit would depend on the age of the primary and reversionary beneficiary;
- there would be no requirement to access superannuation on attaining a certain age (currently, members may be required to access their superannuation benefits on attaining age 65 or 75, depending on specified employment tests);
- the rules defining a pension to be changed and simplified, although pensions would continue to receive favourable tax treatment;
- concessional deductible contributions to superannuation would be limited to \$50,000 per person per annum, with a transitional period to apply for people aged 50 and over (currently deductibility depends on specified age based limits);
- both employers and the self-employed would be able to claim a full deduction for superannuation contributions until the member reaches age 75 (rather than 70, as at present);
- the personal deduction eligibility rule would be simplified by making it consistent with the rule that currently applies for the Government co-contribution;
- a cap of \$150,000 a year to apply on the amount of post-tax superannuation contributions (ie, undeducted contributions) a person can make. The Government is to consider whether the cap should be averaged over three years to allow people to accommodate larger one-off payments;
- the Government co-contribution scheme to be extended to eligible self-employed persons;
- the pension assets test taper rate would be halved from 20 September 2007 so that pension recipients only lose \$1.50 per fortnight (rather than \$3, as at present) for every \$1,000 of assets above the relevant threshold;
- the assets test exemption would be removed for future income streams purchased on or after 20 September 2007;
- some changes are also proposed to limit concessions on large employer (as opposed to superannuation) eligible termination payments (“ETPs”), reflecting the removal of the RBL system and superannuation benefits tax;
- it is proposed that employer ETPs would no longer be able to be rolled over into superannuation;
- changes are also proposed to benefits paid from untaxed funds (mainly affecting public servants), to reduce the tax payable on those benefits;
- finally, changes are proposed that would make it easier for people to find lost superannuation and transfer benefits to a fund of their choice.

The above is only a basic summary of the proposed changes, and it is not yet certain that these changes will take effect, or whether they are to be modified in any way.

In theory, the Government’s proposed plan is intended to:

- (a) simplify superannuation arrangements for retirees, making it easier to understand;
- (b) improve incentives to work and save; and
- (c) introduce greater flexibility in how superannuation savings can be drawn down in retirement.

It is true that the proposed changes would result in some simplification of the superannuation system. However, care is still required in deciding both when and how to access benefits, and also in making contributions to a fund. In particular, careful

Budget 2006 – Superannuation proposals *cont*

consideration would be required if accessing benefits when aged below 60 where that is possible (including as a non-commutable pension), and in receiving employer ETPs and arranging for payment of death benefits from a fund.

Also, as the proposed changes are (with a few exceptions) to take effect from 1 July 2007, careful consideration should be given as to whether it is worthwhile delaying action in relation to existing benefits (that is, accessing benefits where possible, or making contributions to a fund) until then. It may be appropriate to seek expert legal advice on this aspect.

Nevertheless, there is little doubt that the proposed changes (in particular, the proposed removal of tax on benefits for members over 60 and the proposed

abolition of RBLs) make superannuation in general a more attractive and worthwhile proposition. In particular, people who do not already have their own self managed superannuation fund (“SMSF”) should now consider having their own established.

Our standard SMSF deed is reviewed on a regular basis, and is also reviewed immediately following any legislative change or other development and revised as necessary. Our SMSF deed is broadly drafted so any amendments would properly allow for the situation (in relation to making contributions, taking benefits, etc) both before and after the date the proposed changes are to come into effect (being for the most part 1 July 2007).

Self managed superannuation funds and barter credits

The Tax Office has issued a fact sheet warning employers and trustees of SMSFs that the use of barter credits may contravene several key provisions of the *SIS Act* and superannuation guarantee requirements.

The Tax Office notes that “barter credits” (also known as “trade dollars”) are sometimes used instead of money for certain transactions, usually between members of barter exchanges.

The Tax Office states that if trustees of SMSFs acquire barter credits from a related party, they will contravene section 66 of the *SIS Act*, which prohibits (subject to specific exceptions) trustees of superannuation funds from acquiring assets from related parties.

The Commissioner also states that the acquisition of barter credits by an SMSF may raise questions as to whether such an acquisition is in accordance with the sole purpose test, which requires the fund to be operated for the sole purpose of providing retirement benefits. According to the Tax Office, it may be difficult for trustees to demonstrate that it would be in the best interests of members to pay a benefit comprising barter credits.

The Tax Office also warns employers that contributing barter credits on behalf of an employee will not satisfy the employer’s superannuation guarantee obligations. Under these circumstances, the Commissioner also states that the trustees of the SMSF will be required to dispose of the barter credits and the employer will consequently be liable for the superannuation guarantee charge (“SGC”) for not paying the superannuation guarantee on time. The SGC involves the employer paying more than they would have had they paid the superannuation guarantee on time and it is also not tax deductible.

Although the *SIS Act* does not expressly prevent an SMSF from investing in barter credits, any such investment must only be made according to a written investment strategy. According to the Tax Office, if a trustee acquires barter dollars as part of their investment strategy, they may not be in a position to meet the investment strategy requirements under section 52 of the *SIS Act* in terms of risk, return, diversity, liquidity and the ability to discharge liabilities such as benefit payments.

Salary sacrifice arrangements for entertainers and contracts for labour

Draft Superannuation Guarantee Determination SGD 2006/D1, released on 29 March 2006, specifies that an individual deemed to be an “employee” for superannuation guarantee purposes can enter into an effective salary sacrifice arrangement with an “employer”.

Certain non-common law employees are deemed to be employees for superannuation guarantee

purposes under subsection 12(3) (regarding contracts wholly or principally for labour) or subsection 12(8) (regarding entertainers, artists, sportspersons etc) of the *Superannuation Guarantee (Administration) Act 1992* (“SGAA”). Also, section 11 of the SGAA deems payments made under a relevant contract or for relevant work to a person covered by subsections 12(3) or 12(8) to be “salary or wages” of the person for SGAA purposes.

Salary sacrifice arrangements for entertainers and contracts for labour *cont*

The Tax Office considers that contributions to a complying superannuation fund or RSA made under an effective salary sacrifice arrangement in lieu of "salary" for the individual are employer contributions (as opposed to employee contributions) and not considered to be income in the hands of the deemed employee.

Furthermore, the Commissioner states that an employer is entitled to a deduction (subject to the usual conditions such as the employee's age-based limit) under sections 82AAC to 82AAF of the *Income Tax Assessment Act 1936* in respect of such superannuation contributions under an effective salary sacrifice arrangement for a deemed SGAA employee.

According to the Tax Office, although Ruling TR 2001/10 (in relation to effective salary sacrifice

arrangements) does not extend to deemed SGAA employees, the purpose of the SGAA would be frustrated if superannuation contributions made by an employer were regarded as income of the SGAA employee.

The Tax Office states that the reasoning in draft Superannuation Guarantee Determination SGD 2006/D1 does not apply to "contractors" who are not SGAA employees under section 12 of the SGAA and outside the superannuation guarantee regime. Also, the Commissioner states that this draft determination does not apply in respect of non-salary benefits (other than employer superannuation contributions) under an effective salary sacrifice arrangement for an SGAA employee.

Defined benefit funds with less than 50 members – APRA exemptions

APRA has released a new frequently asked question (FAQ 14.1) outlining the circumstances in which it will consider an application for an exemption from the requirement for defined benefit superannuation funds to have at least 50 members under regulation 9.04D of the SIS Regs.

APRA also indicates the circumstances in which it will consider granting an exemption in respect of the prohibition on funds with less than 50 members from providing new defined benefit pensions. This prohibition was subject to the transitional arrangements under regulation 9.04I of the SIS Regs which enabled people who were members of a fund with less than 50 members on 11 May 2004 to commence a defined benefit pension before 1 January 2006.

In FAQ 14.1, APRA states that it will consider, on a case by case basis, requests for exemption under section 328 of the SIS Act in the following types of situation in relation to the defined benefit requirements that apply to superannuation funds with less than 50 members:

- (a) **Exemptions concerning the size of defined benefit funds (SIS Regulation 9.04D)** – for the following circumstances:
- transfers of defined benefit members from funds that are being wound up to a sub-fund of a master fund;
 - transfer of defined benefit members from funds that are being wound up, as part of the restructuring of a business; or
 - where a fund's defined benefit membership temporarily falls below 50;

- (b) **Exemptions from the prohibition on providing a defined benefit pension (SIS Regulation 9.04I)** – for the following circumstances:

- where a pension entitlement reverts from a beneficiary of the exempted fund and that beneficiary had a vested or contingent entitlement to the defined benefit pension on 11 May 2004;
- where the defined benefit pension is provided to a person who was transferred from a fund that was being wound up to a sub-fund of a master fund;
- where the defined benefit pension is provided to a person who was transferred from a fund that was being wound up to another fund, as part of the restructuring of a business.

APRA states that any exemption granted will be subject to the consideration of a range of factors including, as applicable:

- the minimum size of the fund;
- the status and timing of the member transferring to a sub-fund;
- accrued benefit valuations;
- the date the pension becomes payable (ie, generally prior to 1 January 2006); and
- the identity of the reversionary pensioner.

Capital gains tax – marriage breakdown rollover

Is rollover relief available under subsection 126-140 (1) of the *Income Tax Assessment Act 1997* (“ITAA 1997”) when the trustee of a SMSF to which both spouses belong, transfers a CGT asset to another SMSF, to which only one spouse belongs, because of a payment split under the *Family Law Act 1975*?

The above question was considered in ATO Interpretative Decision ID 2006/73.

In the case in question, spouses A and B were members of an SMSF (“SMSF 1”). When their marriage broke down, a payment split under subsection 90MT(4) of the *Family Law Act 1975* was made in favour of B over A’s superannuation interest in SMSF 1.

B set up a second SMSF (“SMSF 2”) in which A was not a member. The purpose was to transfer B’s entire interest in SMSF 1 to SMSF 2.

The trustee of SMSF 1 transferred a CGT asset to the trustee of SMSF 2 to give effect to the waiver notice issued by B under section 90MZA of the *Family Law Act 1975*.

In this case, it was decided that CGT rollover relief is available under subsection 126-140(1) of the ITAA 1997 for the proportion of the CGT asset that relates to the interest subject to the payment split, but is not available for the proportion of the CGT asset that relates to the interest not subject to the payment split.

This decision was based on section 126-140(1) of the ITAA 1997, which provides that there is a rollover if:

- (a) an interest in a small superannuation fund [including a SMSF] is subject to a payment split; and
- (b) the non-member spouse in relation to that interest serves a waiver notice under section 90MZA of the *Family Law Act 1975* in respect of that interest; and
- (c) as a result of serving the notice, the trustee of the fund transfers a CGT asset to the trustee of another small superannuation fund for the benefit of the non-member spouse.

Rollover relief is therefore available where (as in this case) the conditions relating to the payment split, the waiver notice and the transfer of the CGT asset are satisfied. Therefore, when the trustee of SMSF 1 transferred a CGT asset to the trustee of SMSF 2:

- the proportion of the asset that relates to spouse A’s interest in SMSF 1, being the interest that was subject to the payment split, will be covered by rollover relief under subsection 126-140(1) of the ITAA 1997; and
- the proportion of the asset that relates to spouse B’s interest in SMSF 1 will not be covered by rollover relief under subsection 126-140(1) of the ITAA 1997 because spouse B’s interest was not subject to the payment split.