SMSF Updates

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the difference is significant

Maureen Allan

August 2014

Ph: 03 9690 5700
Fax: 03 9690 6509
Email: mallen@morrows.com.au
Website: www.morrows.com.au

What we will cover – SMSF Updates

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- **Contributions**
  - Changes to annual contribution limits
  - Division 293 Tax
  - Excess Contributions Tax
- **Penalty Regime**
- **Social Securities and Centrelink changes**
- **Superannuation strategies**
- **Binding Death nominations**

Contributions

- **From 1 July 2014**
  - General Concessional contributions cap increased to $30,000
    - Higher cap of $35,000 for persons aged 49 as at 30 June 2014
  - Non-concessional contributions cap increased to $180,000
    - the 3 year bring forward limit will increase to $540,000
    - IF you have already triggered your 'bring forward' contribution cap by 30 June 2014, the new limit will not apply to you
  - CGT Non-concessional contributions cap increased to $1,355,000
  - Low rate tax cap increased to $185,000
  - Superannuation Guarantee Charge increased to 9.5%
  - Maximum SG contributions base increased to $49,430 per quarter

Contributions

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- Acceptable Contributions

Age of Member	Contribution and conditions
Under 65	All contributions that are made for the respective member

65 - 75	Contributions made for respective members that are:
	• Mandated employer contributions; or
	• Where the member satisfies the work test during the year in which the contributions are made:
	    • Employer contributions
	    • Member contributions

75 and over	Contributions made for the respective members that are mandated employer contributions (From 1 July 2013 mandated employer contributions include Superannuation Guarantee contributions)

Contributions
Low Income Earners

- **Government Co-Contributions**
  - Maximum co-contribution $500
  - the lower threshold will increase to $34,488, from $33,516
  - the higher threshold will increase to $49,488, from $48,516

  - The Low income Superannuation Contribution (LISC) is not payable in respect of concessional contributions made after the 1st July 2013.

Division 293 Tax
High Income Earners

- **Division 293 Tax**
  - From 1 July 2012, most high-income individuals will have to pay an extra 15% tax on their 'taxable contributions' for an income year if their income for surcharge purposes, plus their low-tax contributions (non-excessive concessional contributions), are greater than the $300,000 threshold
  - Income taken into consideration under this measure will include
    - taxable income
    - concessional superannuation contributions
    - adjusted fringe benefits
    - total net investment loss
    - target foreign income
    - tax-free government pensions and benefits
    - less child support

Division 293 Tax
High Income Earners

- **Division 293 tax**
  - If an individual's income excluding their concessional contributions is less than the $300,000 threshold, but the inclusion of their concessional contributions pushes them over the threshold, the reduced tax concession will only apply to the part of the contributions that are in excess of the threshold
  - Example

    A person has income of $285,000 but also has concessional contributions of $20,000 taking their total income to $305,000.

    The super contributions surcharge of 15%, on top of the standard contributions tax of 15%, would only apply to $5,000 of the person's super contributions

Division 293 Tax
High Income Earners

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- The ATO has started sending our Division 293 Tax assessments
- Paying the assessment personally retains a higher balance in the SMSF, maximising earnings in a low tax environment.
- Alternatively the completed release form allows the SMSF to pay the tax.

Excess Non-Concessional Contributions

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- The government announced in the 2014 Budget for any excess contributions made after 1 July 2013, breaching the non-concessional cap, they will allow individuals to withdraw those excess contributions and associated earnings.
- If an individual chooses to withdraw their excess contributions, no excess contributions tax will be payable and any related earnings will be taxed at the individual's marginal tax rate.
- Individuals who leave their excess contributions in the fund will continue to be taxed on these contributions at the top marginal rate.

New tools to deal with SMSF non-compliance

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Contraventions on or after 1 July 1014.

- The ATO has the discretion to impose the following on SMSF trustees who breach the SIS Act:
  - Rectification Direction
  - Education Direction
  - Administration Penalties

Education directions

- ATO may direct a trustee to undertake SMSF education designed to:

  - improve knowledge and understanding of duties and responsibilities.

  - reduce the risk that trustees will contravene super laws in the future.

- Approved courses are

  - on–line course: Self managed superannuation funds Trustee education (Approved Providers).

  - ATO Webinar: SMSF overview.

- After completing the course

  - sign the Trustee declaration

  - provide the ATO copy of course completion

Education directions

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- When might the ATO give an education direction.
  - First time contravention
  - Trustees unaware of rules.

- When wouldn't the ATO give an education direction
- Prior year contraventions
- Previously advised of the rules

Rectification directions

What is rectification?

- Enforceable undertakings – existing
- Rectification direction – from 1 July 2014

When might the ATO give a rectification direction?

Have regard to

– financial detriment

– the nature and seriousness of the contravention, and

– any other relevant circumstances.

Must be complied with by a specified time

Evidence must be produced

Failure to comply

– Is an offence of strict liability ($1,700)

– May result in stronger action being taken

Administrative penalties

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Applies to certain contraventions

Sliding scale of penalties based on seriousness of contravention

$850 to $10,200

Contravention of lending rules, borrowing and in –house assets $10,200 penalty

Who is the penalty imposed on?

Directors are jointly and severally liable to pay $10,200

Individual trustees must each pay $10,200

Must not be paid from resources of the fund

When considering remission the ATO will take into consideration the compliance history, rectification and any relevant circumstances.

ATO'S Compliance Program

Auditor contravention reports (ACRs)

– Based on overall risk

– Risk models

High-risk SMSFs	Audit
Medium-risk SMSFs	Phone
Lower-risk SMSFs	letter

The ATO will also select SMSFs for audits based on:

- SMSF Annual Return
- Monitoring of scheme or complex transaction
- Intelligence referrals from AUSTRAC,ASIC and other Government Agencies.

Dividend Washing

- The ATO has begun issuing notices for funds that have participated in dividend washing.
- By selling and repurchasing the same share within 3 days, the investor received effectively a double dip in franking credits.
- Divided washing was promoted by several brokers as a way of receiving a great return.
- The ATO letter requires participants to review the past 3 years fund returns, and amend where double imputation credits for the same share have been claimed.
- Failure to amend will result in penalties.
- Letters have been sent directly to trustee and bypassed tax agents/accounts.
- I advise contacting any clients that have participated giving them a head up regarding the ATO activities in this area.
- This is a very harsh approach by the ATO the legislation is retrospective.

Social Security

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Increase in the Age pension qualifying age to 70 years.

- The age pension was already set to increase to 67 by 1 July 2023.
- From 1 July 2025, the Age Pension qualifying age will continue to rise by 6 months every 2 years to gradually reach a qualifying age of 70 years by 1 July 2025.
- This increase will affect anyone born after 30 June 1958 (currently age 55).
- The age increases do not affect veterans applying for the DVA service pension. Eligibility age remains at 60 for these clients.
- Referred to the Senate Community Affairs Legislation Committee.
- Report due 4 September 2014.

Mature Age Worker Tax Offset.

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- It is proposed that the government will abolish the Mature Age Worker Tax Offset (MAWTO) from 1 July 2014.
- This offset provided an offset up to $500 for people born before 1 July 1957 who continued to be employed.
- The savings from this offset will be used to fund a subsidy (called Restart) for employers who employ older workers who have been receiving income support for more than six months.
- A subsidy up to $10,000 will be provided to the employer over a two year period to help cover employments costs for each eligible employee.
- Legislation in not available.(25 July 2014)

Centre link payments

- Deeming on account-based pension start date 1 January 2015.
- Account-based income streams are currently "pension friendly" under Centrelink/Veterans affairs income testing. Deductible component no longer applies for new pensions.
- The current rules are proposed to continue indefinitely for people who are in receipt of a Centrelink/DVA pension before 1 January 2015, provided the income stream was also purchased before that date.
- People who apply for a Centrelink/DVA pension from 1 January 2015 or purchases/switch income streams after that date are proposed to be subject to deeming under the income test.
- Where receiving centrelink payments, care must be taken where pension accounts are commuted and combined after 31 December 2014.
- Pension are often commuted and combined where additional contribution have been made to an account.

Commonwealth Senior Health Card

- The Government will seek to include deemed income from superannuation pensions in the assessment of income to determine eligibility for the CSHC from 1 January 2015.
- The assessment of superannuation income will be the same for CSHC holders as for Age pension recipients and will align with the 2013-14 Federal Budget measure (to deem balances for account-based pension, 'ABP') from 1 January 2015.
- All superannuation ABPs held by CSHC holders as of 1 January 2015 will be grandfathered and any income/lump sums from these income streams will not be assessed.
- A related measure swill extend the period for which seniors health cards holders may travel temporarily overseas without losing qualification for the card from 6 weeks to up to 19 weeks.
- Referred to the Senate Community Affairs Legislation Committee (report due 4/9/2014)

Recontribution Strategy

A superannuation withdrawal and re-contribution strategy allows for the member to reduce the taxable component of their superannuation benefits to reduce potential tax payable by their beneficiaries upon death.

This strategy can only be implemented if a member is able to meet a condition of release and is also able to make contributions back into super.

The recontribution strategy involves withdrawing a lump sum (proportionately from taxable and tax free components) and re-contributing these funds back into super as a non-concessional contribution.

If the member is under age 60, then the tax needs to be calculated on any withdrawals.

Recontribution Strategy

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Example

Fred has $500,000 in his super fund, of which $250,000 is tax free and $250,000 is taxable. Fred is eligible to withdraw his superannuation benefits and decides to withdraw $150,000 and then re-contribute this.

Total	Tax Free	Taxable
Initial Super	$250,000	$250,000
Withdrawal	$(75,000)	$(75,000)
Balance in Fund	$175,000	$175,000
Contribution	$150,000	$0.00
Balance at recontribution	$325,000	$175,000

Please note the above is a summary for illustration purposes only, and each pension account needs to be considered as a separate account.

Odds and Ends of pensions

- Where a member is in pension phase and has unrestricted non preserved benefits an in-specie payment (lump sum) can be paid.
- This lump sum counts towards the minimum pension payment.
- Where a member is less than 60 years of age, and has not accessed their life time tax free component, consider paying a lump sum as a pension payment. This payment will then be tax free.
- This strategy is only possible if there is an unrestricted unpreserved component.
- On death the deceased pension accounts remains in pension mode, allowing capital gains to be realised tax free.
- Death benefit must be paid as soon as possible.
- A pensions is not required to be withdrawn from the deceased accounts unless the a reversionary has been appointed.

Anti Detriment

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- Anti-detriment amount refunds 15% contributions tax on benefit accrued between 1988 and the date of death.
- Must be paid as a lump sum to the beneficiaries . Current of former spouse; children including adult children or estate.
- Cannot reduce the deceased or another member's balance to pay anti detriment.
- Cannot borrow to make anti detriment.
- Anti detriment deduction must be made in the year of the payment.
- If no FITB or reserve will be restricted to the amount of tax refund.

Unpaid Distributions

- There is a widely held belief that pre 8/99 unit trust can to anything.
- The Montgomery Wool case clearly established that this is a myth.
- S10(1) of the SIS Act clearly states a loan to include the provision of credit or any other form of financial accommodation.
- Montgomery supported the ATO’s view that S10(1) included unpaid distributions from a unit trust.
- Where the unit trust has borrowed from a related party, interest must be paid to be compliant
- Cash flow may be a problem for some unit trusts to pay distributions.
- Consider increasing their current borrowings or introducing a new unrelated investor.

ANTI DETRIMENT

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Expense Deductions

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A generally accepted method of apportionment for general administrative expenses is described in TR 93/17 paragraph 8(b):

General administrative expenses * (Assessable income / Total Income)

In the above formula, total income means assessable income plus exempt income. Assessable income for apportionment purposes includes all contributions to the fund.

Expense Deductions

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According to ATO ID 2012/47 the fund's assessable income for purposes of applying deduction provisions includes 'all contributions' made to a complying superannuation fund under subsection 295-95(1) of the ITAA 1997 including

- non-assessable member contributions
- government co-contributions
- rollover-in superannuation benefits

Expense Deductions

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Example

Investment Income = $86,500

Employer Contributions = $34,000

Non-concessional Contributions = $35,000

General Expenses = $13,412

Life Insurance Premiums = $9,254

Actuarial Percentage = 98.01%

Exempt Income = $84,778

Expense Deductions

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By using the traditional method of calculating allowable portion of deductions with the actuarial percentage, the total amount of deductions claimable for the fund is:

General expenses: $13,412 x 1.99%	**= $267**
Life insurance: $9,254 x 100%	**= $9,254**
Total deduction	**$9,521**

Expense Deductions

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By using the "General Administrative Expenses" formula presented in ATO TR 93/17 we can apportion the expenses based on total income of the fund, including any non-concessional contributions received

Apportionment Percentage Calculation

- **Assessable income / Total income**
- **(Total income – Exempt income) / Total income**
- **($86,500 + $34,000 + $35,000 - $84,778) / $155,500**
- **$70,722 / $155,500**
- **45.48%**

Expense Deductions

Applying the apportionment percentage to the fund's expenses allows us to claim a higher proportion of expenses than the traditional method

General expenses: $13,412 x 45.48%	**= $6,100**
Life insurance: $9,254 x 100%	**= $9,254**
Total deduction	**$15,354**

Based on the example figures this super fund would miss out on an extra deduction of $5,833 by using the traditional method!

Standard Formula – calculation of top up amount

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ATO ID Method (ATO ID 2007/219 and ATO ID 2010/5)

C x 0.15 x P / (R – 0.15 x P)

- **C =** taxable component (excluding insurance for which deductions claimed)
- **P =** days in service period R after 30 June 1988
- **R =** days in service period after 30 June 1983

Strategies for passing the 10% test.

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- The rule requires that employment income as a proportion of total assessable income and certain other benefits must be less than 10%.
- The 10% rule should be considered where an individual appears to derive a significant proportion of their assessable income from non-employment sources.
- Self employment, investment and other activities of the kind which do no result in the person being treated as an employee.
- In some cases the amount that the they fail the test is negligible.
- Consider the following strategies:
  - reduction of employment assessable income, RFB and RESC - including through salary sacrificing into non-reportable fringe benefits;
  - increase in other (non employment) assessable income – for example by realising capital gains, or increasing investment returns such as dividends.

Trustee succession

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Consider Trustee Succession

- Whoever holds office as trustee will impact on how death benefits are paid
- As such, this is an important aspect of SMSF succession planning
- Need to examine the differences between:

Corporate v Individual Trustees

Trustee succession
Individual trustee

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- The deed will usually outline who succeeds an individual trustee – generically expressed
- If individual trustees, usually (under the trust deed) the <u>survivor</u> trustee will have power to change the trustee
- This is common in a lot of deeds, ok for perhaps Mum and Dad (depends on facts), but for siblings or business partners?
- Alternatively, the legal personal representative ('LPR') of the deceased member will be appointed – a safer approach
- When an individual trustee dies, change of trustee documents may need to be executed to appoint the replacement

Trustee succession
Corporate trustee

- Smoother succession occurs with a corporate trustee (simply change director)
- The company will continue on after the member's death
- This means no change of trustee upon member's death
- Change of director forms must be lodged via ASIC
- ATO will also need to be notified

Individual trustees can be dangerous ?

Example below is adapted from *Katz v Grossman* [2005] NSWSC 934, a leading case on SMSF succession:

- Mr and Mrs Katz were individual trustees and members of an SMSF
- Mrs Katz died and Mr Katz was the sole surviving trustee and member
- He appointed his daughter, Linda Grossman as a trustee in place of his wife
- Mr Katz also signed a 'non-binding' death benefit nomination
- Non-binding nomination not discussed in detail in judgment
- Likely that nomination did not comply with relevant provisions of SISA (s 59)
- Nomination was probably similar to the standard pro forma 'non-binding' nomination handed out by public offer funds – needs to say it is binding and be properly witnessed!

Katz v Grossman Example

Individual trustees can be dangerous?

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- Mr Katz intended for both his daughter (Linda) and son (Daniel) to benefit from his superannuation assets
- When Mr Katz passed away, Linda was left holding office as the sole trustee of the fund
- Linda appointed her husband, Peter, as a second individual trustee of the fund
- Linda and her husband then resolved to pay Mr Katz's death benefits entirely to her
- NSW Supreme Court held that Linda's appointment of her husband was valid

Katz v Grossman Example Superannuation Succession

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How could this injustice against Daniel been avoided?

- Have a corporate trustee!
- The trustee could have continued with Mr Katz as the sole director after Mrs Katz's death
- Successor directors could be nominated to specifically succeed Mrs Katz, depending on constitution eg, Mr Katz nominates Son and Daughter
- Or complete a valid binding death benefit nomination ('BDBN')
- If Mr Katz properly executed a BDBN, the trustee (Linda and her husband) would be bound to follow it

Disclaimer and questions

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Disclaimer

- The content in this presentation is based on our understanding of relevant laws and proposals as at 5 August 2013
- This presentation is for illustrative purposes and to provide general guidance only. It should not be relied upon as specific legal advice
- We note that the material may be subject to change in the future due to changes in law and/or policy

Questions?

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Maureen Allan

- mallan@morrows.com.au
- (03) 9690 5700

Neil Yeoman

- nyeoman@morrows.com.au
- (03) 9690 5700