



**Tuesday 08 May, 2007**

## **The Clock is Ticking.....**

*Take 10 minutes to read this newsletter; it could save you and your dependants thousands of dollars in unnecessary tax.*

We are counting down the days to 1 July 2007, where we will see the commencement of the new rules, including:

- the removal of tax on benefits withdrawn for members over age 60
- the abolition of Reasonable Benefit Limits (RBLs)
- a new set of rules for contributions
- introduction of simplified pensions
- a full deduction on contributions for the self employed
- extending the co-contribution to the self employed

Along with the numerous changes to the system, we are also going to have to learn new terminology with the replacement of numerous definitions in the Superannuation and Tax legislation. This includes “concessional” & “nonconcessional contributions” and the “tax free” & “taxable component”.

In this issue;

[Lump sum death benefit payments from a SMSF](#)

[How will death benefit pensions be taxed?](#)

[Antidetiment – The best kept secret in town.](#)

[The New “Tax free” Component](#)

[New benefit payment method](#)

[A Line in the sand will be drawn - don't get caught on the wrong side](#)

[Crystallised Segment](#)

[The Pre-July 1983 component](#)

[What is the Eligible Service Period?](#)

[Merging benefits – Creating a larger Tax Free Component](#)

[CGT exempt component rollovers](#)

## Important Dates

May 2007

June 2007

## **Lump sum death benefit payments from a SMSF**

A lump sum death benefit payment will be tax free if paid to a person who is a dependant. A dependant for these purposes is a spouse or former spouse, a child less than 18, a person with whom the deceased had an interdependency relationship just before he or she died, or any other person who was dependant on the deceased just before he or she died. If the lump sum death benefit is paid to a non-dependant, the taxable component will be taxed at 15 per cent.

### ***How will death benefit pensions be taxed?***

The taxation of a death benefit paid as a reversionary pension will depend on the age of the primary and reversionary beneficiary. If the primary beneficiary was aged 60 or over at the time of death, then payments to the reversionary beneficiary will be tax exempt. If the primary beneficiary was under age 60 at the time of death, the pension will be taxed at the reversionary beneficiary's marginal rate (less any deductible amount and pension rebate) unless, or until, the reversionary beneficiary is aged 60 or over, in which case the pension becomes tax exempt.

Death benefits will be able to be paid as a pension to a dependant if the member dies before commencing a pension. These pensions will be taxed in the same way as a reversionary pension — see above.

Death benefits will be able to be paid as a pension to a dependant child, although when the child turns 25, the balance in the fund will have to be paid as a lump sum (tax free) unless the child was permanently disabled.

A pension will not be able to revert or be paid to a non-dependant upon the death of a person. These pensions will be paid out to the non-dependant as a lump sum.

We have noticed there is often some confusion about whether a death benefit ETP must be physically paid out on the death of a SMSF member where the proceeds are to immediately be re-contributed back into the same SMSF for the surviving spouse.

The law and the ATO's views are clear that a death benefit ETP at present must be paid out of the fund via a cash payment from the fund's bank account or where permitted by the fund's trust deed, paid as an in-specie asset transfer. This means that journal entries demonstrating a death benefit ETP and matching contribution back into another member's account is not sufficient.

This requirement may result in a SMSF incurring various transaction costs relating to a required sale of fund assets where cash levels are not adequate for the death benefit payment. SMSFs with property investments may particularly be disadvantaged where stamp duty expenses arise from a necessary property sale to fund a death benefit ETP.

Refer to [ATO Interpretative Decision 2006/132](#) for more information.

*Note:* the Simplified Superannuation reforms allow for death benefits to be paid as a pension to a death benefit dependant if the member dies before commencing a pension. This rule may alleviate transaction costs arising in circumstances where assets would generally have to be sold to pay a lump sum.

### ***Antidetriment – The best kept secret in town.***

Under a little-known section of the Tax Act, beneficiaries of members who die before moving into the pension phase of super can claim back the 15 per cent contributions tax paid by the deceased.

It works like this. Daniel has been earning \$100,000 for the past 10 years and his employer has contributed \$10,000 a year to super. Over that time, Daniel has paid \$15,000 to the Tax Office in contributions tax. When Daniel dies suddenly in his 40s, his beneficiaries may be able to receive this \$15,000 back, in addition to the death benefits payable by his fund.

This so-called anti-detriment provision (Section 279D) of the Income Tax Assessment Act dates back to the introduction of the contributions tax in 1988. Unfortunately, there is no legal obligation in the tax legislation for super funds to make the detriment payout available.

When a member begins an income stream in retirement, he/she can claim a pension rebate which effectively reduces tax by 15 per cent as partial compensation for the contributions tax. When a super member dies before starting an income stream, in the accumulation phase of super, the anti-detriment provision ensures beneficiaries can claim back the contributions tax.

However, because of the formula used to calculate the detriment payout, some payment may be available for people up to about age 65, even if they were in the pension phase.

While the legislators' intentions are admirable, in practice there are obstacles for both beneficiaries and super funds. Many of these obstacles stem from the fact that the anti-detriment provision was drafted before new investment structures such as self-managed super funds, master trusts and wrap accounts were developed.

One problem for the funds is that they have to pay the benefit before they can claim a tax deduction against future taxable income. Because other member balances can't be used to fund the payment, public offer funds generally pay it out of reserves. However, this is not an option for most self-managed funds; few have reserves and funds with only one or two members face practical difficulties in both finding the cash and claiming the deduction. In a single-member fund, the death benefit payout plus detriment payout would generally exceed the assets in the fund. And even in cases where payment is possible, it's unlikely there will be any future taxable income to claim the deduction.

Example of Gary, who died aged 60, leaving death benefits of \$300,000. His beneficiaries were able to claim an additional \$16,134 for contributions tax payments. However, Gary's fund would need to accumulate \$107,000 of taxable income before the loss carried forward was exhausted.

## **The New “Tax free” Component**

The Simplified Superannuation reforms have introduced many changes to the superannuation regime, including payment arrangements of superannuation benefits to members and their beneficiaries. Probably the most well received reform is the tax free payment of superannuation lump sums and pensions to individuals over age 60 from 1 July 2007. However there remains to be tax implications for those under age 60 receiving superannuation benefits and also payments of death benefits to non-dependants (tax definition).

### ***New benefit payment method***

Under the reforms, from 1 July 2007 all payments from superannuation funds will contain both a “tax free” component and a “taxable” component. This will be the case for members under and over age 60 even though no tax will be payable by members over 60. The tracking of the components paid out to members over age 60 is required due to the possibility that a benefit payment may be later paid to a non-dependant (e.g. financially dependant adult child) on the death of a member.

### ***A Line in the sand will be drawn - don't get caught on the wrong side***

The two new components will be required to be withdrawn on a proportional basis for each benefit payment. This means a member will be unable to elect for a superannuation payment to consist of only the undeducted contribution component, whereas this is acceptable up until 30 June 2007. From 1 July 2007 a superannuation benefit will include the following two components:

1. The tax free component. This includes:
  - Contributions made into a fund after 30 June 2007 that will not be included in the assessable income of the super fund. (e.g. undeducted contributions which will be called non-concessional contributions from 1 July 2007)
  - The tax free crystallised segment of the super benefit.
2. The taxable component. This is simply the value of the superannuation benefit less the tax free component.

If you have satisfied a condition of release and have undeducted contributions in your fund, you will lose your option to withdrawal this component exclusively

as at 1 July 2007. As at 1 July 2007 the withdrawal of any benefit will have to be pro-rata based on the "tax free" & "taxable component" of the member account.

*What are the conditions of release?*

*Conditions of release are the nominated events under SIS which a person must satisfy to enable them to withdraw their PBs and RNPBs from a superannuation fund. Trustees need to be aware that the conditions of release are subject to the rules of the individual superannuation fund (as set out in the trust deed). That is, it is possible that a benefit may be payable under SIS but cannot be paid under the rules of the fund. According to SIS, a member's PBs and RNPBs may be paid out when one of the following events occur.*

*Retirement*

*Terminating gainful employment – benefits less than \$200*

*Terminating gainful employment*

*Permanent incapacity*

*Temporary incapacity*

*Severe financial hardship*

*Compassionate grounds*

*Temporary residents departing Australia*

*APRA approved purposes*

*Rollovers and transfers*

See [Self managed superannuation funds - payment of benefits](#)

## **Crystallised Segment**

The crystallised segment is a combination of the current components that are valued at 30 June 2007 as if a member was going to withdraw an eligible termination payment of their entire benefit. These components will be tax free.

### CRYSTALLISED SEGMENT COMPONENTS INCLUDED IN TAX FREE COMPONENT

- undeducted contributions
- pre-July 1983 component
- CGT exempt component
- post-June 1994 invalidity comp.
- concessional component

Essentially the taxable component will consist of the other remaining current components, including the post-June 1983 component and the non-qualifying component.

A summary of the tax implications for a taxed superannuation fund is below:

<b>Superannuation benefit payments - taxed element only</b>			
<b>Age</b>	<b>Lump sum amount</b>	<b>Superannuation lump sum</b>	<b>Superannuation income stream</b>
60 +	any amount	Tax free	Tax free
Preservation age to 59	\$0 - \$140,000 (2)	Nil tax	Marginal tax rates and 15 per cent tax offset.
Preservation age to 59	> \$140,000 (2)	15%	Marginal tax rates and 15 per cent tax offset.
Below preservation age	any amount	20% on taxable component	Marginal tax rates (no tax offset) (1)

(1) A disability superannuation income stream receives a 15 per cent offset.

(2) low rate cap starts at \$140,000 and then will be indexed in \$5,000 amounts.

Note: Untaxed elements commonly found in Governments defined benefit schemes have a different tax treatment and are not provided for in this newsletter.

## ***The Pre-July 1983 component***

The pre-July 1983 component is to be calculated on the value of the benefits as at 30 June 2007 using the existing method for calculating this component (refer to the link below for instructions). Once calculated, this amount will become a fixed component that will form part of the crystallised segment (in the tax free component) and it will not change in the future.

### *Calculating the Pre-July 83 component*

Refer to the ATO publication - [A practical guide for superannuation funds](#) NAT 2699-06.2005

for information relating to the calculation of the Pre-July 83 component including information relating to Eligible Service Periods.

As the Pre-July 83 component will be tax free under the new rules, it is crucial that trustees have this component correctly allocated to a member's benefit if appropriate. The main factor in determining a member's Pre-July 83 component is looking at their Eligible Service Period start date.

If superannuation administrators have an incorrect Eligible Service Period start date allocated to the members account, then the member (or their beneficiaries) may miss out on a tax free portion that they could be entitled to. From 1 July 2007, lump sum benefit payments made to members aged 55 to 59 will be made in-line with this new benefit payment method.

It is possible that some practitioners may use the date the member joined the fund as the ESP start date rather than querying whether an earlier date exists. This is a common error which often arises from SMSF moving around different accountants, planners and super administrators

## ***What is the Eligible Service Period?***

The eligible service period (ESP) date attached to a superannuation benefit is *generally* the earlier of:

- the date the member joined the fund; or
- the date the member commenced employment with the employer who made contributions to the fund.

It is recommended that all clients check all historical rollover forms to ensure the correct ESP is recorded.

## **Merging benefits – Creating a larger Tax Free Component**

However if the fund has received rollovers from other funds or ETPs paid into the fund by an employer, then they may use the ESP date applicable to that employer ETP or superannuation rollover. Therefore where a superannuation member merges a number of benefits, they may be entitled to an earlier ESP. For example:

- if a person had terminated employment and rolled over a golden handshake into a superannuation fund then the ESP start date would be the date the person commenced employment (if earlier than the date they joined the fund).
- if a rollover was received from another fund into the members fund, then the earlier ESP start date will be taken as the member's ESP start date.

*Clients should seek out any superannuation monies and consolidate them into your SMSF where an ESP is pre-83 and earlier than that recorded in your member statement. As many would have already consolidated funds into your SMSF, it may be worth checking the Lost Super Register.*

*Some of you may have done this, but we recommend that you check at least once a year, as this register is updated continuously and you may find benefits due to you, that have been reported to the register since you last checked.*

*What you need?*

*Ensure you have your tax file number handy and click this link [Find Your Lost Super](#).*

*If you find a match, ring the ATO on 13 28 65 and they will give you instructions to contact the relevant trustee.*

*If you are successful it is imperative that you get these benefits rolled into your fund prior to 30 June 2007, as the ATO is silent in this area and post 1 July 2007*

*rollovers. An announcement on this issue is due at the end of May.*

## **CGT exempt component rollovers**

Where there has been a rollover into the fund comprising of a capital gains tax (CGT) component, the ESP start date rules are as follows:

- if rolled over from a sole trader or partnership, the ESP start date is the date the component was paid into the fund.
- if rolled over from a company or trust, the ESP start date will be the employment commencement date with that company or trust.

This is another great reason for SMSF clients try and ensure they have combined their superannuation accounts to maximise the new tax free component (via maximising any available Pre-July 1983 component as at 30 June 2007).

## **Compliance Tip – Self managed super funds and the importance of the investment strategy**

Under superannuation law, SMSF trustees must prepare and implement an investment strategy, even if the investment portfolio is focused on a small number of assets.

The strategy must show the trustees have taken into account all of the circumstances of the fund, including:

- the risks involved in making each investment
- the likely return from making each investment
- the range and diversity of investments
- any risks coming from limited diversification
- the liquidity of the fund's investments
- expected cash flow requirements, and
- the ability of the fund to meet its existing and prospective liabilities such as paying benefits to its members.

We recommend SMSF trustees record their decision and reasons relating to their investment strategy, including details about:

- developing their strategy, and
- departing from their strategy.

SMSF trustees should review their investment strategies regularly to reflect their funds' changing needs and changes in the investment market.

For more information about investment strategies, refer to:

- [Self managed superannuation funds – investment strategy and investment restrictions](#)

- [DIY super – It's your money ... but not yet! \(Nat 11393\)](#)

## Important Dates

### May 2007

- Saturday 12** Quarterly activity statement, quarter 3 (January–March 2007) – due date for lodgment and payment if lodging via paper or ECI
- self assessed deferral is available.
- Monday 14** Reasonable benefit limits (RBL) reporting – all RBL reportable benefits paid in April 2007 must be reported to the Tax Office on or before this date.
- Tuesday 15** 2006 income tax return end date – all other income tax returns not required earlier and not eligible for the 3 June or 5 June 2007 concession lodgment dates – due date for lodgment
- payment (where required) for company and superannuation funds also due this date
  - payment for individuals and trusts in this category is due as per notice of assessment
  - Self Managed Superannuation Funds (SMSF) – the regulatory return and *Superannuation member contribution statements* (MCS) form must also be lodged with income tax returns lodged on this date
  - self assessed deferral is available.
- Monday 21** April 2006 monthly activity statement – due date for lodgment and payment
- self assessed deferral is available.
- Monday 21** Final date for appointment of tax agent for fringe benefits tax role. Advising us by this date will ensure your new clients' fringe benefits tax returns will correctly receive your lodgment concession.
- Saturday 26** Quarterly activity statement, quarter 3 (January–March 2006) – due date for lodgment and payment if lodging via ELS or the Tax Agent Portal – self assessed deferral is available.
- Monday 28** Fringe benefits tax annual return – due date for lodgment and payment (where required)
- self assessed deferral is available.
- Monday 28** Due date for lodgment of the *Superannuation guarantee charge statement – quarterly* and payment of the superannuation guarantee charge for quarter 3 (1 January–31 March 2007) if sufficient contributions were not paid on time. The superannuation guarantee charge is not tax deductible.

## **June 2007**

**Sunday 3** 2006 income tax return for all taxpayers who were non-taxable or refund as per latest year lodged as well as actual non-taxable or refund in the current year (unless due earlier) – (excluding large/medium business taxpayers and head companies of consolidated groups) –due date for lodgment

- self assessed deferral is available.

**Sunday 3** 2006 income tax return for non-taxable new registrants (companies, superannuation funds and trusts) unless due earlier – due date for lodgment

- self assessed deferral is available.

**Tuesday 5** 2006 income tax return for individuals and trusts with a lodgment end date of 15 May 2007 provided payment is also made by this date.

This is not a lodgment end date but a concessional arrangement where penalties will be waived if lodgment and payment is made by this date.

**Thursday 14** Reasonable benefit limits (RBL) reporting – all RBL reportable benefits paid in May 2007 must be reported to the Tax Office on or before this date.

**Friday 15** Due date for lodging amended *Superannuation member contribution statements* (MCS) for inclusion in the August 2007 processing of assessments.

**Friday 15** Due date for payment of assessments of *Superannuation contributions surcharge and termination payments surcharge* issued on 15 May 2007.

**Thursday 21** May 2006 monthly activity statement – due date for lodgment and payment

- self assessed deferral is available.

**Friday 22** Due date for lodgment of *Superannuation assessment variation advice* (AVA), where applicable, for variation of assessment that issued on 15 May 2007.

**Friday 30** Final day for appointment of tax agent for activity statement role. Advising us by this date will ensure your new clients' quarter 4 activity statements will be linked to you.

**Friday 30** Superannuation guarantee contributions need to be paid by this date to qualify for a tax deduction in the 2006–07 financial year.

Surcharge no longer applies to superannuation contributions made or termination payments received on or after 1 July 2006. However, reporting and assessment requirements for contributions and termination payments made before 1 July 2006 remain unchanged.

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