

# Simplified Superannuation: your financial future in perspective

By Garry Pammer, CA, BEc, LLB



*“The impact of Simplified Super on you can only be seen as a great opportunity both before and after 1 July. Your forward planning is important and the taxation and superannuation issues discussed in this article can be great incentives to act...”*

If you’ve not already done so, you still have a month left to ensure you are taking the right perspective on the most dramatic tax changes in over two decades and the largest superannuation changes in a decade.

The simplified superannuation reforms announced by the Federal Government in last year’s budget (Simplified Super) are now law. On 15 March, the Tax Laws Amendment (Simplified Superannuation) Bill 2006 and nine other related Bills, introduced into parliament on 7 December with bi-partisan support, received assent.

As mentioned in my article titled “Thanks for the new super proposals - but should I still pay off my mortgage first?” (ADP Nov/Dec 2007) and notwithstanding that most changes are due to take effect from 1 July 2007, all advisors have been planning client strategies since the Federal Government’s budget announcements back in May 2006.

## Key rule changes

No doubt you’ve already seen the key rule changes summarised in the financial press, wealth planning flyers and articles similar to mine but let’s briefly revisit the key changes again:

- From 1 July, tax on super benefits drawn after 60 years of age from a taxed super fund as either a lump sum or pension, will be abolished;
- From 1 July, reasonable benefit limits (RBL) will be abolished;
- From 1 July, your deductible (now called concessional) contributions will be capped at:
  - \$50,000 per annum if you are under 50 years of age; or
  - \$100,000 per annum if you are over 50 years of age (until 2012).
- From 1 July, your un-deducted (now called non-concessional) contributions are capped at:
  - \$150,000 per annum; or
  - \$450,000 averaged over three years.
- Prior to 1 July, you can still make a last time und-

educted (non-concessional) contribution of up to \$1 million;

- Since the May 2006 budget announcements, you no longer have to compulsorily cash out your superannuation (lump sum or pension) at age 65 if you are not working or working for less than 10 hours a week; and
- Unless you quote your tax file number (TFN) to your super fund before 30 June 2008, a 31.5% penalty tax will be applied to your concessional contributions.

## Key perspective changes

Now let’s put the above key point summary into some perspective that enables you to contemplate action:

- Given that 90% of Australians holds their super money in taxed super funds, the first key point means very generous and flexible withdrawal of superannuation entitlements after 60 years of age;
- The abolition of RBLs means your focus should be on the front-end of investing into superannuation. Arguably there is no longer any such thing as having too much superannuation. As there are no punitive RBL limits to avoid, you can now have as much investment within the superannuation environment as you like;
- The new contribution caps are one limit on building up superannuation indefinitely. The restraints on concessional and non-concessional contributions means your investment focus should be on a disciplined steady superannuation contribution strategy. Traditional wisdom has always argued the compound growth analogy; that investment for retirement should be approached as a marathon rather than a sprint. These legislative changes will begin to reverse a common trend that has emerged; superannuation investment had become more like a sprint than a marathon;
- Be wary that you do pace your investment strategy correctly and do not inadvertently or deliberately breach the annual contribution

limits. Non-concessional contributions classified as excess will be taxed at 46.5%. Bearing in mind that you will have not received a tax deduction for the contribution going in, if you are already in the highest marginal tax rate yourself then you are effectively up for total punitive tax take of 93%!

- There appears universal agreement amongst advisors that should you have the financial resources, you should avail yourself of the opportunity to make the \$1 million non-concessional contribution before 30 June. However, note that divergence amongst advisors occurs if you are less than 50 years of age, seek to borrow funds to so invest or make in specie asset contributions into your super fund;
- Notwithstanding the concessional tax treatment, if you do not need it, the easing of the work test rules means you are no longer forced to withdraw your super money at age 65. The only continued application of work tests (40 hours in 30 consecutive days) is for those aged over 65 and only relate to the ongoing ability to continue to make deductible contributions into superannuation until a month after your 75th birthday! and
- Notwithstanding that the 31.5% penalty tax withheld for non-quotation of your TFN can be refunded (if subsequently quoted within 3 years), it is clear that the Tax Office wants more visibility in terms of checking contributions made by/or on behalf of people with more than one super account.

**The 60-year-old**

For the first time ever, Simplified Super promotes the understanding of the lay person which should encourage more people to invest into superannuation. The obvious advantage - superannuation is extremely tax effective for those over 60.

A superannuation benefit will simply not be taken into account for the 60-year-old because it is specifically defined as being “not assessable income”. Consequently, super will not be considered in any tests that revolve around assessable or taxable income such as the government co-contribution, spouse contribution rebate, Senior Australians tax offset, low income tax offsets, etc. Care should however be taken around special social security benefits such as the age pension. At least some

of the pension income and pension assets will still be included in those eligibility tests but there is more incentive for saving and working beyond 65 years of age now. For example, only \$1.50 of the age pension is forfeited for every \$1,000 of assets from 20 September this year as opposed to the existing \$3 reduction.

Other interesting family tax planning opportunities present themselves too. Now added alongside the 18-year-old dependent children are the low tax paying grandparents who can receive tax-effective distributions from discretionary trusts within the family group. Of course, if the retiree’s tax positions are strong because they already have income generating assets outside of superannuation, then making them beneficiaries is not going to be a viable option.

If significant asset holdings have been built up outside of superannuation, care needs to be taken in assessing whether and how to redress the balance. Counter intuitive outcomes can result when weighing up the extent to which steps should be taken to transfer existing wealth, such as shares and business property, into superannuation. Short term tax costs such as capital gains tax and stamp duty need to be assessed against the long term tax savings within the superannuation environment.

**The “not so” 60-year-old**

Unlike the 60-year-old whose superannuation is “not assessable income”, the taxable component for anyone under 60 is “assessable income”. The tax rates on the taxable components that could be received are set out below:

**Lump Sum**

Under 55 years .....	21.5%
Between 55	
and 60 years .....	Nil up to \$140,000
	16.5% on excess

**Pension**

Under 55 years .....	Marginal tax rates apply
Between 55 and 60 years .....	Marginal tax rates with 15% tax rebate

Essentially, the two other groups of superannuation recipient under 60 are those who are:

- preservation age; and
- Between preservation age and 60.

Note that until now, tax treatment has been determined with reference to age 55. This currently equates to preservation age but from 1 July 2015, the preservation age starts to increase progressively to age 60. Effectively this phasing means that, in time, only the “under preservation age” group will exist and those receiving super benefits before 60 will become extremely small as all funds going into superannuation are now preserved.

Ultimately, therefore, the predominant super taxation rules will be for one group: those over 60. However, until that time arises, the age differentiation between preservation and 60 should be seriously considered and utilized for those approaching the 55-60-year-old age group.

The ability to take lump sums or commute a pension to a lump sum before and after 55 years is a very important and significant factor in weighing up whether your wealth creation strategy should be inside the superannuation environment even though the age of 60 seems so far off.

In this regard, it is important to understand the manner in which the effective 16.5% lump sum tax rate for those over 55 (and 21.5% for those under 55) is achieved. The taxable components of a lump sum are initially taxed at normal marginal tax rates. A special tax offset then applies to reduce the effective tax on that component to 16.5% (or 21.5% if under 55). If, for example, your 40-year-old spouse, with little or no other income, takes a super lump sum of \$20,000, tax of only \$2,310 is payable. This effective tax rate of 11.5% (ignoring the low tax offset) is much less than the implied 21.5%.

Similarly, the 15% rebate on superannuation pensions taken between 55 and 60 years of age is also applied by way of a tax offset. The practical upshot is that if the super pension income is sufficiently low, the unutilized tax offset can be used to defray tax on other income.

The Simplified Superannuation reforms also introduce new superannuation pensions. This is one of the few areas of reform that crystallized changes to superannuation law rather than tax law.

The two new types of pensions are:

- A defined benefit pension; and
- An account-based pension.

Defined benefit pensions are not available to self-managed funds because only

funds with more than 50 members can offer defined benefits. Accordingly, my focus is on the new account-based pensions which will be available to all of you with your own self-managed super fund (SMSF). These new account-based pensions are similar to the existing allocated pensions in that:

- The minimum annual drawing is based on opening fund balance;
- The pension stops when the money runs out;
- A pension can be commenced any time after preservation age; and
- You can continue to contribute into the fund notwithstanding a pension has started.

The latter two points are significant for those approaching 55 years of age. You really should stop thinking in terms of reaching 60 but could consider resetting at least part of your superannuation investment horizon to 55.

Even though you may still be working, you can begin to take superannuation benefits in the form of a transition to retirement pension, any time after 55 years of age. It is simple paperwork for your SMSF and no need to sell assets. Your SMSF stops paying tax on its investment earnings and you can stop your pension again at any time. Depending upon the ratio of your undeducted contributions and “pre-1983” components to the balance within your fund account, you will receive a proportion of your transition to retirement pension tax-

free. The rest of the pension will be subject to a 15% rebate meaning a maximum tax rate of 31.5%. The entire pension will be tax-free once you reach 60.

Remember, even if you do start a pension (or before you do), it may well still be tax effective to take payments over and above the minimum pension (or instead of a pension) as lump sums. Lump sums after 55 will be tax free up to \$140,000 and then taxed at a maximum rate of 16.5% as opposed to pensions which will be taxed at a maximum rate of 31.5%.

You can also continue to make contributions after crystallizing your after 55 transition to retirement pension. Therefore you can effectively recycle, in part, your superannuation pension entitlements (taxed at 31.5%) to help fund ongoing deductible super contributions (at 46.5% if you are on the highest marginal tax rate)! Even if you’re not self-employed and receive employment income, you can use lump sums to help satisfy the 10% substantially self-employed test. Withdrawing all or part of your tax free low cap amount of up to \$140,000 (from 1 July) could thereby enable you to make deductible personal superannuation contributions.

### Keeping your financial future in perspective

The impact of Simplified Super on you can only be seen as a great opportunity both before and after 1 July. Your forward

planning is important and the taxation and superannuation issues discussed in this article can be great incentives to act. However be sure that your actions dovetail within a wholistic investment strategy that includes:

- Investments;
- Asset allocations;
- Effective structures;
- Taxation;
- Estate planning;
- Risk management;
- Cash flow management; and
- Social security and aged care.

### Disclaimer

*This article is designed to provide generic information only and should not be viewed as a recommendation to act. Individuals should seek advice from a qualified advisor to ensure their actions are commensurate with their financial needs and requirements.*

### About the author

*Garry Pammer is advisor with Clark & Jacobs Accounting and Business Advisers who specialise in providing advice to dentists. Advice that includes planning for your financial wellbeing, superannuation, insurance, practice management, computer software and the buying and selling of dental practices. For a free assessment of your financial position and to see how you can achieve your goals, call Mr Pammer on (02) 9264-1111.*