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Superannuation News

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ATO compliance program 2011/2012: target areas

The ATO continues to increase SMSF compliance and audit activities and has announced a focus on:

- Newly-registered funds to ensure they have not been established for illegal early release,
- Funds lodging their first annual return,
- Auditor contravention reports,
- Related party investments to ensure they do not breach the 5 per cent rule or restriction on lending to members,
- Exempt current pension income and non-arms length income, and
- Re-reporting of contributions and compliance with excess contribution tax release authorities.

If you receive any documentation from the ATO in relation to a risk review or audit, you should contact your tax adviser or auditor to discuss.

Member contribution caps

Caps apply to contributions made to your superannuation (super) in a financial year. Any super contributed over a cap amount is subject to extra tax. The cap amount and how much extra tax you pay once you exceed it depend upon whether the contributions are:

- Concessional - which are generally made to a super fund for or by you in a financial year and are included in the assessable income of the super fund (for example, super guarantee, salary sacrificed amounts and any amount you are allowed as a personal super deduction in your income tax return)
- Non-concessional - which are generally made to a super fund by or for you in a financial year and are not included in the super fund's assessable income (for example, personal contributions you make from your after-tax income).

The contribution caps for the financial year 2011-2012 are $25,000 concessional contributions and $150,000 non-concessional contributions.

The government has transitional arrangements in place for taxpayers over the age of 50 to allow for concessional contributions to be doubled to $50,000. It is worth noting that however such transitional arrangement will cease from 1 July 2012 for all members over the age of 50 that currently have superannuation entitlements in excess of $500,000.

Any member making concessional contributions and over the age of 65 must meet the 'works test' – gainfully employed for at least 40 hours over a 30 day period during the year.

2011 – 2012 Contribution Caps

Concessional		Non-Concessional
< 50 years	**Over 50 years**	
$25,000	**$50,000**	**$150,000**

For those who wish to make larger non-concessional contributions during a given year and are under the age of 65, you are able to take advantage of the bring forward provisions where you are able to bring forward three years non-concessional caps and make contributions of $450,000 in year one and none in the remaining two years.

TO DO

Trustees and members need to keep track of all contributions being made into SMSF's to ensure contribution caps are not breached as they may result in severe tax consequences and the commissioner insuring excess contributions tax assessments.

Limited recourse borrowing arrangements

The two most contentious issues with arrangements to borrow through a SMSF are possibly the definition of a single acquirable asset and the restrictions on asset improvements.

Guidance on both issues was provided by the ATO on 14 September in the form of draft ruling SMSFR 2011/D1. This ruling allows some relaxation of the rules in relation improvements and takes a more commonsense approach to the definition of a single asset.

- Single asset – each limited recourse borrowing arrangement needs to involve a single asset. Assets that are registered on more then one title can meet the definition of a single asset provided its physical characteristics are readily identifiable as a single asset and the titles cannot be sold separately.
- Improvements – borrowed money cannot be used to improve an asset, but the ATO will now allow other money to be used to fund improvements. It is still important to ensure that the improvements do not change the character of the asset or create a new different asset as this could cause a breach of the SIS Act. (For example buying land with borrowed funds under a limited recourse borrowing arrangement and then using fund reserves to build on the land would change the nature of the original asset).

Any trustees considering using limited recourse borrowing arrangements within their investment strategy need to consider these and other issues and are strongly advised to consult their advisers prior to making such arrangements.

Deductions for TPD insurance premiums

From 1 July 2011, the premiums for total and permanent disability (TPD) insurance inside super may not be fully deductable as the deduction relies on the likelihood that a superannuation disability benefit will be paid. This can vary according to the policy definition. Super funds holding TPD policies can determine how much of the premium is deductable using either:

1. An actuary to calculate the deductible portion, or
2. The standard deduction percentages specified in the SIS regulations.

The regulations have not been finalised but the proposed standard deductions are outlined as:

Policy Type	Proposed portion deductible
TPD – any occupation	100%
TPD- own occupation	67%
TPD – own occupation bundled with death (life) cover	80%

Trustees need to be weary of the types of policy's they takeout for members of super funds. Not only the implications surrounding the tax deductibility of premiums but also should any claims need to be made for TPD policies and possible tax and SIS implications of paying such benefits out to members.

It is advisable to fully consult your insurance and financial adviser of the implications of each policy type prior to taken out such policies in the name of the SMSF.

Death of a pension member

Draft tax ruling TR 2011/D3 has been released to explain when a super income stream (pension) commences and ceases from a tax prospective. This will impact the taxation of a SMSF when a pension member dies or makes a full commutation of the pension.

According to the ruling, a superannuation income stream ceases on the day that a pension member dies, unless the pension is setup with an automatic reversionary beneficiary. The pension is also deemed to be ceased when full commutation is requested.

If the pension ceases, the money is deemed to be moved back into accumulation phase and tax will apply to earnings including realised capital gains after that date.

This can increase the effective tax on death or commutation benefits unless strategies have been implemented to minimise the consequences while the pension is still in operation. Strategies may include:

- Setting up a reversionary pension,
- Selling assets and repurchasing them on a regular basis while the pension is in operation to reset the cost base (not possible with property assets), and
- Selling assets before effecting a full commutation (not always possible as this would mean knowing when a member was going to die).

It is important that as fund members and trustees get older that these things are addressed to minimise the taxation implications of the surviving members and beneficiaries of the fund. No one wants the tax man robbing their grave any more then is necessary.

TO DO
You should speak to your adviser about what preparation can be put in place to minimise the impact of a sudden and unexpected commutation of pension benefits. You may also want to consult your legal and tax adviser to make sure that your will is updated and structured in the most tax effective way.

SMSF & property development checklist

Using SMSFs as a vehicle to develop property has gained momentum in recent times, particularly due to uncertainty surrounding global equity markets..

<u>Remuneration of trustees:</u>

The Tax Laws Amendment (2011 Measure No. 9) Bill 2011 (Cth) was introduced on 23 November 2011. The bill outlines certain restrictions on remuneration for services performed by trustees.

The Bill requires that trustees must be appropriately qualified, perform services in the ordinary course of a business and the dealings must be at arms length.

This may impact SMSF's developing property that seek to employ the trustee as a builder or project manager. For example, an SMSF trustee who is also a builder wants to develop property and be paid. They would need to be a registered or licensed builder with appropriate insurance cover, etc.

Where an SMSF invests in and develops property via direct investment, the following issues should be considered.

<u>Superannuation issues:</u>

- Sole purpose test – is the property being used for the members' retirement benefit?
- Related party acquisitions – is the property being purchased from a related party? If there is a related party, eg, builder, are

building materials (as compared to services) being acquired from a related party in contravention of s 66 (see SMSFR 2010/1)?

- Borrowing – In SMSFR 2011/D1 the ATO has outlined that borrowing to develop property is not permissible.
- Arm's length – are all the trustees dealings at arm's length? Are relevant transactions supported with evidence?
- No charge over funds assets – most building contracts include these and need to be amended accordingly.
- Investment strategy – does this take into account the investment and development?
- Does the trust deed allow for the course of action and is the trustee acting within power?

Commercial issues:

- Cash flow – does the SMSF have additional funds to support cost blow outs on the development?
- Trustee remuneration is restricted – see above – and must be benchmarked at arm's length.
- Consider risk minimisation strategies – eg, a sole purpose corporate SMSF trustee and appropriate liability insurance.

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NOTE

It is recommended that a full review be undertaken before any building or development project be undertaken to ensure all items are covered off and appropriately documented by trustees.

Excess super contributions tax

The government recently released a consultation paper on the implementation of an announced Budget measure to allow taxpayers that have made excess super contributions to get a refund of the excess and therefore avoid excess contributions tax liability.

The option will only be available from the 2011/12 income year for taxpayers that are first-time offenders and where the cap has been breached by $10,000 or less.

Taxpayers who choose to have such excess contributions refunded to them will have the excess contributions included in their assessable income (subject to a refundable tax offset equal to 15% of the excess contributions).

Notably, the employer is not involved in the new refund process and so will not be affected by this measure.

NOTE

From the 2011/2012 year onwards, if you breach your excess concessional contributions cap for the first time by $10,000 or less, you will be entitled to request a refund of the excess contribution and have it taxed at your marginal tax rate instead.

If you are an employer and your employee breaches the cap and applies for a refund, you will not be required to undertake any action.