

JR news

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Editorial

This edition of JR Super News contains various tax and regulatory issues that are relevant to both individuals and trustees of SMSF's.

Managing individual contribution caps to maximise retirement savings and minimise personal tax is a strategy dear to us all and we outline the changes to the caps and the transitional arrangements to 30 June 2012. Also pertinent to managing contributions is the subject of "Reportable Super" and we address its relevance to those undertaking salary sacrifice arrangements.

For those with related Unit Trust investments in their SMSF, an understanding of the ATO's view on unpaid trust distributions will ensure cashflow constraints do not have an unintended consequence on the compliance of your fund.

We hope you enjoy this edition of JR Super News.

Tracey Norris – Editor



Excess Contributions Tax – Manage Your Contribution Caps Closely

Recently the ATO started issuing excess contribution notices to individuals in respect of 2008 year contributions. Whilst the ATO has acknowledged that many contributions were double counted resulting in assessments being issued in error, it is important to understand how an Excess Contribution Assessment arises.

What is Excess Contributions Tax?

Excess contributions tax is an additional tax that is applied where contributions made to superannuation funds exceed the concessional or non-concessional caps. The additional tax depends on whether the contributions made have exceeded the concessional or non-concessional caps.

From the 2008 year contribution caps have become a "per person" limit and all contributions made to various funds within a year are accumulated to determine compliance with the relevant threshold.

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Relevant Contribution Caps

	Concessional Cap	Non-Concessional Cap
2008-09 financial year	\$50,000 – under 50 \$100,000 – over 50 (transitional arrangement available until 2012)	\$150,000 or \$450,000 over a three year period for those under 65
2009-10 financial year	\$25,000 – under 50 \$50,000 – over 50 (transitional arrangement available until 2012)	\$150,000 or \$450,000 over a three year period for those under 65
Tax on amounts over the cap	31.5% (in addition to the 15% paid by the super fund)	46.5%

It is important to note that contributions in excess of the concessional cap, will count towards the non-concessional cap.

Example:

Jim is 48. In the 2008-09 year he makes \$60,000 in salary sacrifice contributions (concessional) and \$450,000 in non-concessional contributions.

Concessional Cap – Jim has exceeded his concessional cap by \$10,000 and is liable to pay 31.5% on the excess. Tax payable \$3,150.

Non-Concessional Cap – The \$10,000 excess in concessional contributions will be accumulated with his other non-concessional contribution of \$450,000. Therefore Jim has also exceeded his non-concessional cap and is liable to pay 46.5% on the excess. Tax payable \$4,650.

In addition to contributions tax of 15% a further 78% in tax is payable on the excess \$10,000 resulting in total tax of 93% on the \$10,000 contribution.

What Happens if Caps are Exceeded?

If caps are exceeded, the ATO will issue to the member an excess contributions tax assessment and a 'Release Authority'. Payment is generally due within 21 days of the issue date. Treatment differs as to whether the excess has been made on concessional or non-concessional contributions.

Excess Concessional Contributions

Where the individual exceeds the concessional cap, the release authority is known as a 'Voluntary Release Authority'. The member can:

- Request the assessment be withdrawn from the superannuation fund;
- Pay the assessment personally and have the fund reimburse themselves; or
- Pay the assessment personally without reimbursement.

Where the member prefers the amount to be withdrawn from the fund, the 'Voluntary Release Authority' must be provided to the fund within 90 days of the assessment issue date.

Excess Non-Concessional Contributions

Where the individual exceeds the non-concessional cap, the release authority is known as a 'Compulsory Release Authority'. The member must:

- Request the trustees of the fund to pay the assessment (no choice is given); and
- Give the 'Compulsory Release Authority' to the fund within 21 days of the assessment issue date.

In cases where a member has more than one superannuation fund they may choose to give the release authority to more than one fund. The ATO may impose penalties of up to \$2,200 to be paid by the individual personally for non-compliance with the above.

ATO Discretion

The ATO has noted that they will disregard or reallocate contributions where:

- there are special circumstances; and
- doing so is in line with the object of excess contributions tax. That is, to ensure the amount of concessional tax super you will receive results from contributions you have made to accumulate super gradually over time.

Special circumstances are defined by the ATO as circumstances that have been legally defined to be unusual, exceptional, abnormal or uncommon circumstances where applying the law would result in an unjust, unfair or otherwise inappropriate outcome. An application can be made to the ATO where the member believes a special circumstance exists and if successful the ATO will disregard a contribution and include it in another financial year. It is important to note that ignorance of the law does not constitute a special circumstance. If the decision is made to reallocate a contribution, the ATO will advise the member in writing and amend the issued assessment.

It is important to review super contributions made during the financial year and ensure that the concessional and non-concessional caps are not exceeded. This includes managing your employer contributions to ensure all employer and/or salary sacrifice contributions are within the concessional cap limits.

Reportable Super Contributions

What Does it Affect?

Reportable superannuation contributions will not affect assessable or taxable income; however, it will affect the income tests for a range of government benefits and obligations. It may also affect the amount of income tax an individual is liable to pay as eligibility for some tax offsets may be lost.

What are Reportable Employer Super Contributions?

Reportable employer super contributions include contributions your employer makes on your behalf:

- under a salary sacrifice arrangement
- that are additional to the minimum contributions they must make under one of the following:
 - super guarantee law
 - an industrial agreement
 - the trust deed or governing rules of a super fund
 - a federal, state or territory law.

If your employer makes reportable employer super contributions on your behalf, they will include the total amount of these contributions on your end of financial year payment summary. This amount must be reported on the income tax return and it will be used to calculate the total reportable super contributions for the year.

Example:

The employment conditions of Karen (an employee of KK Pty Ltd) are governed by an industrial agreement that was negotiated between Karen and the other employees of KK Pty Ltd, namely Karen's husband and their two adult children. There was no external involvement in the negotiations of the agreement and it was not made at arm's length. The agreement requires KK Pty Ltd to contribute an amount equal to 15% of an employee's salary to superannuation.

As the employer contributions made on behalf of Karen and other employees are required under the terms of an agreement that was not negotiated at arms' length, Karen had capacity to influence the contribution.

The difference between the minimum amount required to be made by KK Pty Ltd to comply with the superannuation guarantee obligations (9%) and the superannuation amount paid under the industrial agreement is a reportable employer superannuation contribution.

Assuming that Karen's salary is \$60,000, then the amount of reportable employer superannuation contributions is \$3,600 (i.e. $(15\% - 9\%) \times \$60,000$).

Changes to Income Tests

From 1 July 2009, changes to tax law will mean changes to the way in which relevant income tests are applied for some government benefits and obligations administered by the ATO and other government organisations.

The changes do not change the income thresholds or the way assessable or taxable income is calculated. **However, it may affect the amount of tax payable due to ineligibility for a previously allowable tax offset.**

Three new income tests will be used when calculating tax offsets and obligations:

- adjusted taxable income (ATI)
- rebate income
- income for surcharge purposes.

Several other income tests will be amended to include new items. These changes will affect:

- Higher Education Loan Repayment and Student Financial Supplement Scheme Repayments
- Superannuation income tests
- Mature age workers tax offset.

As part of the changes, two new items will be included in income for income testing purposes, these are:

- reportable super contributions
- total net investment losses.

This will be added to existing income tests.

How Will the Superannuation Income Tests Change?

From 1 July 2009 reportable employer super contributions will be added to the current income tests for the following measures:

- Spouse superannuation contributions tax offset
- Government super co-contribution
- Deduction for personal superannuation contributions.

Claiming Deductions for Personal Super Contributions

You are eligible to claim a deduction if:

- you satisfy the 'maximum earnings as an employee' condition (10% rule);
- you meet the age-related conditions;
- you have written to your super fund and advised them of the amount you intend to claim as a deduction; and
- your super fund has acknowledged your notice of intent and agreed to the amount you intend to claim as a deduction.

What is the 'Maximum Earnings as an Employee' Condition (10% Rule)?

You can claim a deduction on personal contributions, even if you receive some income as an employee, as long as you satisfy the 'maximum earnings as an employee' condition.

Under this condition, the amount you earn as an employee must be less than 10% of your combined assessable income, reportable fringe benefits and reportable superannuation contributions for that income year. This is the case regardless of whether your employer has paid super on your behalf.

Reportable superannuation contributions are commonly salary sacrificed amounts beyond the 9% super guarantee requirement. Previously, reportable superannuation contributions were not taken into account when assessing if this test was met.

The 10% rule is not relevant if the taxpayer has no employment-related income, e.g. taxpayers who are wholly self-employed or who receive only investment income.

Example:

Bob has earned a significant capital gain during the 2009 year of \$200,000 and derived salary income of \$90,000. Of his salary, Bob salary sacrificed \$81,000.

Bob intends to claim the maximum personal superannuation deduction to reduce his taxable capital gain.

Bob's taxable income:

	\$
Capital Gain (less discount)	100,000
Salary (\$90K - \$81K)	9,000
Total Assessable Income	\$109,000

Employment related income equals salary and reportable superannuation:

	\$
Salary	9,000
Superannuation	81,000
Less SG Amount (9%)	(8,181)
Total	\$81,819

Combined assessable income and reportable super totals \$181,819 (i.e. $\$109,000 + \$81,000 - \$8,181$).

Therefore when applying the 10% rule to determine eligibility it becomes apparent that Bob has failed this test under the new rules as his employment related income equates to 45% of his adjusted assessable income (i.e. $\$81,819 / \$181,819 = 45\%$).

This means that Bob is unable to make a personal deductible superannuation contribution to reduce his taxable income.

This is a significant shift and will hinder one's ability to remove arm's length employment income from the adjusted assessable income line. If you are currently undertaking a salary sacrifice arrangement and would like to better understand how these changes affect you, please call your JR advisor to discuss.



Related Trusts and Unpaid Trust Distributions – What is the Status Quo?

A recent ATO ruling considers whether a fund is in breach of SIS when it is presently entitled to distributions from a related trust and those distributions are not paid over to the fund (i.e. retained in a beneficiary current account in the trust).

The ruling looks to deem these amounts as a loan and as such may contravene the in-house assets provisions. Further it may also be considered a breach of arm's length rules and breach of the sole purpose test.

The conclusions of the ATO are as follows:

- Unpaid distributions would usually be regarded as a loan to the trust, under the extended definition of a loan, where:
 - the trustees of the fund and the unit trust are the same or under substantially the same control;
 - the existence of a formal or informal loan agreement;
 - the amount of unpaid trust distribution is substantial;
 - the amount has remained unpaid for a substantial period of time; and
 - distributions for multiple years remain unpaid.
- Unpaid distributions would generally result in a breach of the arm's length investment rules where:
 - the trustee does not seek payment of substantial trust distributions within a reasonable time; and
 - no interest is paid or compensation given in respect of not seeking that payment.
- The sole purpose test may be breached if the fund is not the sole unitholder of the trust.

The ATO's view on how soon should a distribution be paid after it is declared is 30 days from when the trust's accounts for the year are completed.

Example:

Ed & Martha Sample are the trustees of the Sample Super Fund and also of the Sample Unit Trust, of which the fund has 100% ownership.

The financial accounts for the Sample Unit Trust for the 2009 year were completed on 31 March 2010 and a distribution of income of \$295,000 was recorded in favour of the Sample Super Fund.

On 30 April 2010 the Sample Unit Trust paid \$295,000 cash to the Sample Super Fund.

The ATO's view is that this is an acceptable commercial arrangement and does not constitute financial accommodation or a loan.

Where a loan is deemed to occur, this would be captured as an in-house asset as it would be a loan/investment in a related party.

Generally, as a trustee of an SMSF you cannot lend to, or invest in, a related party trust of the fund, where the loans, or the values of the assets that are subject of the investment or lease arrangement, are greater than 5% of the market value of the fund's total assets.

Further, after 30 June 2009, if your SMSF has investments with related parties or related trusts that were made before 11 August 1999, your SMSF will no longer be able to:

- Reinvest any earnings from those assets;
- Pay up any partly paid shares or units; or
- Make any additional investments in relation to those assets.

The following will be counted towards the 5% limit on in-house assets after 30 June 2009:

- If you continue to reinvest earnings or make additional investments or loans after 30 June 2009, the additional investments or loans will be in-house assets that count towards the 5% limit.
- Any investment in the unit trust or company made after 30 June 2009 will be an in-house asset.
- If you pay calls on partly paid shares or units after 30 June 2009, a proportion of those shares or units will be treated as in-house assets.

It is important to understand the implications of unpaid trust distributions from 1 July 2009. Where a commercial or financial arrangement requires retention of profits within the trust, you should call your JR Advisor to discuss your options.

SMSF Made Non-Complying

Since becoming the regulator for SMSF's the ATO has taken the approach of educating SMSF trustees on their responsibilities. However of late, this has changed to the role of enforcer of compliance. As such the heaviest penalty the ATO can deliver is to deem a fund non-complying.

Recently the Administration Appeals Tribunal (AAT), upheld a notice of non-compliance issued to a self managed fund by the ATO. The fund in question had lent almost all of its assets to a related party, breaching the in-house assets and sole purpose tests.

The trustees had applied to the AAT seeking the overturn of the ATO's decision to not exercise discretion in respect of the breaches. Their application failed as follows:

- The loans commenced in August 2004, when the related party got into financial difficulties. The amounts loaned in the 2005 financial year totalled \$211,000, representing almost 95% of the fund's assets. An amount of \$75,000 was repaid in the 2005 year, with the remainder repaid in the 2008 and 2009 financial years. Interest of 10% was paid and the loan was documented.
- The trustees admitted that they were aware they were contravening the Act but the alternative was to liquidate their company.
- In July 2007, the fund's auditor lodged an Auditor Contravention Report with the ATO which resulted in further questions being asked. In February and June 2008, the trustees made offers to the ATO in the form of enforceable undertakings proposing certain timeframes in which to repay the monies. Those offers were rejected by the ATO because of the timeframe offered for repayment (15 months in the first instance and five months in the second instance).
- The ATO declared the fund non-complying in July 2008.
- The ATO is permitted to exercise its discretion and overlook a breach of the provisions. Factors it must take into account include:
 - The taxation consequences of making the fund non-complying (i.e. tax of 45% on the fund's assets);
 - The seriousness of the contravention; and
 - Any other relevant circumstances. The ATO decided not to exercise discretion in this case.
- On review of the matter, the AAT also decided not to exercise discretion. The AAT's reasons included:
 - The trustees had treated "as one" the fund and all other entities in which they were involved. This led them to ignore the fundamental principles of the SIS Act.
 - The trustees did not, and still do not, appear to appreciate the seriousness of the situation.
 - The trustees failed to take the steps necessary to repay the loans. Even after the Auditor Contravention Report was lodged, the trustees took almost two years to repay the final amount which the AAT described as "making no attempt, in any real sense, to rectify the situation".
 - The AAT readily accepted health issues, financial difficulties and cyclones as factors relevant in the situation but only up to a point. It was demonstrated that the individuals had the capacity to repay the loans but no serious attempt was made to do so.
 - The trustees were experienced business people who received professional advice but instead chose to use the fund as a line of credit.

The last 12 months has seen unprecedented audit activity by the ATO and whilst the ATO has the ability to exercise discretion and overlook breaches, and appears to have done so readily in the past, it is not obliged to do so. This case provides an example to trustees of the importance of their duties and the cost of non-compliance.

Should you require any assistance or guidance regarding compliance matters for your SMSF, we are well placed to provide relevant and helpful options.

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