# TECHNICAL NOTE

# AUSTRALIAN SUPERANNUATION SYSTEM OVERVIEW

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# AUSTRALIAN SUPERANNUATION SYSTEM OVERVIEW

## A. GENERAL OVERVIEW

This technical note is designed as a basic overview of superannuation requirements in Australia. For compliance type issues, the ATO has a useful booklet entitled *"Running a self-managed super fund. Introduction for SMSF Trustees"*. As most superannuation legislation is common to all funds, it will contain useful information for many types of readers. The Australian retirement income system has the compulsory superannuation guarantee regime, voluntary super contributions and a means tested social security age pension. The primary objective has been defined "*to provide income in retirement to substitute or supplement the Age Pension."* There are also subsidiary objectives.

### A1. THE SOLE PURPOSE TEST

This is an **essential requirement** that **must categorically be met**! A superannuation fund must be solely maintained for one or more of the core requirements and certain specified ancillary purposes. In essence the core purposes are the provision of retirement or death benefits for members. Ancillary benefits may include (for example) the provision of a benefit on termination of employment of a member. The purpose is not to provide tax minimisation or estate planning.

### A2. SELF MANAGED SUPERANNUATION FUNDS

Many readers will have – or will want to establish – a SMSF. If the fund is established with individual trustees, then it must have 4 or less members; each member is a trustee; no member is an employee of another member unless they are related; and no trustee is paid for their trustee duties. A fund with a corporate trustee is very similar. A single member fund can have a second trustee or director who is a relative or not employed. A parent can act for a child member.

### A3. OBLIGATIONS

Trustees must comply with: the fund's trust deed; the Superannuation Industry (Supervision) Act and Regulations (SIS); the Income Tax Assessment Act (ITAA); and general trust law.

Trustees have obligations to act honestly, exercise skill and diligence, act in the best interests of members and to keep the assets separate. Advisers can be appointed to assist with duties. The SMSF must have an approved auditor to undertake annually a compliance and financial audit.

**A4. ACCEPTABLE INVESTMENTS**

Trustees must have an investment strategy and review it regularly. The investment strategy details the methods to achieve the objectives. A reserving strategy is required – or it may be as simple as no reserves are to be built up ie fully distribute earnings each year.

There are some investment restrictions. Non-compliance is an unwise action and penalties include prosecution that may result in fines or imprisonment. Here are some of the more usual legislative requirements:

- Loans or financial help to members or relatives is prohibited – even if indirect.
- Ability to borrow is very limited to short periods to meet benefit payments to members or via instalment warrants that meet certain conditions and limited recourse loans.
- Can't acquire assets from a related party with limited exceptions. Listed securities and business real property at market value are two such exceptions.

There are "in-house asset" provisions that allow 5% of the fund to be lent to or invested in a related party.

The ATO has a useful compliance checklist for SMSF trustees. There is also material available on how to wind up a fund.

Many of the requirements are supervised by the ATO, however, larger funds have APRA and ASIC regulatory aspects to also fulfil.

**<u>B SUPERANNUATION CONTRIBUTIONS</u>**

The information shown in this section is for the 2017-18 financial year and reflects the recent legislative changes. This section details how contributions are taxed, limits on the level of contributions that apply, and related issues. This section does not detail the super surcharge system that is now defunct (except for some unfunded benefits).

**B1. ACCEPTANCE OF CONTRIBUTIONS**

Since 01/07/2007 a super fund must not accept member contributions unless the member's TFN has been quoted. Anyone under the age of 65 can make contributions without needing to meet the work test.

After age 65 – and until age 75 – the work test of having been gainfully employed for at least 40 hours in a period of not more than 30 consecutive days in the financial year must be met in order to make personal or "non-concessional" super contributions. The superannuation fund may still accept mandated employer contributions, even if the test is not met.

Current mandated employer superannuation guaranteed contributions must be paid at least four times a year for employees earning $450 p.m. or more.

On the sale of a small business, a contribution up to a lifetime limit can be accepted provided various legislative requirements are met. These contributions don't incur either CGT or personal tax liabilities and don't count towards either contribution cap.

The fund cannot accept a single transaction non-concessional contribution above the contribution cap limit, to limit inadvertently excess contributions being made.

## B2. TAXATION OF CONTRIBUTIONS

Before tax contributions made by an employer (including salary sacrifice contributions) or self employed members are known as tax deductible, or concessional contributions.

After tax contributions have been known under a variety of names, including non-deductible, non-concessional, undeducted or personal contributions.

Tax at a 15% rate is levied on concessional contributions. For superannuation death benefits, in certain circumstances anti-detriment provisions allow this contribution tax to be claimed back. (The anti-detriment provision will cease from 01/07/2017). If the contributions exceed certain caps, an excess tax (detailed later) applies.

There is an 18% rebate for low income spouses up to a maximum contribution of $3,000 contribution p.a. The spouse's assessable income, reportable fringe benefits and super contributions must be less than $40,000 for the maximum $540 rebate. This phases out on a dollar for dollar basis.

Superannuation contributions can be transferred to a spouse. Since 05/04/2007 the splittable contributions are limited to 85% of taxed splittable contributions ie personal non-concessional contributions can't be split.

Where an individual earns above $250,000 p.a. in 2017-18 an extra Div 293 tax of an addition 15% applies (ie 30% in total) on superannuation concessional contributions.

From 01/07/2017 the Low Income Superannuation Tax offset will essentially refund for a low income earner ($37,000 or less adjusted taxable income) the tax paid on that individual's concessional contributions to a maximum of $500 p.a.

## B3. NON-CONCESSIONAL CONTRIBUTIONS

In 2017-18 an annual limit of $100,000 applies. For those people under the age of 65 it is possible to bring forward 2 years to make a 3 year limit of $300,000. For those above age 65, the $100,000 cap applies but without the ability to bring forward 2 subsequent years. The work test must be met for those older than age 65.

Tax at 46.5% is imposed on non-concessional contributions above these annual limits. Members may pay the tax from the super account. Non-concessional contributions can't be made where total balances are above $1.6m. The bring-forward can only be used to the extent that the $1.6m balance cap is not exceeded.

## B4. CONCESSIONAL CONTRIBUTIONS

The concessional contribution cap for 2017-18 is $25,000 (indexed) irrespective of age. From 01/07/2018 individuals will have the ability to make catch-up concessional contributions where their total superannuation balance was less than $500,000 as of 30 June in the previous financial year.

An additional tax of 32% is imposed on contributions above the cap bringing the total impost up to the top marginal cap. The excess counts towards the non-concessional cap and so a double excess tax impost is possible if both caps are exceeded.

Self employed persons can claim the same tax deductions for superannuation contributions. Less than 10% of such person's assessable income and reportable fringe benefits must be employment as an employee.

Rollover of superannuation benefits and transfers from an overseas fund do not fall under these provisions. Nor do family law splits.

Most of the tax-deductible contributions are paid in accordance with industrial awards or superannuation guarantee (SG) provisions. The SG scheme requires all employers to provide a minimum 9.5% support in 2017-18 (with limited exceptions) of ordinary times earnings. Most items are included in the definition of ordinary times earnings, except overtime payments and a reimbursement of expenses. The SG arrangement does not include: employees under 18 years of age and employed part time; where an employee is paid less than $450 p.m.; domestic work for not more than 30 hours per week. The SG rates will rise in 0.5% steps to 12.0% from July 2025. The SG contributions must be made with 28 days on the end of the relevant quarter. SG is not required on earnings above $57,620 per quarter for the 2016-17 year.

**B5. CO-CONTRIBUTION FOR LOW INCOME EARNERS**

Co-contributions are non-concessional contributions that don't count towards either contribution cap. The government contributes $500 if an employee with an income of less than $36,021 in 2016-17 makes $1,000 or more in personal contributions. The co-contribution is reduced by 3.333 cents for each dollar above $36,021. It is also lower if the personal contributions are less than $1,000.

The definition of "*total income*" is now annual tax assessable income plus annual reportable fringe benefits plus salary sacrifice super contributions.

## C. BENEFIT PAYMENTS

Most benefits are subject to preservation rules and can only be paid once a condition of release is met. This section will not consider in depth unfunded arrangements such as those enjoyed by many public servants, or where the benefits have an untaxed element in the taxable component.

**C1. PRESERVATION**

While a member is alive (since 10/05/2006) they are able to leave their benefits in a superannuation fund indefinitely. Preservation refers to the legislative requirement to leave most superannuation benefits in a fund until a condition of release is met. The preservation age varies by date of birth as follows:

| Date of Birth | Preservation Age |
|---|---|
| Before 01/07/1960 | 55 |
| 01/07/1960 – 30/06/1961 | 56 |
| 01/07/1961 – 30/06/1962 | 57 |
| 01/07/1962 – 30/06/1963 | 58 |
| 01/07/1963 – 30/06/1964 | 59 |
| After 30/06/1964 | 60 |

There are some pre 01/07/1999 monies that can be accessed prior to preservation.

**C2. ACCESS OF BENEFITS BEFORE RETIREMENT**

Subject to strict rules, benefits on compassionate grounds, severe financial hardship, or because of permanent incapacity can be accessed before retirement.

Transition to retirement pensions (but not lump sums) can be paid after preservation age and before a condition of release has been satisfied. No more than 10% of the account balance can be withdrawn in a single year. These measures were introduced from 01/07/2005 to allow a gradual implementation of retirement, however, they are used mainly for tax efficiency structuring. From 01/07/2017 there are no tax-free investment earnings on assets backing a TTR pension. This reduces the attraction of this strategy.

Since 01/07/2007 a benefit may be paid to a person of any age tax free if they have a terminal illness.

## C3. TAXATION OF BENEFITS

From 01/07/2007 a superannuation benefit has the following:

- A tax free component;
- A taxable component which may include:
  - An element taxed in the fund; and/or
  - An element untaxed in the fund.
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The tax free component is made up of the non-concessional contributions without interest in accumulation mode. The balance is taxable. The untaxed element is usually from *Pay As You Go* public sector benefits, but is also relevant for the future service part of an insurance payment.

The tax payable (Medicare levy of 2% is also payable on above zero tax rates) for the 2016-17 year is:

| **Age When Benefit Received** | **Superannuation Lump Sum** | **Superannuation Pension** |
|---|---|---|
| Age 60 and above | Tax Free | Tax Free |
| Preservation age to 59 | 0% up to $195,000 - then 15% | Marginal tax rate but with a 15% tax offset |
| Below Preservation Age | 20% | Marginal tax rate but no tax offset (other than disability pensions) |

The tax offset is 15% of the pension arising from the taxed source.

## C4. PENSION PAYMENT RULES

Account based pensions must pay a minimum amount at least once a year. There is no maximum. The minimum payment (pro rata in first year) is:

| Age | Minimum Payment Percentage |
|---|---|
| Under age 65 | 4% |
| 65-74 | 5% |
| 75-79 | 6% |
| 80-84 | 7% |
| 85-89 | 9% |
| 90-95 | 11% |
| 95 or more | 14% |

SMSFs are no longer allowed to pay a defined benefit pension. The maximum amount that can be transferred to a tax-free income stream is limited to $1.6m from 01/07/2017. Earnings on the transferred balance don't count towards the $1.6m cap. Assets above $1.6m at 01/07/2017 must either be transferred back to accumulation phase or withdrawn. The cost base will be reset.

## C5. DEATH BENEFITS

A lump sum super death benefit paid to a dependant of the deceased is tax free. A non-dependant is only entitled to a lump sum benefit. Tax at 15% is payable on the taxed component.

A pension can only be payable to dependants on death. The tax payable is as follows:

| Age of Deceased at Time of Death | Age of the Recipient | Tax Treatment |
|---|---|---|
| 60 or above | Any Age | Tax Free |
| Below age 60 | Above Age 60 | Tax Free |
| Below age 60 | Below Age 60 | Income arising from the taxable component taxed at marginal rates with 15% tax offset |

The dependant definition was widened from 30/06/2004 to include an interdependent relationship.

A death benefit lump sum previously could be increased by an anti-detriment payment, and recover the extra amount paid by a tax deduction. This represents tax paid on contributions since 01/07/1998. This ceases from 01/07/2017.

## D. MISCELLANEOUS

Superannuation assets exceeded $2,146 billion at the end of the September 2016 quarter. A summary note like this can only hope to cover the more important provisions that apply. Superannuation is a very dynamic area with changes and developments being made very frequently.

### D1. CHOICE OF SUPERANNUATION

Since 01/07/2005 most employees have been able to choose which complying fund they wish to receive their SG contributions. There are certain exclusions. Where an election is not made, the contributions are sent to the employer default fund which must be a MySuper fund.

### D2. TAXATION OF FUND EARNINGS

Assessable earnings of a fund consist of investment earnings, realised capital gains and concessional contributions. For capital assets held for more than 12 months, there is a one third capital gains tax discount. The tax rate is 15%.

The tax actually paid is reduced by imputation credits, exempt current pension income and deductible expenses. Non-complying funds and non arms-length income is taxed at the top marginal tax rate.

### D3. INTERNATIONAL TRANSFERS IN

Transfers of retirement monies from many overseas countries often consist of a withdrawal (tax payable in many instances), and a re-contribution subject to caps in Australia. The USA 401K and IRA benefits fall into this category. Exceptions include the UK and NZ. Monies from the UK are transferred fund-to-fund. There is UK Qualifying Registered Overseas Pension Scheme legislation to comply with initially, and for a further 6 full UK tax years in order to avoid UK charges. The growth in the value of the fund since the member became an Australian tax resident is taxed at 15% if the member opts for the tax liability to be paid by the receiving fund. Only SMSFs where all members are older than age 55 can be registered with HMRC as a ROPS.

The Trans Tasman Portability Scheme has been operational for a while. It allows for retirement monies to be moved in either direction with the receiving funds to be a Kiwi Saver and an APRA fund, respectively.

## D4. INTERNATIONAL TRANSFERS OUT

Since 01/07/2002 temporary Australian residents who depart permanently, qualify to receive their accumulated retirement benefits as a Departing Australia Superannuation Payment. The withholding tax rates claw back the tax concessions and are:

- Tax free component – 0%
- Taxable component – 38%
- Untaxed component – 47%

Unclaimed benefits after 6 months from permanent departure are paid to the ATO. The benefits can subsequently be claimed back by the departed member at any time.

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