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2006 Budget Announcements: Outcome of Consultation

After an extensive consultation process, the Treasurer yesterday (5 September 2006) announced that the Government will be proceeding with the proposals to simplify and streamline superannuation as announced in this year's Federal Budget.

As part of this announcement the Treasurer confirmed a number of transitional arrangements would apply to make the transition to the new rules easier. While some of these announcements represent significant changes to the proposals others assist by simply clarifying how the rules are likely to work post 1 July 2007.

To assist you with keeping abreast of these important changes FirstTech have provided a summary of these announcements below:

Undeducted Contribution (UDC) Cap

A transitional cap of $1 million will apply for UDCs made between 10 May 2006 and 30 June 2007. This will allow people who were planning to make a large contribution under the existing rules to do so. This will be available to all individuals eligible to contribute to superannuation in the relevant year and will include any contributions already made during that period.

From 1 July 2007, a cap of $150,000 on UDCs will apply per financial year per person. The ability to make larger contributions of up to $450,000 averaged over a 3 year period will also apply from this date. For example a person under age 65 could make a $450,000 UDC in the 2007/08 financial year and will then be unable to make further UDCs until the 2010/11 financial year. The UDC cap will be maintained at 3 times the concessional deductible contribution limit, which will be indexed by Average Weekly Ordinary Times Earnings (AWOTE).

Also from 1 July 2007, a person who turns 65 will be able to make a $150,000 UDC each financial year provided they satisfy the work test. Those people aged 63 and 64 who contribute $450,000 will not be required to meet the existing work test in the two years after they make the contribution.

Contributions included in the UDC Cap

- The cap will generally apply to all post tax contributions made on behalf of an individual.
- Contributions made directly by a person into their spouse's account to qualify for the spouse contributions rebate will be counted against the receiving spouse's cap.
- Deductible contributions made above the concessional cap will also count towards the UDC cap.
- Transfers from overseas superannuation funds that are not treated as a taxable contribution will be regarded as a UDC and count against the UDC cap.

Exemptions to the UDC Cap

- Proceeds from the sale of assets that qualify for the small business capital gains tax (CGT) exemptions, (ie the 15-year exemption and the $500,000 retirement exemption) up to a lifetime limit of $1 million (indexed).
- Proceeds from a settlement for an injury resulting in permanent disablement.
- The Government co-contribution will not be included in the cap.

Excessive UDC

Contributions in excess of the UDC cap will not be required to be refunded as per the original proposals. Instead, contributions in excess of the UDC cap will be taxed at the top marginal tax rate (MTR) plus Medicare levy. The liability for this tax will be levied on the individual who will nominate a super fund to release monies to pay the liability. The balance of the excess contribution will be able to remain in the fund.

Super funds will be prohibited from accepting contributions in excess of the maximum allowable UDC cap in a year (ie $450,000 for members under 65). The Australian Taxation Office (ATO) will have discretion to reduce the amount of excess contributions subject to tax if a 'genuine inadvertent breach' should arise. Members who make UDCs in excess of the transitional cap of $1 million mentioned above will be able to withdraw these amounts without penalty prior to 1 July 2007.

Currently super funds report UDC amounts to the ATO. The ATO will use this information to determine if a member has exceeded the annual UDC cap.

Deductible contributions
Age based limits on deductible contributions will be abolished. From 1 July 2007, a limit on concessional deductible contributions of $50,000 per person per year will apply and will be taxed at 15%. The $50,000 threshold will be indexed to AWOTE but will only increase once the increase in the indexed amount is greater than $5,000.

Where the ATO identifies that a person's deductible contributions have exceeded $50,000 in a financial year, the amount in excess of $50,000 will be taxed at the top MTR (an additional 31.5% on top of the original 15% paid by the fund). The new threshold will apply per person, irrespective of the number of employers contributing on behalf of the member.

Where a person wishes to claim a deduction for a personal contribution they will need to notify the trustee by the earlier of when they lodge their tax return or the end of the following financial year. After this time the notice will not be permitted to be varied.

Defined benefit schemes
The $50,000 cap will apply to contributions made to funded defined benefit schemes (except constitutionally protected funds which are exempt from tax). 'Notional taxable contributions' (definition to be determined through further consultation) will be added to any other deductible contributions for each employee to determine whether the $50,000 cap has been exceeded.

As of 5 September 2006, transitional arrangements will apply which will allow existing members with notional contributions above the concessional contribution cap to be deemed as having made contributions at the maximum level of the cap for the individual. This arrangement will no longer apply if the scheme amends their rules to increase member benefits.

Administrative arrangements for contributions tax
Super funds (except those that are untaxed) will report to the ATO all taxable contributions (including notional taxable contributions) made by a member. Any additional liability for tax will be levied on the member. The member will be able to elect for their super fund to release monies to pay the tax. The ATO will be able to reduce the amount of excess tax contributions subject to tax in the event of inadvertent breaches of the cap.

Benefits paid to individuals under age 60 (taxed super funds)
Lump sums will have two components - an exempt component and a taxable component.

- The exempt component will be tax free and will include the pre-July 1983 component, the CGT exempt component, the post June 1994 invalidity component, concessional component and UDCs.
- The taxed component will include the current post-June 1983 component and the non-qualifying component) will be tax free up to the low-rate threshold and then taxed at a maximum rate of 15%. The low-rate threshold will be set at $140,000 on 1 July 2007 and indexed to AWOTE in $5,000 amounts.

- Those aged under 55 with this component will be taxed at a maximum rate of 20% when taking a benefit.

Calculating the pre-July 1983 component
Super funds will be required to calculate a pre-July 1983 amount based on the value of benefits as at 30 June 2007. The existing legislative formula is to be used. Super funds will have until 30 June 2008 to calculate this amount. Once this amount is calculated it will become a fixed component that will not change in the future and will form part of the new exempt component.

Importantly, there will be no crystallisation of the pre-July 1983 component of employer ETPs. The pre-July 1983 component will continue to be calculated by the employer upon termination of employment.

Proportional drawdown of benefits
Where a member draws down part of their benefits after 1 July 2007 the benefit will be considered to be made up of both taxable and exempt component with the relevant portions of each reflecting the portions that the components make up of their total super benefit. This appears to imply that taxable component will not be able to be drawn down in isolation from any exempt component or vice versa.

Death Benefits
Lump sum death benefit payments will be tax free if paid to a dependant. The definition of dependant will remain as currently defined in the Tax Act. The taxable component of a lump sum paid to a non-dependant will be taxed at 15% (this is currently the case for the post-June 1983 taxed element).

Death benefits will be able to be paid as a pension to a dependant from the accumulation phase where the member dies before commencing a pension. However, where the pension is paid to a dependant child, the pension will be required to be commuted (tax free) once the child reaches age 25 (unless the child was permanently disabled).

Pensions will not be able to revert or be paid to a non-dependant on death and will have to be paid as a lump sum.

Pension Payments
People will be able to choose the amount they take from their pension each year. A minimum amount will be required to ensure that capital drawn down over time. The minimum annual pension payment amounts are set out below.

Age	% of account balance
55-64	4
65-74	5
75-84	6
85-94	10
95+	14

Commutation of Complying Pensions
'The Government does not intend to increase the ability for people to commute a complying pension.'

Existing Allocated Pensions
Members of existing allocated pensions will be allowed to transfer to the new pension products (that meet the new minimum standards) from 1 July 2007, without the need to commute their existing pension. This will potentially save many people the cost and administrative burden of commuting their existing pension to satisfy the new minimum standards.

Pension Assets Test
The pension assets test taper rate is to be halved from $3.00 to $1.50 for every $1,000 of assets above the relative threshold.

This Government has announced that this reduced taper rate will only apply to the following payments:

- Age and service pensions
- Disability support pensions
- Carer payment
- Wife pension
- Widow B pension
- Bereavement allowance

Employer payments and transitional provisions
The Government has confirmed that the proposals on the treatment and taxation of employer ETPs will be implemented as announced.

However, they have announced transitional provisions for people with Employer ETPs specified in existing employment contracts as at 9 May provided the payment is made by 1 July 2012. Under the transitional arrangements these employer ETPs will be taxed as follows:

ETP amount	Tax
Up to $140,000	15% (30% if under 55)
$140,000 - $1 million	30%
Over $1 million	46.5%

These employer ETPs will also be able to be rolled over to superannuation until 1 July 2012. However, amounts over $1 million will be taxed at 46.5% on rollover. Amounts under $1 million will be treated as a taxable contribution to super but will not count towards the cap on concessional contributions.

Invalidity payments
The Government has confirmed that people suffering permanent disablement will continue to be entitled to a post 94 invalidity component to reduce tax on a lump sum or income stream. The Government has also announced this benefit will be extended to self employed people as well as employees.

Tax File Numbers
In addition to confirming that tax will apply at 46.5% to total contributions in excess of $1,000 where a TFN has not been quoted, the Government has also confirmed that the $1,000 threshold will not apply for accounts opened on or after 1 July 2007.

To minimise the number of accounts impacted by these rules the Government has announced the following:

- funds will not be required to apply the higher tax for accounts where a TFN has not been quoted until 30 June each year – this will give people up to 30 June 2008 to quote their TFN
- the additional tax will be refunded back to the fund where a valid TFN is provided within the period a fund can amend its own assessment – generally 4 years

In addition, where an employee quotes a TFN to an employer for employment purposes it will automatically be taken to have been provided for superannuation purposes. An employer must generally then pass this on to a superannuation fund within 14 days.

TFNs and benefit payments
In accordance with current rules where a person has not quoted their TFN a trustee is required to withhold tax at the top marginal rate on both pre and post component. However under the new arrangements this will only apply to the post (taxable) component as any pre will be included in exempt component and be tax free.

Untaxed schemes
The taxation of lump sum benefits taken from an untaxed fund has been changed and is now as follows:

- people 60 or over – tax of 15% will apply to all payments up to $1 million (up from $700,000) and then taxed at 46.5%
- people age 55 to 59 – tax of 15% will apply for payments up to the low rate threshold ($140,000), 30% over this amount up to $1 million and then at the top marginal rate
- people under age 55 – tax of 30% up to $1 million and then at the top marginal rate

The limit of $1 million will apply on a life time basis to each member of the fund and will be indexed by AWOTE.

The treatment of pensions paid from untaxed schemes remains as previously announced.

All lump sum death benefits paid to a dependant will be tax free. Payments to non-dependants (of any age) of post-June 1983 untaxed element will be taxed at 30% up to $1 million and at the top marginal tax rate above that.

The taxation of death benefit payments as a reversionary pension will depend on the age of the primary and reversionary beneficiary. The rules are broadly similar to the general death benefit rules that apply to taxed funds except that instead of being tax free the application of the 10% offset will depend on the age of the primary pensioner on death.

Like the general rules for taxed funds a pension will not be able to revert to a non-dependant on death. In this situation death benefit payments to non-dependants will have to be made as a lump sum.

Amounts rolled over from an untaxed fund may also have tax withheld at the top marginal rate where the amount rolled over is in excess of $1 million. Amounts under $1 million will be treated as a taxable contribution by the receiving fund.

Self Managed Super Funds

To allow the improved regulation of self managed funds the Government will increase funding to the ATO to carry out compliance activities as well as education campaigns for trustees and auditors. They have also announced the introduction of one single annual return. This form will include the annual regulatory return, tax return and member contribution statement.

The Government has also announced new administrative penalties will be introduced for failure to lodge returns and for making false or misleading statements. The supervisory level will also be increased from $45 to $150 and fringe benefits tax will no longer apply to in-specie employer contributions.

To assist you further FirstTech will soon be releasing an updated version of our 2006 Budget Ready Reckoner. This will allow you to compare the original announcements with where the rules currently stand.

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