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Government passes 'fairer' super changes

The Australian Government has recently passed what it is calling the 'most comprehensive suite of superannuation reforms in a decade.'

The reforms include the introduction of a $1.6 million transfer balance cap, which places a limit on the amount an individual can transfer into the tax-free earnings retirement phase and the introduction of the Low Income Superannuation Tax Offset, which is expected to boost the retirement incomes of around 3.1 million low-income earners.

Under the confirmed changes, which will come into effect 1 July 2017, the cap on concessional (before-tax) contributions will be decreased from $30,000 (for those under the age of 50) or $35,000 (for those aged 50 years old and over) to the flat rate of $25,000 per year.

From 1 July 2018, individuals with less than $500,000 in their superannuation accounts will also be allowed to make 'catch-up' concessional contributions. This is designed to help those with broken work patterns – many of whom are women – better save for their retirement. Previously, this option did not exist for those who had left the workforce.

The tax rate of 15 per cent on concessional contributions for those who earn up to $300,000 and 30 per cent for those who earn income above that amount has also been changed. The new income threshold at which the higher tax rate will start will be $250,000.

The overall changes to concessional contributions are designed to level the playing field and provide more Australians with the opportunity to make full use of their concessional contributions cap.

The new annual cap for non-concessional (after-tax) contributions will be reduced from $180,000 to $100,000, and a new lifetime cap of $1.6 million will be introduced. Individuals under the age of 65 will be able to bring-forward three years of contributions.

The tax offset for spouse contributions will be allowed where the spouse's annual income is less than $40,000. Previously, this offset was only allowed where the recipient's income was less than $13,800.

After 1 July 2017, the tax-free transfer limit for a fund in pension phase will change to $1.6 million for each member. Earnings will also be tax-free for those with pension balances of up to $1.6 million. Any balances above $1.6 million will need to be withdrawn or returned to the accumulation phase. If returned to the accumulation phase the earnings will be subject to 15 per cent tax.

The removal of the '10 per cent rule' will also help ensure a level playing field for access to superannuation tax concessions irrespective of a person's employment situation. According to the Government, this will be of particular help to contractors who also draw income from salary and wages.

KEYPOINT BUSINESS CONSULTANTS

CPA

LEVEL 1
56 NERANG STREET
SOUTHPORT
QLD 4215

TEL (07) 5585 0600
FAX (07) 5571 2777

EMAIL
info@keypointbc.com.au

WEBSITE
www.keypointbc.com.au

PRINCIPALS
Chris Dobbie
Les Dobbie

ASSOCIATE
Reine Clemow

Tax Accountants
Business Advisory
Wealth Planning
Bookkeeping
Superannuation (SMSF)
Business Structuring

ATO releases new Taxation Determination

The ATO has provided further guidance regarding limited recourse borrowing arrangements (LRBAs) and when non-arm's length income (NALI) rules apply to a related party LRBA.

The Tax Office recently released a Taxation Determination (TD 2016/16) and updated its Practical Compliance Guideline (PCG 2016/5) to provide further clarification concerning the circumstances where a self-managed super fund (SMSF) with a related party LRBA would attract a higher marginal tax rate of 47 per cent under NALI provisions.

The ATO will continue to use the "safe harbour" terms for LRBAs set out in PCG 2016/5. The "safe habour" terms are designed as a safety net for SMSF trustees to ensure their LRBAs meet the guidelines.

Limited recourse borrowing arrangements (LRBAs) must be sustainable on normal commercial rates and structured in accordance with the ATO's "safe harbour" guidelines to ensure the NALI provisions (47 per cent tax) do not apply.

Furthermore, the Tax Office will assess whether an arrangement was on arm's length terms by assessing if the SMSF has derived more ordinary or statutory income under the scheme then it might be expected to derive if the parties had been dealing with each other on an arm's length basis.

The ATO will assess what the terms of the borrowing arrangement may have been if the parties were dealing with each other at arm's length (hypothetical borrowing arrangement). It is then necessary to establish whether it is reasonable to conclude that the SMSF could have and would have entered into the hypothetical borrowing arrangement.

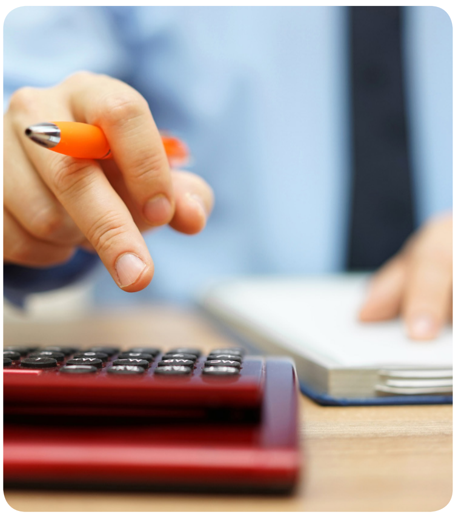
If the SMSF could not have or would not have entered into the hypothetical borrowing arrangement, the SMSF will have derived more ordinary or statutory income under the scheme than under the hypothetical borrowing arrangement. In this instance, the ordinary or statutory income derived is NALI.

SMSF trustees have until 31 January 2017 to ensure they meet the "safe harbour" terms set out in the Practical Compliance Guideline (PCG 2016/5).

Benefits of franking credits

Dividend franking turns 30 in 2017. Despite this, many are unfamiliar with the benefits franking credits can bring, especially to SMSFs.

SMSF trustees who invest in Australian shares can benefit from franking credit refunds which can offset the fund's expenses, such as tax payable. A franking credit, also known as an imputation credit, is the amount of tax paid by a company of the dividend to the SMSF.



Franking credits are particularly beneficial for SMSFs as the maximum tax rate for the fund is 15 per cent, while franking credits can be equal to 30 per cent of the gross dividend - leaving a significant excess to offset any tax payable on the other taxable income earned by the fund.

When the fund is in pension phase, there are even more benefits as the tax rate is reduced to zero per cent. If the franking credits are larger than the SMSFs tax liabilities, the fund will receive a refund for the excess credits.

A company will only distribute franking credits if an SMSF satisfies the holding period rule, where the fund retains the shares "at risk" for at least 45 days excluding the day the fund acquires or sells its shares. This is extended to at least 90 days for some preference shares.

Adding children to a super fund

There are financial benefits to including children in a super fund, such as the increased pool of assets created over time that can allow for a greater diversification of assets.

Parents may also choose to invite their children to join their super fund as it allows them to provide their children with a financial education on how to manage money and appreciate the benefits of super.

However, there are a variety of issues to think about before including children in the super fund.

For example, adding children means the super fund will need to cater to a wider range of ages, which can present challenges for parties that have different needs.

Also, all members of a DIY fund with a corporate trustee are expected to be actively involved directors of the fund. This means that the children will also be expected to be directors of the fund and will, therefore, play an important role in the fund's decision-making.

Although the children may be happy to leave the fund's investment arrangements as they are, will they be in the future when their circumstances may change?

The handling of situations listed above should be mapped out before children are invited to join the super fund to avoid any arguments or confusion.