

Superannuation

One million super opportunities available this financial year only

The 2006/2007 Federal Budget, handed down on 9th May 2006, proposed the most sweeping changes to superannuation since 1994.

The highly publicised reforms included:

- ✂ abolition of Reasonable Benefit Limits (RBLs)
- ✂ tax free benefits if paid to a member 60 years of age or older
- ✂ simplification of the treatment of deductible contributions

...and much more. In order to control potential abuse of this new, very generous superannuation system, the Government is also imposing limits on the amount of post-tax contributions that you can make.

What are 'post-tax' contributions?

These are most commonly known as 'undeducted contributions', so we'll refer to them as that from now on. Undeducted contributions are superannuation contributions made from after-tax savings. No tax deduction is claimed for the contribution, and no tax is deducted from it when it goes into the fund.

From 1 July 2007, each individual will be limited to only \$150,000 of undeducted contributions per year. Those under 65 years old will be able to take advantage of an 'averaging' provision. That is, those aged 64 or less will be able to contribute up to three years' worth of contributions in one year up to, a maximum of \$450,000. If they do this, they won't be able to contribute undeducted contributions for the following two financial years.

For example, if a \$450,000 undeducted contribution is made in June 2008 by a 60 year old, that person would not be able to make an undeducted contribution in the 2008/2009 financial year, or the 2009/2010 year. He or she could contribute again in the 2010/2011 financial year.

What is the benefit of making undeducted contributions?

The main reason for making undeducted contributions is that the maximum tax rate on superannuation fund income or earnings is a concessional 15%. This means that when you make undeducted contributions to a super fund, the earnings and capital gains are taxed at a maximum rate of 15%. If your own tax rate is higher than this, then you would save in tax by investing through super as opposed to investing in your own name.

In fact, often the effective tax rate on a superannuation investment is even lower if you invest in Australian shares that receive franking credits.

Eventually when you retire and access your super, the undeducted contributions are tax free if you receive them as a pension or lump sum. In addition, the earnings can also be paid to you either as a lump sum or pension completely tax free, provided you are 60 or over on receipt.

There are also strategies that you can talk to your tax adviser about to minimise or even eliminate any capital gains tax when the super fund sells the investment.

Let's look at a simple example comparing a five year investment of \$100,000 as an undeducted contribution to super, with the same amount in the same investments, but outside of the superannuation system in the individual's own name.

We will assume that at the end of the five years, the person is over the age of 60.

| Net lump sum value after five years | As undeducted contribution | Invested outside of super |
|-------------------------------------|----------------------------|---------------------------|
| | \$143,897 | \$131,052 |

Assumptions: growth 5%, income 3%, no franking, super fund tax rate 15%, marginal tax rate 46.5%, investor has turned 60 at the end of the period, no capital gains tax paid on sell down of super assets. This is a difference of 9.8% in the net lump sum value over just five years – a relatively short period of time in the context of investment horizons.

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So what's the big opportunity with undeducted contributions?

We've told you about the limits that are coming in next July. Originally these limits were to commence on 10 May this year. However, the Government has taken a step back and allowed a transitional arrangement.

For the period from 10 May 2006 to 30 June 2007, you can make undeducted contributions of up to \$1 million! If you have a partner, that means \$2 million between you!

Anyone under the age of 65 can take advantage of this closing opportunity. Many people over 64 but under 75 can too, but they need to meet a work test to be able to contribute to super.

Who will benefit?

Anyone with over \$150,000 in savings or investments. But here are some ideas:

- ♯ Single Bob is selling his residential investment property, and expects to receive \$800,000 for it. He can contribute the proceeds to super before 30 June 2007. If he waits until after 30 June 2007, he could only get \$450,000 into super.
- ♯ Mr & Mrs Rich are both under 65, retiring and have sold the business they have owned for the last eight years for \$2,500,000. They can each contribute \$1,000,000 to superannuation. The remaining \$500,000 can be contributed to super on 1 July 2007 (max \$450,000 each).

♯ Charles has emigrated to Australia from the UK. The balance in his UK pension fund when he became a resident of Australia was AUD\$900,000. When he transfers it to an Australian fund, that amount is treated as an undeducted contribution and included in the new limits. Charles needs to get the transfer completed before 30 June 2007 in order to get the whole lot across.

♯ Jane is 59, single and is sole beneficiary of her elderly father's estate worth around \$1,500,000. Her father decides to give Jane an early bequest of \$1 million so that she can contribute it to super to provide her with an income stream in her retirement.

It is important that you speak to your financial adviser about the appropriateness of making large undeducted contributions, as other factors need to be considered that we haven't addressed here, such as preservation. There are also some exemptions to the limit, such as selling small business assets owned for 15 years or more, and proceeds from settlements for injury resulting in permanent disablement. Superannuation is set to become a simple, tax effective savings vehicle, and you have until the end of the financial year to make the best of a closing opportunity. If you are selling an investment property or business assets, receiving an inheritance or just have some savings to invest, contact your financial planner to discuss how you can take advantage of the new rules.