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Don't Pay Too Much Tax

I understand that we all need to pay our fair share of tax. I absolutely hate it though when I pay or I see people pay more tax than they need to. I hate it even more when the tax is a penalty tax! I am concerned that if I am seeing a few people who are falling into this trap there will be many others who could also.

The recent superannuation rule changes mean people need to review their circumstances to ensure they do not end up lining the coffers of government.

Recently, I have met with a number of people who were unaware that they were on track to exceeding their superannuation contribution caps by retaining their employer salary sacrifice contributions. This would have lead to them paying an additional 31.5% tax over and above the standard 15% paid when you make this type of contributions and in some circumstances may have had to pay up to 93% tax.

This unwitting mistake can occur due to many different reasons. Some of these are:

- Timing of payments from employer (cut off is 28 July) – A lot of people are unaware that their employer can make quarterly SG payments after the end of financial year.
- Notional amounts for those with defined benefit funds - This catches people because they do not appreciate these notional contributions count also.
- Simply not adjusting down due to the changes in caps (only \$25,000 if you are under 50 now)
- Multiple employers – If you were under 50 years old, had 3 employers and you were earning \$100,000 from each (some doctors can have this problem) you would exceed your cap even if you made no contributions yourself.

Letter from the Tax Man

Earlier this year the Australian Taxation Office sent letters to approximately 24,000 Australians advising that, according to Tax Office records, those receiving the letter may have either made, or had made on their behalf, superannuation contributions that exceeded the relevant contribution caps.

Just to recap, effective from 1st July 2007, the Government introduced new limits on the amounts that could be contributed to a superannuation fund without incurring a tax penalty. The limit applying to concessional (i.e. generally tax deductible) contributions was \$50,000 (\$100,000 for those aged 50 or over). For non-concessional contributions (i.e. personal contributions where a tax deduction is not being claimed), the limit was \$150,000 per financial year, with the capacity for those under 65 to bring forward up to three years contributions.

The letter from the tax man suggested that those taxpayer's receiving the letter should check their contributions made during the relevant period and if the ATO's records appear to be incorrect, an invitation was extended to correct the information. The ATO has found that in some cases, superannuation funds had incorrectly reported contributions, leading to an assumption that an excess contribution may have arisen.

Where a contribution has exceeded the relevant contribution cap, the excess contribution is effectively taxed at a rate of 46.5%. If you have exceeded both caps this amount could be up to 93%.

In certain circumstances the Taxation Commissioner may exercise discretion and agree to either disregard an excess contribution, or have it applied to another financial year. But, in such cases discretion will generally only apply in those cases where the taxpayer had little or no influence over the payment of the contribution (such as the timing of contributions made by their employer). It appears that the ATO will not be sympathetic where a taxpayer simply didn't understand the limits applying to contributions!

The Government announced, in their 2009 Budget, the cap, or limit, on concessional contributions for the financial year commencing 1st July 2009 (and beyond) would be halved. This will significantly reduce the amount of tax deductible contributions that can be made in the future, particularly for self employee people, and those making contributions under a salary sacrifice arrangement.

Non-concessional contribution limits remain unaltered.

So, for the current financial year (2009/10), the caps applying to superannuation contributions are:

Type of contribution	Age	Contribution cap
Concessional	Under 50	\$25,000
	50 and older	\$50,000
Non-concessional	Under 65 at 1/7/09	\$150,000*, or up to \$450,000* under the 3 year "bring" forward provision
	If 65* or older at 1/7/09	\$150,000

* concessional contributions may be limited to a lesser amount where the three year bring forward provision has been triggered in a previous financial year. If aged 65 or over, a work test must be met in order that concessional contributions can be made

Even the once simple task of making a contribution to a superannuation fund has its complexity. Once excessive contributions have been made, there is a very limited opportunity to undo the transaction. It is therefore increasingly important to seek appropriate advice before making contributions to a superannuation fund.

Time to Review Salary Sacrifice Arrangements

The halving of concessional (i.e. tax deductible) contribution caps from 1st July 2009 has had far reaching ramifications for many higher income earning Australians looking to maximise their retirement nest egg.

While the topic has been covered previously in the pages of Timely Tips, to recap, prior to 1st July 2009, a person under 50 years of age could make concessional contributions of up to \$50,000 pa and someone aged 50 or over, could contribute up to \$100,000 pa.

In the Federal Budget in May 2009, it was announced that these caps would be reduced to \$25,000 and \$50,000 respectively from the start of the 2009/10 financial year. The consequence of exceeding the concessional contribution cap will see the excess contribution taxed at a rate of 31.5%. This is additional to the 15% tax already paid on the contribution by the super fund to which the contribution was made.

Concessional contributions include those contributions to which a tax deduction attaches. These will include employer contributions (both the 9% super guarantee contribution and any additional employer contributions such as those made under a salary sacrifice arrangement). Furthermore, self-employed and substantially self-employed people are generally able to claim a tax deduction for personal contributions. In addition, a person who is under 65 years of age and is not engaged in any form of employment activity may also claim a tax deduction for personal contributions under the rules that apply to substantially self-employed people.

A substantially self-employed person is someone who derives income in part from an employment arrangement, and in part from other sources; be it – self employment, investments, trust distributions and even pension and social security payments.

Where the income from employment is less than 10% of a taxpayers total income, they are regarded as being substantially self-employed and, as such, are eligible to claim a tax deduction for any personal contributions they may make to a superannuation fund.

It has been a common strategy for people who derived income from a number of different sources, to reduce the employment component of their income to below this 10% limit in order to claim a tax deduction for their personal super contributions.

One very popular way of reducing employment income was to enter into a salary sacrifice arrangement with an employer whereby all or a part of the “employment income” was contributed by the employer to a superannuation fund on behalf of their employee. Salary sacrificed superannuation contributions were excluded from the definition of income for purposes of determining the 10% limit.

What has changed?

However, from 1st July 2009, the definition of “income” used to determine the 10% test has changed.

Income for this purpose now includes “reportable employer superannuation contributions” (i.e. salary sacrificed contributions).

For the 2009/10 financial year and beyond, in order to be eligible to claim a tax deduction for personal superannuation contributions, less than 10% of a person’s assessable income, plus reportable fringe benefits, plus net investment losses, plus **reportable employer superannuation contributions** can be derived from employment.

This means any salary sacrificed superannuation contributions will now be added back to income for purposes of determining eligibility to claim a tax deduction for personal contributions.

For those readers that have previously participated in a sacrificed salary to superannuation in order to claim a tax deduction for personal superannuation contributions, you may be affected by this most recent change.

It is important for any previous arrangement to be reviewed as a matter of some urgency so as to ensure an unintended tax liability does not arise.

Superannuation continues to be a highly effective structure for building wealth for retirement. However, recent changes may require some fine tuning of current arrangements.

Source: Professional Investment Services – July 2009

Case study

- Michael is aged 47
- Earns salary of \$100,000 pa
- Receives employer 9% SG contributions (\$9,000)
- Wants to retire in 15 years
- Has no debt
- Had planned to make salary sacrifice contributions of \$20,000 pa from 1/7/2009

	Before Budget	After Budget
CC Cap under 50	\$50,000	\$25,000
Less SG contributions at 9%	<u>\$9,000</u>	<u>\$9,000</u>
Amount still available within cap	\$41,000	\$16,000
Amount he’d like to salary sacrifice	\$20,000	\$20,000

Michael should make only \$16,000 of salary sacrifice contributions and contribute the \$4,000 after tax amount (\$2,420) as an after tax or non-concessional contribution.

Case study 2

- Suzie is aged 50
- Earns salary of \$100,000 pa
- Wants to retire in 10 years
- Has home loan of \$120,000
- Making min. P&I repayment of \$1,393 per month over 10 year term
- Wants to make salary sacrifice super contributions
- Has no spare cashflow

So what can she do?

Suzie could consider converting her home loan to an interest only loan which would free up over \$690 per month of after tax money. This equates to \$1,146 per month pre tax or \$13,752 per year that can be used to contribute to super.

Doing this would mean she accumulates over \$173,000 in super. She would be able to cash out in 10 years time and repay the loan of \$120,000 leaving her \$53,000 better off.

There are important issues to consider with every situation and some of these are:

- Results will depend on range of factors, including:
 - Marginal tax rate
 - Loan interest rate
 - Investment returns from super
 - Time horizon
- Risk - Government could change rules
- May pay lump sum tax if you withdraw before age 60 (first \$145,000 indexed to AWOTE tax free)

Key message is to seek advice relevant to your own personal circumstances.

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