

# RodneyGibson

## FINANCIAL SERVICES PTY LTD

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## 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 | Associated Advisory Practices

## Did you know?

Australia has the world’s 7<sup>th</sup> highest life expectancy. The overall life expectancy from birth is 81.73 years. The country/region with the highest life expectancy is Macau (84.36 years). Filling the gap between Macau and Australia are Andorra, Japan, Singapore, San Marino, and Hong Kong.

The lowest life expectancy is just 31.99 years in Swasiland.

Source | Wikipedia | CIA World Fact Book | 2009 Estimates

## Holding Life Insurance Inside Super

Ruben and Ruth are in their early 50's and have successfully raised three children who are now out in the world making it on their own. Even though they are looking forward to retirement in the next 10 years or so, Ruben and Ruth still have some debts and see the need for retaining their life insurance cover, at least for some years to come.

Their current death cover was arranged some years ago when household finances were a bit tight. To ease the pressure on the family budget, their insurance adviser arranged for the life insurance to be held through their superannuation fund.



Many Australians like Ruben and Ruth have life insurance through their superannuation fund. In some cases the insurance is deliberately structured this way but in other cases, membership of a superannuation fund may confer life insurance cover.

However, have you considered what happens to the proceeds of a life insurance policy if the member were to

pass away?



As the policy is "owned" by the superannuation fund, the insurance death benefit will be paid to the trustees of the superannuation fund who, in turn will (generally) add it to the deceased member's accumulated superannuation benefits. The total death benefit proceeds will then be paid out by the trustees either as directed by a binding death benefit nomination, or if there is no valid binding death benefit nomination, as the trustees see fit. Death benefits from a superannuation fund must generally be paid to the dependants of the deceased. In certain circumstances a death benefit may be paid to the estate of the deceased. Dependants, for the purpose of paying a superannuation benefit, are defined in superannuation legislation.

When a superannuation death benefit is paid as a lump sum to a "tax" dependant (as defined in the Tax Act) of the deceased, the benefit is tax free in the hands of the beneficiary. However, where a benefit is paid to a non-dependant (for tax purposes), it may be subject to tax. Both the superannuation and the tax legislation define what a dependant is... but the definitions are different!

Let's turn back to Ruben and Ruth.

Some years have passed and Ruben and Ruth have divorced. They are no longer dependants of each other for superannuation purposes. Ruben passes away and the trustees of his superannuation fund direct that his superannuation death benefit (which includes life insurance proceeds) be paid equally to his three adult children. Even though the adult children are dependants for superannuation purposes, unless they are otherwise financially dependent on Ruben at the time of his death, they are not dependants for tax purposes. This means that all or a part of the death benefit they receive will be taxed.

The taxable portion of a superannuation death benefit paid to non-financially dependent adult children will be taxed at a rate of 15% (plus Medicare levy), however, all or part of the portion arising from the life insurance proceeds may be taxed at 30% (plus Medicare levy). This is a significant tax impost where a superannuation death benefit is paid to a non-dependant.

In order to best manage the potential tax consequences of life insurance proceeds held inside super, it is important to have existing arrangements reviewed from time to time. A qualified life insurance adviser can help you through the maze.



Source | Associated Advisory Practices

### Contact your adviser:

Level 2, 54 Amelia Street  
FORTITUDE VALLEY QLD 4006

PO Box 1223  
FORTITUDE VALLEY QLD 4006

Tel: 07 3252 9990

Fax: 07 3257 7366

Email: [admin@rodneygibson.com.au](mailto:admin@rodneygibson.com.au)

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