



CAVENDISH

# TECHNICAL UPDATE

ISSUE #3 - 2011

## PRE 30 JUNE REVIEW

**The Budget is now behind us and 30 June is upon us so it is time to ensure you dot all the i's and cross all the t's as the ATO have little tolerance for those who over contribute and under pay pensions.**

In this bulletin we will review the contribution cap rules and what action can be taken to minimise the impact of over contributing. We also look at the consequence of a SMSF paying insufficient pension or too much "transition to retirement" pension.

### CONTRIBUTION CAPS

As a result of the Government halving the concessional contribution caps, effective 1 July 2009, an incredible number of individuals, estimated to be 70,000, exceeded the cap for the 2009/2010 year. Significantly the majority of these excessive amounts are likely to be small in size but may lead to a substantial tax liability because the excess concessional contributions counts towards the non-concessional cap which in some instances triggers the bring forward provision a year earlier than expected, potentially furthering the tax liability.

### WHAT MIGHT HAVE BEEN

Whilst all attention has been on how many people have exceeded the caps there is another consideration that has been overlooked.

Due to the Government halving the caps, contribution levels have not been indexed since the removal of aged based deduction limits in the 2006/07 Financial Year.

By referencing all other existing Superannuation thresholds, had the Government not halved the caps the current levels would be as follows:

Concessional Cap	\$60,000
Non-concessional cap	\$180,000
3 year bring forward:	\$540,000

It is unlikely that the concessional cap is going to increase until the 2013/14 Financial Year at the earliest, based on the average weekly ordinary times earnings (AWOTE) increases since the introduction of the caps. It would be reasonable to assume a further \$5000 increase would have occurred to the old caps by then.

***"An incredible number of individuals, estimated to be 70,000, exceeded the cap for the 2009/2010 year"***

### AVOIDING AN EXCESS CONTRIBUTION ASSESSMENT

Concessional contributions are employer contributions or personal contributions where a member is entitled to claim a personal tax deduction i.e. substantially self-employed.

Both sources can create excessive tax situations and both provide limited opportunities to rectify the problem.

### IN THIS ISSUE

- **Contribution Caps**
- **What Might Have Been**
- **Avoiding an Excess Contribution Assessment**
- **Employer Contributions**
- **Excess Employer Contributions**
- **No Guarantees**
- **Personal Deductible Contributions**
- **Contribution Reserves (Holding Account)**
- **2011 Budget Announcement**
- **Minimum Pension Requirements**
- **Exempt Pension Income Deduction**
- **ATO Position**
- **Maximum Pension – Transition to Retirement**
- **Underpayment of Pension Strategies**
- **Transition to Retirement Overpayment Strategies**
- **Cheques & Promissory Notes**
- **Pension Summary**

## EMPLOYER CONTRIBUTIONS

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An arm's length employee can do little to ensure that their employer does not over contribute in a year; however if they have entered into a salary sacrifice arrangement it is prudent for the employee to ensure that they know exactly how much is going to be contributed and whether the employer includes the Superannuation Guarantee in the salary sacrificed amount or pays it in addition to this amount. It is these small matters which were previously insignificant that may now have such a detrimental impact.

## EXCESS EMPLOYER CONTRIBUTIONS

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If employer contributions exceed the cap there are only effectively two options available to the member and trustees of the SMSF.

**Option one:** if apparent by June that an employer is going to contribute more than the cap, the trustees may establish a contribution reserve for any contribution made on or after 1 June as this amount can be allocated up to and including 28 July the following Financial Year. The employer still receives a tax deduction in the year the contribution was made, however the contribution is counted against the cap in the year it is allocated. This is not a true "reserve" as the concept of allocating contributions to a reserve account was abolished during the Superannuation Surcharge regime, it is more akin to a holding account.

**Option two:** if the concessional contributions exceed the cap because the employer has made an irregular number of contributions for the year i.e. for deduction purposes. In these instances the member may apply to the Commissioner to reallocate the contribution to another year as this activity is outside the control of the member. The Government recently released a paper dealing with their proposal to retain the \$50,000 concessional cap for members aged 50 or over if their balance was under \$500,000. This proposal was to be effective from 1 July 2012.

The Budget has confirmed that this will proceed and that members aged 50 or over will be entitled to contribute \$25,000 more than the standard concessional cap.

## NO GUARANTEES

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Applying to the Commissioner does not guarantee a contribution will be reallocated or disregarded.

Trustees and members who take things into their own hands and attempt to rectify the situation by some other means, such as refunding contributions or adding members after the event risk scrutiny from the ATO that may result in not only the original tax assessment standing but a number of other SIS contraventions occurring.

## PERSONAL DEDUCTIBLE CONTRIBUTIONS

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An area of significant risk is members making contributions they intend claiming a personal tax deduction on only to find at year end, and often afterwards, they don't have the ability to claim the deduction in its entirety due to insufficient assessable income.

This will not always create an issue as personal contributions

in excess of what is allowed as a deduction will be treated as non-concessional contributions. The issue will arise if the member has made a contribution with the intention of claiming the deduction and subsequently made a non-concessional contribution up to or near the non-concessional cap as well.

Contributions associated with disallowed deductions cannot be returned to the member unless they were made as part of a single contribution that itself exceeded the contribution cap had it not been for the member lodging the 'notice of intention to claim a deduction'.

Compounding this matter is the possibility a member makes a large non-concessional contribution the following year which subsequently exceeds the cap because the bring-forward provision has been triggered earlier than expected.

## CONTRIBUTION RESERVES (HOLDING ACCOUNT)

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The ATO have acknowledged the use of a contribution reserve is a practical means of allocating contributions from one year to the following subject to the contributions being made in June. There is no restriction on whether this reserve applies to concessional or non-concessional contributions, Whilst it is acknowledged that identifying who contributions

are for in the SMSF is a relatively easy task, this practical process is still available.

In addition to being useful in allocating excessive employer contributions, it may also prove a useful tool for members wanting to make personal deductible contributions.

***“The key to using the contribution reserves is that it should not be considered as a retrospective action”***

Making contributions in June provides a safety net if there are any issues that may result in the deduction being disallowed or reduced. The excessive amount can be allocated in the following Financial Year and form part of any bring-forward non-concessional contribution that year.

The key to using the contribution reserves is that it should not be considered as a retrospective action. Amending Financial Statements to move a contribution from one year to another will provide a better than average chance that the Fund will be the subject of an ATO audit issued with a “please explain”.

## **2011 BUDGET ANNOUNCEMENT**

As indicated in our recent Budget Bulletin, the Government have announced that members who exceed the Concessional Cap by an amount not exceeding \$10,000 will be able to withdraw the excess amount and treat it as assessable income to be taxed at marginal tax rates.

Whilst the mechanics of this are unclear what is clear is that this relief, albeit a band-aid approach rather than legitimate relief, will not apply until the 2011/12 Financial Year so anyone who exceeds the cap by the smallest of margin in 2010/11 will suffer the same fate as those in the years since the caps were introduced.

## **MINIMUM PENSION REQUIREMENTS**

It has long been SMSF administrative practice that Trustees who don't pay sufficient pension in a Financial Year raise a liability for the Fund at 30 June to the level of any shortfall and pay the member as soon as possible in the following Financial Year, therefore entitling the Fund to the exempt pension income deduction.

## **EXEMPT PENSION INCOME DEDUCTION**

To be entitled to the exempt pension income deduction a fund is required to satisfy the minimum pension standards as outlined in the SIS Regulations, inclusive of the requirement to pay the pension at least annually.

## **ATO POSITION**

The ATO has stated, via the National Tax Liaison Group – Superannuation Subgroup, that the underpayment of a pension during a Financial Year, whether made up the following year or not, would not satisfy the SIS Regulations which would mean the Fund would not be entitled to the deduction.

This puts a greater onus on Trustees to ensure that they pay the minimum pension.

## **MAXIMUM PENSION – TRANSITION TO RETIREMENT**

Underpayment of pensions is definitely the more common error however the overpayment of a Transition to Retirement or Market Linked Pension has the same impact and this was also highlighted by the ATO.

Trustees paying a Transition to Retirement Pension to a member need to be mindful that the 10% Maximum requirement is inclusive of PAYG Withholding Tax. Often Trustees overlook the withholding tax for the member and pay the 10% as a gross amount. By adding the tax the member has breached the pension standards and penalties may apply.

## **UNDERPAYMENT OF PENSION STRATEGIES**

Where the Trustee has failed to pay sufficient pension for the year but has paid some, it may be possible to commute the pension at an appropriate date that equates to the pension actually paid. Whilst this would result in the Fund not receiving the tax exemption for the entire year it would at least provide a part year exemption and depending on the tax liability of the Fund could save a reasonable amount of tax. Trustees can always recommence a member's pension on or after 1 June giving the Fund an additional amount of exempt pension income.

It would need to be recognised that such activity may incur fees and a cost benefit analysis would need to be done to determine the appropriateness of such a transaction.

## **TRANSITION TO RETIREMENT OVERPAYMENT STRATEGIES**

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The first thing the member needs to do is pay the excessive amount back into the Fund as an overpayment error. If this is not possible then the Fund will need to consider what options are available. Firstly the member may have some unrestricted non-preserved benefits in which case a lump sum may be possible. Alternatively if additional contributions have been paid into the Fund prior to the over-draw, there may be an option to commence an additional pension with contributions and incorporate the extra payment into that pension.

## **CHEQUES AND PROMISSORY NOTES**

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In a recent SMSF Determination, SMSFD 2011/1, the Commissioner has indicated that a pension payment

made via Promissory Note or cheque is "cashed" when the member receives the note or cheque.

This is subject to the Trustee being able to meet its liability and actually pay the member promptly. Effectively this allows a very small window late June and early July for a cheque or Promissory Note to be used to pay a pension.

## **PENSION SUMMARY**

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With the Government's announcement to amend the minimum pension relief from a 50% discount to a 25% discount from 1 July 2011, Trustees need to be cautious and ensure they increase the minimum to meet the Fund's liability.

The payment of a pension is not mandatory but to be entitled to the associated tax benefits the Fund must meet its liability.

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