TAX AND SUPERANNUATION

A paper presented[1] by Michael Bennett for Legalwise Seminar
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Taxation and Superannuation

Introduction

The concessional tax environment within the superannuation system provides significant opportunities for long-term wealth creation through:

1. the compounding effect of significant annual tax savings over the members' working life (compared to the member on higher tax rates deriving that income personally); and

2. specific strategies to reduce or even eliminate tax on gains in the superannuation environment.

The system is geared towards facilitating the ability of individual's to self-fund their retirement (although contribution limits are imposed such that wealth creation over and above the ability to self-fund retirement is actively discouraged, most recently with the introduction of 'Division 293 tax' for those on high incomes).

This paper is separated into 6 parts.

Part I will outlines the taxation of contributions and fund income (including non-arm's length income and segregated current pension assets).

Part II discusses the taxation of superannuation benefits and anti-detriment payments.

Part III outlines the rules surrounding Division 293 tax.

Part IV highlights the utilisation of the small business CGT concessions and the lifetime CGT cap to boost retirement savings outside the ordinary concessional/non-concessional cap limits.

Part V is a reminder to carefully consider the ongoing status of the fund if your clients have a self-managed superannuation fund ("**SMSF**") and relocate overseas.

Part VI discusses the taxation of transfers from overseas pension funds to Australia.

Part I – Taxation of superannuation contributions and fund income

Superannuation contributions

The taxation of superannuation contributions depends on whether the contributions are concessional[2] or non-concessional contributions.[3]

Concessional contributions

A *concessional contribution* is assessable to the fund at the 15% tax rate and generally deductible to the contributor, for example:

1. employer contributions (subject to certain conditions);[4]

[2] See sections 291-25 and 291-165 of the ITAA 1997
[3] See section 292-85 of the ITAA 1997
[4] Section 290-60 of the ITAA 1997

2. certain personal contributions where, amongst other things, the following conditions are satisfied:[5]

   (a) the recipient fund is a complying superannuation fund;[6]

   (b) if you are:[7]

      (i) holding an office or appointment;

      (ii) performing functions or duties; What is

      (iii) engaging in work;

      (iv) doing acts or things, and

   the activities result in you being treated as an employee for the purposes of the *Superannuation Guarantee (Administration) Act* 1992 (assuming that subsection 12(11) of that Act had not been enacted); and

   (c) your assessable income from the above activities (if applicable) is less than 10% of the sum of:[8]

      (i) your assessable income for the income year (disregarding any excess concessional contributions you may have);

      (ii) your reportable fringe benefits for the income year;

      (iii) your reportable employer superannuation contributions for the income year.

Concessional contributions are subject to a contributions cap, which is currently:

1. $30,000 – for those individual under 50 years of age;[9] and

2. $35,000 – for those individuals 50 years of age and over.[10]

Excess concessional contributions

From 1 July 2013, excess concessional contributions are included in an individual's assessable income and taxed at their marginal tax rates together with an interest component.[11] Individuals may then elect to release up to 85% of the excess concessional contributions from their superannuation fund as a credit to cover their personal tax liability.[12]

In addition to the above, excess concessional contributions are also counted towards the non-concessional contributions cap (see below).[13]

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[5] Section 290-150 of the ITAA 1997
[6] Note 1 (above)
[7] Subsection 290-160(1) of the ITAA 1997
[8] Subsection 290-160(2) and (3) of the ITAA 1997
[9] Section 291-20 of the ITAA 1997
[10] Subsection 291-20(1) of the *Income Tax (Transitional Provisions) Act* 1997 ("**TPA**")
[11] Division 291 of the ITAA 1997
[12] Divisions 95, 96 and 97 of Schedule 1 to the *Taxation Administration Act* 1953 ("**TAA**")
[13] Paragraph 292-90(1)(b) of the ITAA 1997

Non-concessional contributions

A *non-concessional contribution* is not assessable to the fund.[14]

Non-concessional contributions are also subject to an annual cap, which is currently $180,000.[15] However, individuals under 65 years of age may take advantage of the 'bring forward rule' to contribute up to 3 years' worth of non-concessional contributions (or currently $540,000) at once without breaching the non-concessional contributions cap.[16]

The consequences of breaching the non-concessional contributions cap is that the individual is taxed at (currently) 49%.[17]

Taxation of fund income

The income of a complying superannuation fund[18] is split into two components:[19]

1. the non-arm's length component; and

2. the low-tax component.

The non-arm's length component is the fund's non-arm's length income less deductions attributable to that income (see below).[20]

The low-tax component is the fund's income other than the non-arm's length component (if any).[21] Note, however, that certain amounts are specifically excluded from the fund's income, such as non-concessional contributions as outlined above.

The low-tax component is taxed at 15%[22] (and capital gains may be entitled to a 33.33% discount reducing the effective tax rate to 10%).[23]

The non-arm's length component is taxed at 45%.[24]

Non-arm's length income

Broadly, an amount of income is non-arm's length income of a complying superannuation fund if:[25]

1. it is *both*:

   (a) derived from a scheme the parties to which were not dealing with each other at arm's length in relation to the scheme; and

[14] Subdivision 295-C of the ITAA 1997
[15] Section 292-85 of the ITAA 1997
[16] Subsections 292-85(3) and (4) of the ITAA 1997
[17] Section 5 of the *Superannuation Excess Non-concessional Contributions Tax) Act* 2007 and section 292-80 of the ITAA 1997
[18] See section 995-1 of the *Income Tax Assessment Act* 1997 ("**ITAA 1997**") and section 45 of the *Superannuation Industry (Supervision) Act* 1993 ("**SIS Act**") as to the definition of a 'complying superannuation fund'
[19] Subsection 295-545 of the ITAA 1997
[20] Subsection 295-545(2) of the ITAA 1997
[21] Subsection 295-545(3) of the ITAA 1997
[22] Paragraph 26(1)(a) of the *Income Tax Rates Act* 1986 ("**ITRA 1986**")
[23] See Subdivision 115-A of the ITAA 1997
[24] Paragraph 26(1)(b) of the ITRA 1986
[25] Subsection 295-550(1) of the ITAA 1997

(b) the amount is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme;

2. if it is *either*:[26]

   (a) a dividend paid to the entity by a private company; or

   (b) ordinary income or statutory income that is reasonably attributable to such a dividend,

   unless the amount is consistent with an arm's length dealing and relevant factors in this regard include:[27]

   (a) the value of shares in the company that are assets of the entity; and

   (b) the cost to the entity of the shares on which the dividend was paid; and

   (c) the rate of that dividend; and

   (d) whether the company has paid a dividend on other shares in the company and, if so, the rate of that dividend; and

   (e) whether the company has issued any shares to the entity in satisfaction of a dividend paid by the company (or part of it) and, if so, the circumstances of the issue; and

   (f) any other relevant matters;

3. income derived by the fund as a beneficiary of a trust other than by virtue of a *fixed entitlement* (see below);

4. income derived by the fund as a beneficiary holding a *fixed entitlement* if:

   (a) the fund acquired the entitlement under a scheme, or the income was derived under a scheme, the parties to which were not dealing with each other at arm's length; and

   (b) the amount of the income is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length.

The Commissioner's views on non-arm's length income are outlined in *Taxation Ruling* TR 2006/7. Although the ruling refers to the previous 'special income' regime, the Commissioner's views as to the operation of the relevant provisions have not changed,[28] although it is important to note that the current regime requires taxpayers to self-assess whether income is non-arm's length whereas previously certain amounts were deemed to be special income (and subject to high tax rates) unless the Commissioner exercised his discretion to treat it otherwise.[29]

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[26] Subsection 295-550(2) of the ITAA 1997
[27] Subsection 295-550(3) of the ITAA 1997
28 See Explanatory Memorandum to the Tax Laws Amendment (Simplified Superannuation) Bill 2006 (Cth) at paragraph 3.14
29 See *Darrelan Pty Ltd (trustee if the Henfam Superannuation Fund) v FCT* [2010] FCAFC 35 – no single factor decisive, rate of dividend

What is a 'fixed entitlement'?

There has been much confusion surrounding the meaning of the phrase, 'fixed entitlement' in the context of the non-arm's length income rules.

The problem centres on the fact that the term, 'fixed entitlement' is defined in Schedule 2F of the *Income Tax Assessment Act* 1936 ("**ITAA 1936**") but that definition appears to have a limited application to that particular Schedule.

The Commissioner accepts that the term, 'fixed entitlement' for present purposes was separate and distinct to that which applies for the purposes of Schedule 2F of the ITAA 1936 as follows:[30]

> "The term 'fixed entitlement' is not defined for the purposes of section 273. The meaning to be ascribed to these terms must therefore be determined according to the ordinary meaning of the words having regard to the context in which they appear.
>
> When inserting subsections 273(6) to (8), Parliament sought to distinguish between investment returns on 'fixed entitlements' in 'unit trusts' and distributions made to persons as beneficiaries of 'discretionary trusts' resulting from the exercise of discretions. Parliament considered it appropriate that the latter should be treated as special income taxed at the non-concessional rate whereas the former should only be treated as special income if the acquisition of the fixed entitlement or the derivation of the income failed to satisfy an arm's length test.
>
> Having regard to the statutory context, it is considered that the composite expression 'income derived....by virtue of a fixed entitlement to the income' is designed to test whether an amount of trust income that had been included in the assessable income of a superannuation entity under subsection 97(1) was included because the entity had an interest in the income of the trust that was, at the very least, vested in interest, if not in possession, immediately before the amount was derived by the trustee."

As outlined above, other than the change to a self-assessment model, the replacement of the 'special income' regime with the 'non-arm's length income' regime did not involve a change in underlying policy or legislative operation other than moving to a self-assessment model.

However, if the term, 'fixed entitlement' for present purposes is covered by the definition in Schedule 2F of the ITAA 1936 the move to self-assessment model would be largely defeated. That is, the Commissioner has discretion to deem a fixed entitlement under Schedule 2F of the ITAA 1936 where:

1. a beneficiary with an interest in a share of income that the trust derives from time to time, or of the capital of a trust, does not have a fixed entitlement to the share; and

2. the Commissioner considers that the beneficiary should be treated as having the fixed entitlement, having regard to:

   (a) the circumstances in which the entitlement is capable of not vesting or the defeasance can happen; and

   (b) the likelihood of the entitlement not vesting or the defeasance happening; and

relevant.

30 See TR 2006/7 at paragraphs 206-208

(c) the nature of the trust;

the beneficiary has the fixed entitlement.

The Commissioner's discretion is intended to provide for circumstances where, despite the trust not technically meeting the requirements to be a 'fixed entitlement', the likelihood of the beneficiary's vested interest being defeated is low, and it would be unreasonable in the context of the statutory scheme to treat the beneficiary's interest as not constituting a 'fixed entitlement'.[31]

Further, in the Trust Consultation Sub-Group Issues Register, the Commissioner states in this regard:[32]

> "For unlisted unit trusts (including those that are not registered managed investment schemes for the purposes of the *Corporations Act* 2001) with a single class of units on issue, it would generally be expected that the Commissioner would exercise the discretion on a year by year basis or for a certain point in time (depending on the relevant legislative provision) provided that, for the relevant year of income:
>
> (a) any issue or redemption of units was actually done at a price determined on the basis of the net asset value at the time of the redemption or issue (that is, the price does not necessarily have to equate precisely to the net asset value, provided that the deviation from that value does not unduly favour or prejudice particular unit holders, is done in the best interests of all unit holders, complies with any relevant ASIC relief, and the Commissioner considers the extent of the deviation to be reasonable in all the circumstances); and
>
> (b) no amendments have been made to the trust's constitution that have had the effect of significantly defeasing a beneficiary's interest in the income or capital of the trust."

Returning to the non-arm's length income rule, the policy intent of moving to a self-assessment model would be significantly undermined by adopting the position that a fixed entitlement for present purposes was defined by reference to the meaning of that term under Schedule 2F of the ITAA 1936 as taxpayers would have to approach the Commissioner for the exercise of his discretion to treat a trust interest as a fixed entitlement which is not administratively distinguishable to approaching the Commissioner to treat special income as *ordinary* income under the former regime.

However, in *The Trustee for MH Ghali Superannuation Fund v FCT* ("***Ghali***"),[33] Egon Fice SM held that the term was defined in Schedule 2F of the ITAA 1936 and covered the meaning of that term for the purposes of the (former) special income rules.

In his Decision Impact Statement ("**DIS**") on *Ghali*, the Commissioner concluded:

> "The Tribunal considered that 'fixed entitlement' in s 273 takes the meaning provided in s 272-5 in Schedule 2F to the ITAA36. This is contrary to, and would be less favourable to taxpayers than, the Commissioner's existing approach."

And further:

[31] See Explanatory Memorandum to the Tax Laws Amendment (Trust Loss and Other Deductions) Bill 1997 at paragraph 13.13

[32] See https://www.ato.gov.au/General/Consultation/In-detail/Technical-and-special-purpose-working-groups---minutes/Trust-Reform-and-Compliance-Working-Group/Trust-Consultation-Sub-group-issues-register/ (accessed 16 January 2016)

[33] [2012] AATA 527

> "Section 272-5 of Schedule 2F provides that if a beneficiary has a vested and indefeasible interest in a share of income of a trust that the trust derives from time to time, the beneficiary has a fixed entitlement to that share of income. The Tribunal made some observations regarding the nature of that test which are discussed further below. Because of the way the case was argued, the Tribunal did not have the benefit of submissions on the way in which the test operates including relevant case law."

And finally:

> "In light of recent authority, it might be said that the fixed entitlement test in Schedule 2F is relatively difficult to satisfy. See, for example, *Colonial First State Investments Ltd v. FCT* , and the Commissioner's Decision Impact Statement in respect of that case. Having regard to the strictness of that test, the Commissioner perceives that the adoption of the Schedule 2F definition for the purposes of s 273 (or its successor, s 295-550) would give rise to adverse and unintended impacts on superannuation funds that hold arm's length trust investments.
>
> The Commissioner proposes to adhere to his existing view that the Schedule 2F definition is inapplicable for the purposes of s 273. Although not considered by the Tribunal, we note that the Commissioner's view is that the Schedule 2F definition also does not apply for the purposes of s 295-550: see TR 2006/7 and the minutes to NTLG Superannuation Subcommittee meeting of March 2010."

Despite the Commissioner's public views on *Ghali* in his DIS, in Private Ruling 1012585947911, the Commissioner ruled that an amount was non-arm's length income applying the definition of a fixed entitlement under Schedule 2F of the ITAA 1936 (that is, the complete opposite to what was publicly stated!).

The writer does note that Private Rulings are not binding other than in relation to the particular rulee and the Private Binding Rulings Register does contain unfavourable rulings from which taxpayers may have successfully objected.

However, the critical point is that advisers would be loath to advise on the operation of these provisions in the absence of extraordinarily rigid trust deed or a successful Private Ruling, whether in relation to:

1. the meaning of 'fixed entitlement' for present purposes falling outside the scope of the definition in Schedule 2F of the ITAA 1936; or

2. if the Commissioner seeks to rely on *Ghali* – the exercise of his discretion to treat the relevant interest as a fixed entitlement.

Segregated current pension assets

Complying superannuation funds are generally taxed at 15% (except non-arm's length income). In addition, the trustee of a complying superannuation fund will be able to apply a 33.33% discount to the gross capital gain where:[34]

1. the CGT event giving rise to the gain occurred after 11:45am (ACT time) on 21 September 1999; and

[34] Section 115-5 of the ITAA 1997

2. the gain was determined without indexation; and

3. the CGT asset was held for at least 12 months prior to the CGT event.

In this scenario, the effective tax rate on capital gains is 10% (15% x [1-0.3333]).

However, where an asset of a complying superannuation fund is used to satisfy pension obligations (known as a segregated current pension asset), the income and capital gains generated by the asset is exempt (although a carve out for non-arm's length income applies).[35]

An asset is a segregated current pension asset if:[36]

1. both of the following apply:

   (a) the assets are invested, held in reserve or otherwise dealt with at that time solely to enable the fund to discharge all or part of its liabilities (contingent or not) in respect of superannuation income stream benefits that are payable by the fund at that time; and

   (b) the trustee of the fund obtains an actuary's certificate before the date for lodgment of the fund's income tax return for the income year to the effect that the assets and the earnings that the actuary expects will be made from them would provide the amount required to discharge in full those liabilities, or that part of those liabilities, as they fall due; or

2. the assets are invested, held in reserve or otherwise being dealt with at that time for the sole purpose of enabling the fund to discharge all or part of its liabilities (contingent or not), as they become due, in respect of superannuation income stream benefits:

   (a) that are payable by the fund at that time; and

   (b) prescribed by the regulations for the purposes of this section.

In the context of capital gains, the use of segregated current pension asset strategies can deliver an additional 10% tax saving which, on long-term capital gains, can deliver very significant tax savings. Consider the following example:

[35] Section 295-385 of the ITAA 1997

[36] Subsection 295-385(3) and (4) of the ITAA 1997

Example

Annabelle is (35) and William is (33) are siblings. Together with their respective spouses, they decide to start an SMSF and purchase an apartment complex in the inner Brisbane suburbs that has re-development potential now and is likely to be rezoned for even higher density in the future.

The purchase price is $2.5m, the SMSF contributes $500k in equity ($2m borrowings) and the property is neutrally geared.

Assume that the property is held until Annabelle is 65 and at that stage it is worth $25m (on account of general market movements over 30 years and rezoning). In the ordinary source, if the property was sold it would have a gross capital gain of $22.5m, a net capital gain $14.99m and CGT payable of $2.25m.

However, if the property was converted to a segregated current pension asset (perhaps as part of Annabelle and William's transition to retirement), the CGT payable on the disposal of the property would be nil!

Part II – Taxation of superannuation benefits and anti-detriment payments

Taxation of superannuation life benefits

In the ordinary course, individuals are able to access their superannuation where they reach:

1. their preservation age *and* actually retire; or

2. 65 (regardless of whether they retire or not).

An individual's preservation age depends on their date of birth, that is:

Date of Birth	Preservation Age
Before 1 July 1960	55
1 July 1960 - 30 June 1961	56
1 July 1961 – 30 June 1962	57
1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
1 July 1964 +	60

The specific tax outcomes depend on a number of variables, including:

1. an individual's age when they seek to access your superannuation;

2. the components of their superannuation member balance (tax-free and taxable components);

3. whether the benefit is by way of lump sum or superannuation income stream; and

4. the amount of the benefit.

As outlined above, a fund is divided up into the tax-free component and the taxable component,[37] that is:

1. the tax-free component is the proportion of the fund consisting of:[38]

   (a) the contributions segment[39] - broadly, non-concessional contributions (contributions from after-tax income of the member that were not taxed to the fund on contribution) made after 30 June 2007; and

   (b) the crystallised segment[40] - part of the fund that is the total of:[41]

      (i) the concessional component;

      (ii) the post-June 1994 invalidity component;

      (iii) the undeducted contributions;

      (iv) the CGT exempt component; and

      (v) the pre-July 1983 component.

2. the taxable component is the portion of the fund that is not tax-free and may include both:[42]

   (a) the 'taxed element'; and

   (b) the 'untaxed element'.

However, the taxable component consists wholly of a taxed element except as specifically provided under the tax law,[43] for example, in relation to superannuation benefits paid by:

1. constitutionally protected funds;[44] or

2. public sector funds that are not constitutionally protected funds.[45]

For those individuals 60 or over:[46]

1. the tax-free component of a superannuation benefit is completely tax-free;

2. in relation to the taxable component:

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[37] Section 307-120 of the ITAA 1997
[38] See section 307-210 of the ITAA 1997
[39] Section 307-220 of the ITAA 1997
[40] Section 307-225 of the ITAA 1997
[41] See subsection 307-225(4) of the ITAA 1997 and subsection 27A(1) of the ITAA 1936 as to the meaning of the relevant terms
[42] Subsection 307-275 of the ITAA 1997
[43] Subsection 307-275(2) of the ITAA 1997
[44] See section 307-280 of the ITAA 1997
[45] See section 307-295 of the ITAA 1997
[46] See sections 301-10, 301-90, 301-95 and 301-100 of the ITAA 1997

(a) the element taxed in the fund is tax-free; and

(b) the element untaxed in the fund is subject to tax at your marginal tax rate, however, if the superannuation benefit is:

(i) an income stream (pension) – a 10% tax offset applies; and

(ii) a lump sum – a tax offset applies to reduce the maximum tax payable to 15%.

The Commissioner summarises the position as follows (again, for those 60 years of age or more):[47]

Superannuation – Taxable Component	Type of Withdrawal	Effective Tax Rate
Taxed element	Income Stream	No tax
	Lump Sum	No Tax
Untaxed element	Income Stream	MTR* – 10% tax offset (+ ML**)
	Lump Sum	Lower of MTR* or 15% (+ ML**)

* MTR = Marginal Tax Rate ** ML = Medicare Levy

Taxation of superannuation death benefits

A superannuation death benefit includes various amounts paid because of the death of an individual.[48]

Again, superannuation benefits are split into taxable and non-taxable (both taxed and untaxed) components.[49]

In relation to superannuation lump sum death benefits:

1. both the tax-free and taxable components are tax-free in the hands of a death benefits dependent;[50]

2. the tax-free component is tax-free in the hands of a non-dependent,[51] however, the taxable component is assessable income taxed at the recipient's marginal tax rate with a tax offset in relation to the element:[52]

   (a) taxed in the fund to pay a maximum 15% (plus Medicare Levy); and

   (b) untaxed in the fund to pay a maximum 30% (plus Medicare Levy).

A death benefits dependent is:[53]

1. the deceased's spouse or former spouse;

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[47] https://www.ato.gov.au/Individuals/Super/In-detail/Withdrawing-and-paying-tax/Withdrawing-your-super-and-paying-tax/?page=3#TAxableOrTaxFreeSuper
[48] Section 307-5 of the ITAA 1997
[49] Note 33 (above)
[50] Section 302-60 of the ITAA 1997
[51] Section 302-140 of the ITAA 1997
[52] Section 302-145 of the ITAA 1997
[53] Section 302-195 of the ITAA 1997

2. a minor child of the deceased;

3. any person with whom the deceased had an interdependency relationship just before they died;[54]

4. any other person who was a dependent of the deceased just before they died.

Note, due to the proportioning rule,[55] it is not possible to effectively *stream* the tax-free component to non-dependents and taxable amounts to death benefits dependents so as to escape tax. For this reasons, strategies may be implemented during the deceased's lifetime to reduce or even eliminate the tax impact on their death, including:

1. re-contribution strategies (to boost the tax-free component within the fund so as to facilitate tax-free lump sum payments to dependents or non-dependents following death);

2. simply withdrawing from the superannuation environment (that is, the individual withdraws their superannuation tax-free during their lifetime and gifts the cash directly during their lifetime or via their estate following their death).

The Commissioner summarises the position as follows:

Taxable Component	Effective Tax Rate
Taxed element	Lower of MTR* or 15% (+ ML**)
Untaxed element	Lower of MTR* or 30% (+ ML**)

* MTR = Marginal Tax Rate ** ML = Medicare Levy

Anti-detriment payments

A complying superannuation fund is not entitled to a tax deduction for the payment of superannuation death benefits.[56] However, a complying superannuation fund may deduct an amount if:[57]

1. it pays a superannuation lump sum death benefit to:

    (a) the trustee of the deceased's estate; or

    (b) an individual who was a:

        (i) spouse;

        (ii) former spouse; or

        (iii) child,

    of the deceased; and

2. it increases the lump sum by an amount (known as the tax saving amount) so that the amount of the lump sum is the amount that the fund could have paid if no tax were

[54] See section 302-200 of the ITAA 1997; reg 302-200.01 of the *Income Tax Assessment Regulations* 1997
[55] Section 307-125 of the ITAA 1997
[56] Section 295-495 of the ITAA 1997
[57] Subsection 295-485(1) of the ITAA 1936

payable on amounts included in assessable income under Subdivision 295-C of the ITAA 1997 and a deduction for that amount (grossed-up to reflect the 15% tax rate on the relevant contributions) is allowed.

Where the actual tax paid by the fund cannot be determined (for example, because the trustee's records do not extend back far enough), the Commissioner accepts the following alternative formula:[58]

$$(0.15*P)/ (R-0.15*P)*C$$

Where:

P = The number of days in component R that occur after 30 June 1988.

R = The total number of days in the service period as defined in section 307-400 of the ITAA 1997 that occur after 30 June 1983.

C = The taxable component of the lump sum calculated under section 307-125 of the ITAA 1997, as if no deduction under subsection 295-485(2) of the ITAA 1997 were allowed, after excluding the actual (if any) insured amount for which deductions have been claimed under section 295-465 or 295-470 of the ITAA 1997.

This amount of the deduction is calculated as follows:[59]

$$\frac{\text{Tax Saving Amount}}{\text{Low tax component rate}}$$

The 'low tax component rate' is the rate of tax imposed on the low tax component of the fund's taxable income for the income year.

In terms of funding an anti-detriment payment, it is common to utilise either:

1. a separate life insurance policy; or

2. a reserve strategy (to build up sufficient funds over time).

Part III – Division 293 tax

From 1 July 2012, individuals with income above the high income threshold of $300,000 are subject to an addition 15% tax on their low tax contributions to superannuation.[60] That is, they are liable to 'Division 293 tax' if they have taxable contributions for an income year.

An individual's taxable contributions for an income year is the lesser of:[61]

1. their low tax contributions (generally their concessional contributions less any excess concessional contributions);[62] and

[58] See ATOID 2007/219; ATOID 2010/5
[59] Subsection 295-485(3) of the ITAA 1997
[60] Section 293-15 of the ITAA 1997
[61] Section 293-20 of the ITAA 1997
[62] Sections 293-25 and 293-30 of the ITAA 1997

2. the amount of the excess above the $300,000 threshold.

The Division 293 tax is payable where the sum of the following exceeds the $300,000 high income threshold:[63]

1. income for surcharge purposes (less reportable superannuation contributions); plus

2. low tax contributions.

In turn, 'income for surcharge purposes' is defined as:[64]

1. taxable income;

2. reportable fringe benefits;

3. reportable superannuation contributions;

4. total net investment losses; *less*

5. any superannuation lump sum amounts entitled to a tax offset.

Please see the following example:[65]

Example

Sabina's income (income for surcharge purposes other than reportable superannuation contributions) is $275,000 for an income year and her low tax contributions are $35,000 for the corresponding financial year. Sabina's combined income and low tax contributions are $310,000, being $275,000 (income for surcharge purposes other than reportable superannuation contributions) plus $35,000 (low tax contributions).

The amount of low tax contributions ($35,000) is greater than the excess of the amount of combined income and low tax contributions over the $300,000 threshold. The excess equals $10,000 ($310,000 less $300,000).

Hence, Sabina's taxable contributions are $10,000 and the extra Division 293 tax payable is $1,500 (ie 15% of $10,000).

Part IV – Small business CGT concessions and boosting retirement savings

Overview and basic conditions for small business CGT relief

Where available, the small business CGT concessions can apply (in addition to the general 50% CGT discount if applicable) to reduce or even eliminate a capital gain.

The basic conditions for small business CGT relief are as follows:[66]

1. a CGT event happens in relation to a CGT asset of yours;[67] and

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[63] Note 60 (above)
[64] Section 995-1 of the ITAA 1997
[65] Explanatory Memorandum to the Tax and Superannuation Laws Amendment (Increased Concessional Contributions Cap and Other
Measures) Bill 2013 at paragraph
[66] Section 152-10 of the ITAA 1997
[67] See section 104-10 of the ITAA 1997

2. but for the small business CGT concessions, the CGT event would have resulted in a capital gain; and

3. at least one of the following applies:

   (a) you are a 'small business entity';[68] or

   (b) you satisfy the 'maximum net asset value test';[69] or
   (c) you satisfy subsection 152-10(1A) of the ITAA 1997 (in relation to passively held assets by connected or affiliated entities of a small business entity); and

   (d) the CGT asset satisfies the active asset test.[70]

What is a small business entity?

An entity is a 'small business entity' if:[71]

1. you carry on business for an income year; and

2. one or both of the following apply:

   (a) you carried on business in the income year before the current year and your aggregated turnover for the previous year was less than $2m; or

   (b) your aggregated turnover for the current year is likely to be less than $2m.

What is aggregated turnover?

Aggregated turnover is the sum of the relevant annual turnovers, being:[72]

1. your annual turnover;

2. the annual turnover of any entity 'connected with' you; and

3. the annual turnover of any entity that is an 'affiliate' of yours.

Annual turnover is the total ordinary income that an entity derives in the income year in the ordinary course of a business.[73]

What is a 'connected entity'?

An entity is connected with another entity if:[74]

1. either entity controls the other; or

2. both entities are controlled by the same third party.

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[68] Section 328-110 of the ITAA 1997
[69] See section 152-15 of the ITAA 1997
[70] See section 152-35 of the ITAA 1997
[71] Section 328-110 of the ITAA 1997
[72] Section 328-115 of the ITAA 1997
[73] Section 328-120 of the ITAA 1997
[74] Section 328-125 of the ITAA 1997

An entity controls a company if they own, or have the right to acquire the ownership of interests in the company carrying the right to at least 40% of voting power.[75]

An entity controls a company if they own, or have the right to acquire beneficial ownership of, equity interests in the company that carry between them the right to receive at least 40% of the voting power of the company.[76]

What is an 'affiliate'?

An individual or company is an affiliate of yours if the individual or company acts, or could reasonably be expected to act, in accordance with your directions or wishes, or in concert with you in relation to the affairs of the business of the individual or company.[77]

What is the maximum net asset value test?

The maximum net asset value test requires that just prior to the relevant CGT event, the particular entity, together with all connected and affiliated entities, have net assets of no more than $6m.

In determining net assets, certain assets are:

1. specifically included although they are not generally deductible for tax purposes (such as provisions for annual leave, long service leave);[78]

2. specifically disregarded, including an individual's main residence, personal used assets, superannuation member balances and life insurance policies.[79]

In addition, not all liabilities that would appear on a balance sheet are liabilities for the purposes of the $6m net asset value test. Rather, only those liabilities that *relate to* relevant assets are included for present purposes.[80]

Further, as to the *timing* of a liability for present purposes, that is, whether an item is a liability *just prior* to the relevant CGT event.[81]

What is the 'active asset test'?

A CGT asset satisfies the active asset test if you have owned it for:

1. 15 years or less and the asset was an active asset for a total *of at least half the period* between acquisition and the relevant CGT event;[82] or

2. more than 15 years and it was an active asset for at least 7.5 years.[83]

Note, the relevant ownership period starts when you acquire the asset and ends at the earlier of:

1. the CGT event; and

[75] Section 328-125(2) of the ITAA 1997
[76] Paragraph 328-125(2)(b) of the ITAA 1997
[77] Section 328-130 of the ITAA 1997
[78] Paragraph 152-20(1)(b) of the ITAA 1997
[79] Paragraph 152-20(2)(b) of the ITAA 1997
[80] See paragraph 152-20(1)(a) of the ITAA 1997; *Bell v FCT* [2012] AATA 45;
[81] See *FCT v Byrne Hotels QLD Pty Ltd* [2011] FCAFC 127
[82] Paragraph 152-35(1)(a) of the ITAA 1997
[83] Paragraph 152-35(1)(b) of the ITAA 1997

2. if the relevant business ceased to be carried on in the 12 months before that time or any longer period the Commissioner allows – the cessation of the business.

What is an 'active asset'?

A CGT asset is an active asset if you own the asset and it is used, or held ready for use, in carrying on business that is carried on by:

1. you;

2. your affiliate; or

3. an entity connected with you.[84]

Despite the above, there is a specific exclusion from the active asset test for assets whose *main use* by you is to derive interest, an annuity, rent, royalties, or foreign exchange gains.[85]

In the context of assets used mainly to derive rent and whether it will ever constitute an active asset for small business CGT purposes, the Commissioner states that where an otherwise passive investment is used by a connected entity in carrying on business it *will* be an active asset for present purposes and gives the following example:[86]

> "Joe owns 100 % of the shares in Smash Repair Co, which carries on a panel beating business. Joe and the company are therefore connected with each other. Joe also owns the business premises and leases them to the company for the conduct of its business.
>
> Although Joe is wholly using the premises to derive rent, Smash Repair Co (a connected entity) is wholly using them in the course of carrying on a business. The premises are therefore not excluded under paragraph 152-40(4)(e) of the ITAA 1997 and are therefore an active asset of Joe's under subparagraph 152-40(1)(a)(iii) of the ITAA 1997."

Therefore, an otherwise passive asset, such as a commercial property leased to an arm's length 3rd party *will not* be an active asset for present purposes, however, where that commercial property is leased to a related party in relation to the carrying on of its business, it may be an active asset in this regard.

What are the small business CGT concessions?

If the basic conditions for small business CGT relief are satisfied, you may be able to apply:

1. the 15-year exemption – which, subject to certain *additional conditions*, provides complete exemption from CGT;

2. the 50% active asset reduction – which operates in addition to the general 50% CGT discount (if applicable, noting that companies are specifically ineligible for the general 50% CGT discount) such that the gross gain is reduced by 75%;

3. the small business retirement concession – which does not actually require the individual to retire and provides a tax shelter up to a lifetime limit of $500,000 *provided*

[84] Section 152-40 of the ITAA 1997
[85] Paragraph 152-40(4)(e) of the ITAA 1997
[86] See Taxation Determination TD 2006/63

that, if the individual is under 55 years old, it is contributed to a complying superannuation fund (if they are 55 years or more they can just keep the cash!); and

4. small business rollover relief – which allows the relevant taxpayer to defer tax on the disposal off the relevant CGT assets if and to the extent that they use the proceeds of the disposal to acquire a replacement active asset.

Interaction with the lifetime CGT cap

As outlined above, contributions are ordinary subject to the concessional or non-concessional contributions caps. However, non-concessional contributions specifically exclude contributions covered by section 292-100 of the ITAA 1997 (up to the lifetime CGT cap).[87]

That is, subject to certain conditions, amounts sheltered from tax by certain small business CGT concessions may be contributed to a complying superannuation fund up to a lifetime CGT cap of $1.395m (for 2016) without being counted towards the ordinary concessional or non-concessional contributions caps.

A contribution is covered by section 292-100 of the ITAA 1997 if:

1. it is made to a complying superannuation fund in respect of an income year; and

2. the requirements in subsection 292-100(2), (4), (7) or (8) of the ITAA 1997 are met; and

3. the choice is made, in accordance with subsection 292-100(9) of the ITAA 1997, to apply this section to an amount that is all or part of the contribution.

The requirements are essentially:

1. in relation to *direct* capital gains in relation to which the 15-year exemption[88] or the small business retirement concession[89] (the latter of which is itself subject to a lifetime cap of $500,000) was claimed – the contribution to the complying superannuation fund was made on or before the later of:

   (a) the day you are required to lodge your return for the relevant income year; and

   (b) 30 days after the day you receive the capital proceeds;

2. in relation to *indirect* capital gains in relation to which the 15-year exemption[90] or the small business retirement concession[91] was claimed:

   (a) just before the CGT event, you were a CGT concession stakeholder of the entity; and

   (b) the entity makes a payment to you within 2 years; and

[87] Paragraph 292-95(2)(c) of the ITAA 1997
[88] Subsection 292-100(2) of the ITAA 1997
[89] Subsection 292-100(7) of the ITAA 1997
[90] Subsection 292-100(4) of the ITAA 1997
[91] Subsection 292-100(8) of the ITAA 1997

(c) the contribution is equal to all or part of your stakeholder's participation percentage of the capital proceeds up to their interest in the exempt amount sheltered from tax by the 15-year exemption or small business retirement concession; and

(d) the contribution to the complying superannuation fund is made within 30 days of the receipt of the payment (outlined in (b) above).

The choice must be made in the approved form and given to the superannuation provider on or before the time when the contribution is made.[92]
Based on the above, provided that the contributions are made within the relevant timeframes, they do not count towards the non-concessional contributions cap and therefore:

1. non-concessional contributions could be made *in addition* to these 'exempt' contributions; and

2. these 'exempt' contributions could be made even if the relevant individual did not satisfy the work test.

Example

Alyssa, Mia and Cooper are unrelated parties that operate a business in NSW via a company ("**Op Co**"). The shares in Op Co are held equally (33.33% each) and the business has been operated for since 1998 (18 years).

Alyssa is 60, Mia is 57 and Cooper is 53 when Op Co receives an offer to acquire its business for $9m. Op Co turns over $5m a year and therefore, it is not a small business entity and the only way to access the small business CGT concessions is to satisfy the $6m net asset value test. With no debt and a $9m proxy valuation (the offer from the arm's length third party purchaser), Op Co cannot satisfy the alternative test either and the shareholders are able to negotiate for the purchase of their shares (using a mixture of the stamp duty the purchaser will save, tax consolidation and duty strategies to isolate risk post-acquisition and a small retention).

The cost base of the shareholder's shares in Op Co is $1 per share and each shareholder holds 25,000 shares ($25,000 cost base each).

Ordinarily, the capital gain would be worked out as follows:

Capital Proceeds	$3,000,000
Cost Base	$ 25,000
Gross Capital Gain	$2,975,000
50% CGT Discount	($1,487,500)
Net capital gain	$1,487,500
Tax on Net Capital Gain	$ 669,375
Net proceeds of sale	$2,330,625

However, assume that Alyssa and Mia satisfy the requirements for the small business 15-year exemption (Cooper is not 55 or permanently incapacitated so cannot satisfy the requirements for the 15-year but does satisfy the small business retirement concession – *which does not require him to actually retire*).

Neither Alyssa nor Mia has made any non-concessional contributions to their respective superannuation funds in the previous 3 years and each of them wish to maximise their superannuation member balances. From their respective capital gains of $2.75m each, Alyssa and Mia may each contribute:

1. $1,395,000 to superannuation *outside the non-concessional contributions limit*;

Example (continued)

In this way, Alyssa and Mia can each boost their retirement savings by $1,935,000 without breaching any contributions caps (and still have over $1,000,000 in cash outside superannuation to celebrate their life's work).

Whilst at 53 years of age, Cooper was ineligible for the 15-year exemption, he could utilise a series of concessions to boost his retirement savings and reduce his effective tax rate on the gain to approximately 3.7%, that is:

Capital Proceeds	$ 3,000,000
Cost Base	$ 25,000
Gross Capital Gain	$2,975,000
50% CGT Discount	($1,487,500)
50% active asset reduction	($743,750)
Small business retirement concessi	($500,000)
Net capital gain	$ 243,750
*Tax on Net Capital Gain**	$ 109,688
Net proceeds of sale	$ 2,890,312

In addition to the $500,000 contribution required by the small business retirement concession (which is not counted towards his contributions caps), Cooper may make non-concessional contributions of up to $540,000 utilising the bring-forward rule to boost his retirement savings by over $1,000,000 without breaching contribution caps!

Although this paper focusses on superannuation issues, practitioners should be aware that the legal personal representative of a deceased or a beneficiary of the deceased's estate may access the small business CGT concessions (to reduce or eliminate CGT on the disposal of an active CGT asset) if the deceased would have been able to access those concessions immediately before their death provided that the CGT event occurs within 2 years of the deceased death.[93]

Part V – SMSF members relocating overseas

Overview

SMSFs are a large and growing area of the Australian superannuation landscape. Further, Australia has an increasingly globally mobile workforce.

Together, these two trends are likely to interact going forward, with outbound Australians leaving behind assets in an SMSF.

[93] Section 152-80 of the ITAA 1997

As advisers, part of our role is to anticipate potential problems for our clients. Where an SMSF ceases to be a complying superannuation fund the income and adjusted capital value of the entire fund is subject to tax at 45% (plus levies).[94]

Therefore, it is critical to ensure that departing members take appropriate measures to ensure ongoing complying fund status or simply roll-over to:

1. a small APRA fund;

2. a retail superannuation; or

3. an industry superannuation fund.

What is a complying superannuation fund?

A fund is a complying superannuation fund if:[95]

1. the Regulator has given notice to a trustee of the fund under section 40 of the SIS Act stating that the fund is a complying superannuation fund in relation to the current year of income; or

2. the Regulator has given a notice to a trustee of the fund under section 40 of the SIS Act stating that the fund is a complying superannuation fund in relation to a previous year of income and has not given a notice to a trustee of the fund under that section stating that the fund was not a complying superannuation fund in relation to:

    (a) the current year of income; or

    (b) a year of income that is:

        (i) later than that previous year of income; and

        (ii) earlier than the current year of income.

In turn, in the context of SMSFs, an entity that was an SMSF at all times during an income year is a complying superannuation fund if:[96]

1. either:

    (a) the entity was a resident regulated superannuation fund at all times during the year of income when the entity was in existence; or

    (b) the entity was a resident regulated superannuation fund at all times during the year of income when the entity was in existence other than a time, before it became a resident regulated superannuation fund, when the entity was a resident approved deposit fund; and

[94] Sections 295-320 and 295-325 of the ITAA 1997
[95] Section 995-1 of the ITAA 1997 and section 45 of the SIS Act
[96] Subsection 42A(1) of the SIS Act

2. the entity passes the test in subsection 42A(5) of the SIS Act (that is, the trustee has not contravened any regulatory provisions or, having contravened such provisions the Regulator, after considering the issues, determines that a notice should be given stating that it is a complying superannuation fund.

What is a resident regulated superannuation fund?

Based on the above, one of the conditions for complying superannuation fund status is that the fund is a 'resident regulated superannuation fund'.

In turn, a resident regulated superannuation fund is defined as a regulated superannuation fund that is an 'Australian superannuation fund'.[97]

What is an Australian superannuation fund?

A fund is an 'Australian superannuation fund' at a time if:[98]

1. the fund was established in Australia (or any asset is situated in Australia); and

2. the central management and control of the fund is ordinarily in Australia; and

3. either:

   (a) the fund had no active members; or

   (b) at least 50% of:

      (i) the total market value of the fund's assets were held by active members who are Australian residents; or

      (ii) the sum of the amounts that would be payable to or in respect of active members who are Australian residents in the event that they voluntarily ceased membership.

What is an active member?

A member is an 'active member' if the member is:[99]

1. a contributor to the fund at that time;

2. an individual on whose behalf contributions have been made, other than an individual:

   (a) is a foreign resident; and

   (b) who is not a contributor at that time; and

   (c) for whom contributions made to the fund on the individual's behalf after the individual became a foreign resident are only payments in respect of a time when the individual was an Australian resident.

[97] See section 10 of the SIS Act
[98] Subsection 295-95(2) of the ITAA 1997
[99] Subsection 295-95(3) of the ITAA 1997

What is a contribution?

There is no legislative definition of a 'contribution'.

In ATOID 2012/47, the Commissioner states:

> "The term 'contribution' is not defined in the ITAA 1997 and is therefore given its ordinary meaning, having regard to the context and purpose of the provision in which it appears.
>
> Taxation Ruling TR 2010/1 Income tax: superannuation contributions sets out the Commissioner's view on the ordinary meaning of the word 'contribution' in so far as it is used in relation to a superannuation fund, approved deposit fund or retirement savings account in the ITAA 1997. Paragraph 4 of the Ruling relevantly provides:
>
> In the superannuation context, a 'contribution' is anything of value that increases the capital of the superannuation fund provided by a person whose purpose is to benefit one or more particular members of the fund or all of the members in general."

The ATOID makes it clear that a roll-over superannuation benefit, even if not assessable to the recipient fund, is a contribution, as it would operate to render the member in relation to which to rollover was made an 'active member' for present purposes.

What is 'central management and control'?

With regard to the central management and control condition, the tax law provides that a fund will remain *ordinarily* in Australia at a time even if that central management and control is *temporarily outside* Australia for a period of not more than 2 years.[100]

However, the Commissioner's views as to the meaning of 'temporarily outside Australia' are more limiting than the wording may suggest. That is, in *Taxation Ruling* TR 2008/9 the Commissioner notes:

1. as to the meaning of central management and control:[101]

> "The CM&C of a superannuation fund involves a focus on the who, when and where of the strategic and high level decision making processes and activities of the fund. In the context of the operations of a superannuation fund, the strategic and high level decision making processes includes:
>
> - formulating the investment strategy for the fund;
> - reviewing and updating or varying the fund's investment strategy as well as monitoring and reviewing the performance of the fund's investments;
> - if the fund has reserves - the formulation of a strategy for their prudential management; and
> - determining how the assets of the fund are to be used to fund member benefits.

[100] Subsection 295-95(4) of the ITAA 1997

[101] TR 2008/9 at paragraphs 20-21

> The other principal areas of operation of a superannuation fund that form part of the day-to-day or operational side of the fund's activities will not constitute CM&C. These activities do not form part of the CM&C of the fund because they are not of a strategic or high level nature. Rather, these activities are of a more formalistic or administrative nature. Examples of such activities include the acceptance of contributions that are made on a regular basis, the actual investment of the fund's assets, the fulfilment of administrative duties and the preservation, payment and portability of benefits."

2. with regard to 2 year 'temporary' absence concession:[102]

> "While the CM&C of a fund can be outside Australia for a period greater than 2 years, the period of absence of the CM&C must still be temporary. Furthermore, if the CM&C of the fund is not temporarily outside Australia, it will not be 'ordinarily' in Australia at a time even if the period of absence of the CM&C is 2 years or less.
>
> The CM&C of a fund will be 'temporarily' outside Australia if the person or persons who exercise the CM&C of the fund are outside Australia for a relatively short period of time and during that time they exercise the CM&C of the fund overseas. The duration of the absence must either be defined in advance or related (both in intention and fact) to the fulfilment of a specific, passing purpose. Whether an absence is considered to be temporary involves consideration of questions of degree which must be decided by reference to the circumstances of each particular case.
>
> Whether an absence is temporary must be determined objectively by reference to all the relevant facts and circumstances on a 'real time' basis. That is, it cannot be established in retrospect."

Based on the above, if an individual leaves Australia permanently, or for an indefinite period of time they will not be able to satisfy the *temporary* requirement even if they in fact return to Australia within the 2 year period.

Pre-departure planning options

Unless outbound Australians are able to satisfy the conditions above, their SMSF will not be able to maintain complying superannuation fund status if they cease to be Australian resident for tax purposes. In this regard, individuals may wish to consider:

1. ceasing all contributions going forward (provided that ;

2. rolling over to a small APRA fund;

3. rolling over to a public offer (retail or industry) fund;

3. if a public offer fund is not available because clients wish to retain certain assets (such as direct real property) – rolling over to a small APRA fund (which are required to have an independent trustee);

4. having the trustees (or directors of the corporate trustee) appoint Australian residents to act in that capacity under Powers of Attorney.

[102] TR 2008/9 at paragraphs 32 to 34

The Commissioner's views as to the appointment of Powers of Attorney under this last scenario are outlined in SMSF Ruling 2010/2. Here, the Commissioner notes that a person appointed under Power of Attorney constitutes a legal personal representative of the principal such that the residency requirement (assuming that the Attorney is and remains an Australian resident for tax purposes) will be satisfied.

Note, there are very specific legal requirements for the creation of a valid Power of Attorney.

These requirements must be carefully adhered to and the relevant documents validly created *prior* to a client's departure as if they depart permanently or indefinitely without putting a valid Power of Attorney in place, then the central management and control test may be breached immediately on departure and it is already too late.

Part VI – Transferring foreign pension balances to Australia

Overview

The tax law contains specific rules with regard to the treatment of superannuation benefits received from foreign superannuation funds.[103]

Broadly:

1. a superannuation lump sum an individual receives from a foreign superannuation fund is potentially non-assessable and non-exempt income ("**NANE**");

2. a superannuation lump sum received from a foreign superannuation fund after 6 months of becoming an Australian resident gives rise to income tax on applicable fund earnings (although subject to certain conditions, individuals may elect for a complying superannuation fund to pay the tax.

What is a superannuation fund?

A *superannuation fund* is:[104]

1. an indefinitely continuing fund; and

2. a provident, benefit, superannuation or retirement fund; or

3. a public sector superannuation scheme.

It is clear that where the provision of retirement benefits is but one of a number of possible purposes of the fund (including the simple withdrawal of funds at any time even if subject to economic penalty), it will not be a superannuation or retirement fund.[105]

What is a foreign superannuation fund?

A *foreign superannuation fund* is defined as follows:[106]

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[103] Subdivision 305-B of the ITAA 1997
[104] Section 995-1 of the ITAA 1997 and section 10 of the SIS Act
[105] See *Re Baker and FCT* [2015] AATA 469
[106] Subsection 995-1(1) of the ITAA 1997

1. a superannuation fund is a *foreign superannuation fund* at a time if the fund is not an Australian superannuation fund at that time; and

2. a superannuation fund is a *foreign superannuation fund* for an income year if the fund is not an Australian superannuation fund for the income year.

What is an Australian superannuation fund?

An Australian superannuation fund is defined as follows:[107]

> "A superannuation fund is an *Australian superannuation fund* at a time, and for the income year in which that time occurs, if:
>
> (a) the fund was established in Australia, or any asset of the fund is situated in Australia at that time; and
>
> (b) at that time, the central management and control of the fund is ordinarily in Australia; and
>
> (c) at that time either the fund had no member covered by subsection (3) (an *active member*) or at least 50% of:
>
> (i) the total market value of the fund's assets attributable to superannuation interests held by active members; or
>
> (ii) the sum of the amounts that would be payable to or in respect of active members if they voluntarily ceased to be members;
>
> is attributable to superannuation interests held by active members who are Australian residents."

What are the tax consequences of a lump sum transfer to superannuation?

The tax implications of superannuation lump sum transfers from foreign superannuation funds depend on whether:

1. the transfer occurs within 6 months of the relevant individual becoming an Australian resident, or

2. at any point thereafter.

Transfers within 6 months of becoming an Australian resident

A superannuation lump sum received from a foreign superannuation fund is not assessable income and is not exempt income if:[108]

1. it is received within 6 months of you becoming an Australian resident; and

2. it relates only to a period:

   (a) when you were not an Australian resident; or

[107] Subsection 295-95(2) of the ITAA 1997
[108] Section 305-60 of the ITAA 1997

(b) starting after you became an Australian resident and ending before you receive the payment; and

(c) it does not exceed the amount in the fund that was vested in you when you received the payment.

Note, however, that any non-taxable amount of a superannuation benefit transferred from a foreign fund to an Australian superannuation fund is treated as a non-concessional contribution.[109]

Transfers after 6 months of becoming an Australian resident

An individual that receives a superannuation lump sum from a foreign superannuation fund must include in their assessable income so much of the lump sum as is equal to:[110]

1. their 'applicable fund earnings'; or

2. if the individual has made a choice under section 305-80 of the ITAA 1997 (as to which see below), their applicable fund earnings less the amount covered by the choice.

The assessable portion is subject to tax at the individual's marginal rate of tax, with the remainder NANE.

Where a person becomes an Australian resident after the start of the period to which the lump sum relates (but before they received it) the amount of their 'applicable fund earnings' is worked out as follows:[111]

"(a) work out the total of the following amounts:
   (i) the amount in the fund that was vested in you just before the day (the *start day*) you first became an Australian resident during the period;

   (ii) the part of the payment that is attributable to contributions to the fund made by or in respect of you during the remainder of the period;

   (iii) the part of the payment (if any) that is attributable to amounts transferred into the fund from any other foreign superannuation fund during the remainder of the period;

(b) subtract that total amount from the amount in the fund that was vested in you when the lump sum was paid (before any deduction for foreign tax);

(c) multiply the resulting amount by the proportion of the total days during the period when you were an Australian resident;

(d) add the total of all previously exempt fund earnings (if any) covered by subsections (5) and (6)."

[109] Section 292-90 of the ITAA 1997
[110] Subsection 305-70(2) of the ITAA 1997
[111] Subsection 305-75(3) of the ITAA 1997

An individual can choose to have all or part of their 'applicable fund earnings' included in the assessable income of the complying superannuation plan.[112] However, the choice can only be made if the certain conditions are satisfied,[113] that is:

1. a superannuation lump sum that is paid from a foreign superannuation fund; and

2. the individual is taken to receive the lump sum under section 307-15 of the ITAA 1997; and

3. all of the lump sum is paid into a complying superannuation fund; and

4. immediately after the lump sum is paid into the complying superannuation fund, the individual no longer has a superannuation interest in the foreign superannuation fund.

Further, the choice must be in writing and comply with the requirements (if any) specified in the regulations.[114] However, to date, no regulations have been made for this purpose.

Based on the above, this option is not available for partial transfers from a foreign superannuation fund.

In addition, section 307-15 of the ITAA 1997 states that a payment is treated as being made to you, or received by you, if it is made:

1. for your benefit; or

2. to another person or to an entity at your direction or request.

In this regard, in circumstances where the foreign superannuation fund will only transfer the relevant funds to the member personally, the Commissioner states:[115]

> "It can be seen that section 307-15 of the ITAA 1997 is a deeming provision. It operates to treat payments a person has not directly received as if they had received the payment. Such a section is of no effect where a person actually receives the payment directly.
>
> The note to this section . . . clarifies this by specifically stating that the section applies to payments rolled over, ie made directly, from one superannuation fund to another.
>
> From the above, it is considered that for a person to be able to make an election under section 305-80 of the ITAA 1997 that payment must be paid directly from a foreign superannuation fund into a complying superannuation fund. The payment must be deemed to have been received by the taxpayer in accordance with section 307-15 of the ITAA 1997, and not actually received by that person.
>
> In this case, you will receive the payment directly, as the Fund will not transfer your entitlements directly to your Australian complying superannuation fund. As such, section 307-15 of the ITAA 1997 will not apply to you and you will not satisfy the condition in paragraph 305-80(1)(b) of the ITAA 1997.
>
> The Commissioner does not have a discretion under this legislation to disregard any or all of these conditions."

[112] Subsection 305-80(2) of the ITAA 1997
[113] Subsection 305-80(1) of the ITAA 1997
[114] Subsection 305-80(3) of the ITAA 1997
[115] See Private Ruling 1011555612802

Therefore, where the foreign superannuation fund, whether for administrative or substantive reasons will only make the payment directly to the member, the Commissioner takes the view that the individual cannot contribute the amount to superannuation and elect for the fund to bear the tax under section 305-80 of the ITAA 1997 and one of the conditions for such treatment, being the satisfaction of the deeming provisions in section 307-15 of the ITAA 1997, cannot be satisfied.

What if the foreign fund is not a superannuation fund?

Even if the relevant fund does not fall within the definition of a superannuation fund, Subdivision 305-B of the ITAA 1997 applies if you receive a payment, other than a pension payment, from a scheme for the payment of benefits in the *nature* of superannuation upon retirement or death that:[116]

1. is not, and never has been, an Australian superannuation fund or a foreign superannuation fund; and

2. was not established in Australia; and

3. is not centrally managed and controlled in Australia.

Note, however, that in *Baker v Commissioner of Taxation*,[117] the AAT concluded in the context of a US Individual Retirement Account:[118]

> "While it can readily be accepted that the USA IRA is a method that might be commonly adopted and used to plan and save for retirement income, that such planning and saving is incentivized by means that have their parallels in Australia, that these vehicles and the concessions that are afforded to them if certain behaviors are observed are part of a strategy designed by the USA government to encourage self-provision for and in retirement, the restrictive features required of trusts so as to be superannuation funds for Australian income tax purposes do not accommodate the flexible structures that appear to be promoted in the USA to achieve equivalent purposes in Australia.
>
> It follows that the IRA is not a superannuation fund as defined and therefore is not a foreign superannuation fund within the meaning of s 305-80(1).
>
> The flexibility of monetary withdrawals from an IRA is such that payments in the nature of superannuation payments from it are but one of a number of possibilities which means that the scheme does not qualify as one *for the payment of benefits in the nature of superannuation upon retirement or death within the meaning of s 305-55(2).*"

Based on the above, great care must be taken in determining whether a foreign fund is, or is in the *nature* of, a superannuation fund (to be judged by strict Australian standards) as this will determine whether or not an amount is assessable income or NANE.

[116] Subsection 305-55(2) of the ITAA 1997
[117] Note 104 (above)
[118] At paragraphs 32-34

Conclusion

Superannuation is a large (and growing) part of an individual's overall wealth. Although as tax practitioners we cannot cross the line into giving financial advice:

1. the use of the concessional superannuation environment as a vehicle to build wealth vis-à-vis alternative vehicles such as family trusts;

2. taking advantage of specific, inter-related tax and superannuation exemptions/concessions;
3. the implementation of particular strategies that are concessional even by superannuation standards (such as segregated current pension assets); and

4. the avoidance of triggering non-complying status (e.g. by ensuring that central management control remains in Australia),

all operate to boost after-tax returns and the funds available for clients in retirement or their families on their death.

It is absolutely critical that practitioners are aware of these issues in order to provide value-added strategies for their clients.

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