



July 2004

TECHNICAL UPDATE

A YEAR OF MUCH ACTION AND FURTHER CONFUSION

To coin a phrase “that was the year that was” in superannuation. It is amazing just how much our politicians fiddled with super over the year. A year of change culminated in the Federal Budget on Tuesday 11 May 2004 when the Federal Treasurer, Peter Costello, announced even more changes to superannuation, many of which he didn’t have the political power to implement.

Here is a list of some of the things that were changed over the year:

EXECUTIVE SUMMARY

- Changes to the work test for those over 64;
- Changes to the age related and other eligibility rules to contribute to, and requirements to take benefits from, super;
- Extended Co-contribution arrangements;
- A further reduction in the Surcharge rates;
- Changes to the super portability rules;
- Changes to the tax regime on the transfer of overseas super to Australia;
- The introduction of Market Linked pensions and the slashing of the asset test exemption;
- The passing of the Superannuation Safety Amendment Bill and the introduction of licensing of Trustees;
- The Superannuation (Choice of Fund) Bill is passed, at last;
- Extension of the class of beneficiary who can receive a super death benefit tax free;
- New SG earnings base from 1 July 2008;
- The dropping of the silly requirement for an actuarial certificate for most allocated pensions;
- Preservation of rolled over employer ETPs;
- So called superannuation integrity measures;

Now, most of the above matters would require a three or four page note to fully describe the changes and the reasons for the changes. For the benefit of the reader we try to keep our explanatory comments to a minimum.

A word of warning – these issues are quite technical and we recommend you seek further advice before implementing changes.

CHANGES TO THE WORK TEST

The work test allows people to remain in the workforce and continue to make contributions to a superannuation fund. It applies to people aged 65 to 74. From 1 July 2004 rather than 10 hours work a week it has been changed to 40 hours in a consecutive period of 30 days. Those who meet the test will be able to make contributions for the rest of the financial year.



UNDER AGE 65 – ELIGIBILITY TO CONTRIBUTUTE

From 1 July 2004 all Australians under age 65, whether working or not, can contribute to super and, subject to the comment at the end of this paragraph, claim a tax deduction for those contributions. However, those under age 18 will have to derive eligible employment or business income in order to claim a deduction on their super contributions. Anyone earning more than 10% of income from employment will **not** be eligible to claim a deduction for their super contributions.

75 OR OVER – REQUIRED TO ACCESS SUPER

Those over 75 will be required to access their super. Those who were over 75 on 1 July 2004 will not be affected by this measure.

GOVERNMENT CO-CONTRIBUTIONS

The Co-contributions legislation is designed to encourage additional contributions from “low income earners”.

From 1 July 2004 the Government Co-contribution will be increased from \$1 to \$1.50 for every dollar contributed after tax. The maximum Co-contribution rate applies to those earning up to \$28,000 per annum (i.e. a maximum Co-contribution of \$1,500). It will phase out at a rate of five cents for every dollar earned over \$28,000, cutting out completely on earnings of \$58,000 per annum. Earnings are defined as assessable income plus reportable fringe benefits.

The eligibility rules for receipt of the Co-contributions have also been broadened. To be eligible for the payment of the co-contributions a person must be making after-tax member contributions and earn at least 10% of their income as an employee. This now includes people who earn less than \$450 per month and are not eligible for employer superannuation support. The co-contributions do not attract the 15% contributions tax and are fully preserved.

The Tax Office will compare the information supplied by superannuation funds with individual tax returns to ascertain the Co-contribution entitlement.

REDUCTION IN SUPERANNUATION SURCHARGE

Since August 1996 there has been an additional surcharge (i.e. tax) on employer contributions for so called “high income earners”.

There have been several recent attempts to reduce this. The current legislated reductions in the surcharge are follows:

Financial Year	Maximum Contribution Surcharge Rate
2004/2005	12.5%
2005/2006 onwards	10.0%

For the 2004/05 financial year the Contribution Surcharge is phased in for those employees who have adjusted taxable income in excess of \$99,710 and the full 12.5% Contribution



Surcharge is payable for those employees who have taxable income in excess of \$121,075 (these thresholds are indexed each year).

SUPER PORTABILITY

Subject to limited exceptions, from 1 July 2004 trustees must roll over super benefits from inactive accounts at the request of the member. An inactive account is one where an employer contribution has not been received within the last six months. The request to roll over must be actioned by the trustee as soon as practical after the request but no later than 90 days after all relevant information is received.

Trustees will not be required to meet a partial roll over request if that would mean that the balance of the account will fall below \$5,000 and can refuse a request if a previous partial roll over had been requested in the last 12 months.

The portability regime will apply to regulated super funds and approved deposit funds but not to unfunded public sector schemes, self managed funds and the defined benefit component in an employer sponsored arrangement.

TAXING SUPER FROM OVERSEAS

Previous to 1 July 2004, if an individual transferred his or her overseas super benefit to an Australian complying fund and the payment was made within six months of the individual becoming an Australian resident then the payment was not taxable under Australian law. The whole amount was treated as an undeducted contribution. However, the increase in the overseas benefit during the time the person becomes an Australian tax resident to the date of transfer of the benefit was a taxable amount to be declared in the individual's tax return.

From 1 July 2004 the individual can elect to have this increase, if any, treated as a taxable contribution and the receiving fund will then pay tax on the increase at the rate of 15% (rather than the individual's marginal tax rate). However, if this election is made, the increase in benefit will be treated as pre/post '83 component instead of being entirely undeducted.

MARKET LINKED PENSIONS

A new market-linked income stream product becomes available from 20 September 2004. This product should provide a less complicated and more flexible option for retirees wanting a complying income stream product. The product will be eligible for the higher pension RBLs and qualifies for the new (reduced) 50% Centrelink asset test exemption.

The main features of the new complying market-linked pension are as follows:

General ~ a market-linked income stream combines the investment flexibility of an allocated pension with the tax and social security benefits of a complying pension. All superannuation funds, including self-managed superannuation or "DIY" funds, will be able to provide this income stream.

Concessions ~ As a complying pension, market-linked pensions are eligible for the higher pension reasonable benefit limit of \$1,238,440 and for a 50% asset test exemption.



Flexible term ~ The market-linked pension provides a complying pension with flexibility over the term. A person will be able to choose a term between their life expectancy and their life expectancy if they were five years younger. The term can also be based on the spouse's life expectancy (or the spouse's life expectancy if they were five years younger). This can substantially extend the term of the pension.

Investment choice ~ Market-linked pensions offer the same investment choice as an allocated pension. There are no specific restrictions on investments, aside from limits on superannuation funds. People who are risk averse can invest in fixed interest assets to provide a stable income stream that resembles a life expectancy pension. Alternatively, people who want the opportunity for higher returns can invest in equities and other growth-oriented investments.

Simplicity ~ The market-linked pension is a simple, account-based pension product that can be offered by any superannuation fund. It offers a complying pension that does not require the involvement of an actuary.

Drawdown ~ the payment factors set out in regulations will extinguish the capital over the term of the product. The factors are also designed so that the person will receive higher levels of income over time (subject to investment returns).

Commutation ~ the pension can be commuted as follows: within the first six months, upon death, to purchase another complying pension, to pay a surcharge liability, and to effect a payment split under family law.

Treatment of capital upon death ~ a market-linked pension is commutable on death with the remaining assets paid to a spouse, dependant or estate. This is the same treatment that applies to life expectancy pensions. However, if the term of the pension was based on the life expectancy of a spouse, the pension cannot be commuted on death until the death of the surviving spouse.

TRUSTEE APRA LICENSING

The Superannuation Safety Amendment Bill 2003 introduced a range of reforms to the SIS Act to modernise and strengthen the prudential regulation of superannuation. The Bill was proclaimed into law as the Superannuation Safety Amendment Act 2004. This Act amends the Superannuation Industry (Supervision) Act 1993. The Superannuation Industry (Supervision) Amendment Regulations 2004 (No 3) were issued pursuant to that Act on 3 June 2004.

The legislation applies to all superannuation trustees of “registrable superannuation entities” (RSEs). An RSE is defined to mean:

- A regulated superannuation fund; or
- An approved deposit fund; or
- A pooled superannuation trust.

Under the Act, trustees of APRA regulated superannuation entities must be licensed by APRA. The licence requires trustees to meet, and continue to meet, minimum standards of fitness and



propriety; maintain risk management strategies governing the trustee's operations; complete risk management plans for each fund under the trustee's control and comply with all other conditions prescribed by the Regulations.

The new regime commenced on 1 July 2004. Existing trustees can continue to operate under existing arrangements, but must obtain a licence by the end of a two-year transition period ending on 1 July 2006. Existing trustees applications must be in by 31 December 2005. All RSE licensees must register their RSE with APRA.

CHOICE OF FUND

The Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004 received assent on 30 June 2004.

What Does It Do?

It introduces from 1 July 2005 the requirement on an employer to make superannuation contributions on behalf of an employee to a super arrangement in compliance with the choice of fund requirements and provides for penalties for breaches of those requirements. It seems that the penalty per employee will be capped at a maximum of \$500 per breach where a breach is for a "notice period" which starts from the commencement of choice or the first day of employment if later, and ends when the ATO notifies the employer in writing.

The legislation also introduces protection to employers from liability to compensate any person for loss or damage arising from anything done by the employer in complying with the Choice requirements.

Who Is Exempted From Choice?

Choice of Fund will not apply:

- To most Federal Government employees;
- Where super contributions are made under Australian Workplace Agreements or Certified Agreements under the Workplace Relations Act 1996 or a Certified Agreement under the Industrial Relations Act 1988;
- Where super contributions are made in accordance with an employment agreement under the Employee Relations Act 1992 of Victoria and which continues to operate by virtue of section 515 of the Workplace Relations Act 1996;
- Where super contributions are paid under a State industrial award; or
- If the employer pays super contributions to an existing defined benefit member where the defined benefit would not be reduced if contributions were made to another fund.

What Will Employers Have To Do?

An employer will be required to provide an employee with a "standard choice form" that contains:



- A statement that the employee may choose any “eligible choice fund” (any complying superannuation fund or scheme or Retirement Savings Account);
- The name of the fund to which the employer will contribute if the employee does not make a choice (formerly known as a default fund); and
- Additional information if the employee is a member of a defined benefits scheme.

The employee’s choice will take effect two months after the notice is given to the employer, or earlier at the employer’s discretion.

A standard choice form can be provided at any time, but is required to be provided by the employer:

- Before 29 July 2005 to all current employees as at 1 July 2005;
- Within 28 days of commencing employment after 1 July 2005; or
- Within 28 days of an employee requesting, in writing, a standard choice form.

In addition to the standard choice form, the employee will need to provide their employer:

- Contact details for the fund;
- Evidence that the fund will accept contributions for the benefit of the employee; and
- Any other prescribed information.

The employer will not have to accept a standard choice form if the employee has chosen a fund within the past twelve months.

What About The Default Fund?

If the employee does not make a choice the employer will be able to contribute to the default fund (which must be disclosed on the standard choice form). The default fund is the default under the applicable Federal award or, if no such fund, any complying fund.

Anything Else I Should Know?

The following additional measures are proposed:

- Default funds will be required to offer a minimum level of insurance;
- “Kickbacks” to employers will be prohibited;
- A Choice education campaign will be carried out; and
- ASIC or APRA will be required to monitor and report on super fees for the first five years of Choice.

The above details about Choice are as we currently understand them to be. Further regulations will be introduced to clarify and expand on the details.

SUPER DEATH BENEFITS AND INTERDEPENDENCY RELATIONSHIPS

The Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004 also contained the trade off legislation which encouraged the Democrats to allow the passage of the



Bill. This change extends the class of beneficiary of a super death benefit who can receive the benefit tax free.

In SIS and the Tax Acts the definition of dependant is now expanded to recognise “interdependency relationships”. An interdependency relationship will exist between two people provided they meet all of the following criteria:

- They have a close personal relationship;
- They live together;
- One or each of them provides the other with financial support; and
- One or each of them provides the other with domestic support and personal care.

Examples of such a relationship could include same-sex couples, two elderly sisters who live together or members of a family who care for their elderly grandmother in their home.

SUPERANNUATION GUARANTEE NOTIONAL EARNINGS BASE

Superannuation Guarantee (SG) is calculated on an employee’s salary where the salary is calculated in accordance with the employee’s “Notional Earnings Base” (NEB). NEB is the employee’s “Ordinary Time Earnings” (OTE) unless a (usually lower) amount can be used because the employer was paying on this lower amount prior to 19 August 1991.

With effect from 1 July 2008 the earnings base will be a minimum of OTE.

ACTUARIAL CERTIFICATES WHERE ALLOCATED PENSIONS ARE PAID

From 1 July 2004 the requirement has been removed for a super fund to obtain an actuarial certificate in order to be able to claim a tax exemption for investment income from assets supporting allocated pensions and market linked income streams.

PRESERVATION AND ROLLED OVER EMPLOYER ETPs

From 1 July 2004 employer ETPs rolled over into super will be fully preserved. Prior to 1 July 2004, such amounts were unrestricted non-preserved.

SUPER INTEGRITY MEASURES

The 11 May 2004 Budget introduced restrictions on defined benefit funds with less than 50 members being able to establish and pay lifetime or fixed term pensions. (A transitional arrangement allows members as at 11 May to commence a lifetime pension, if eligible, prior to 30 June 2005). This restriction will not effect defined benefit funds of less than 50 members established before 11 May 2004 where the terms and conditions of such pensions are fully set out in the pre 12 May 2004 deed and rules. Further issues can arise for defined benefit funds of less than 50 members, especially Small Managed Superannuation Funds (SMSF) i.e. funds with less than 5 members which are regulated by the ATO. Please ask us for further advice if you are managing such a fund.



The Budget also introduced restrictions in respect of reserves held in an accumulation fund. From 12 May contributions must fully vest in a member and cannot fall to reserves on the member leaving the fund.

An example of an arrangement that would now not comply is where the employer pays contributions above the SG level with the excess contributions vesting in the member over a future period of employment. On leaving earlier the unvested contributions would have fallen into reserve.

FOR FURTHER INFORMATION

As you can see, much has happened in the last year in super. Believe it or not, we have been a little selective in what we have included in the above!

For further information please contact either David Lewis or Brendan Paddison at NFC on (02) 9929 2700, e-mail us at info@northbridgeadmin.com.au or visit our website www.northbridgeadmin.com.au.

The purpose of this publication is to provide general information only and should not be relied upon as a substitute for specialist advice. We strongly recommend that you seek further advice before acting upon these issues.