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Technically Speaking – a closer look at the 2016 Budget changes (Part 2)

Our first Technically Speaking article on the 2016 Federal Budget rightly focused on the two most controversial proposals contained in the Budget papers being the lifetime non-concessional contribution limit of $500,000 and the pension account cap of $1.6 million.

Both of these measures have been the focus of much discussion and debate as to their merits or otherwise.

Unfortunately, they have overshadowed a number of very good and long awaited changes to superannuation tax laws which will benefit many taxpayers who are genuinely trying to adequately save to fund their retirement. These changes include the abolition of the current work test for members between age 65 and 74, dropping the 10% test requirement when claiming a personal tax deduction for concessional contributions, and catch-up concessional contributions opportunities for specific taxpayers.

We will look at these measures in this edition of Technically Speaking. However, a note of caution – the Australian Labor Party recently announced that they would not be supporting these three measures to be passed by the Parliament.

There were also a number of integrity measures announced which have not necessarily received widespread approval but are argued to make the superannuation system fairer and more equitable. These include the lowering of the Division 293 threshold from $300,000 to $250,000, the taxation of income and realised gains on assets supporting transition to retirement pensions, the removal of the ability to nominate certain pension payments to be taxed as lump sums, and lastly the removal of the anti-detriment payment provisions.

These may form the text of later Technically Speaking articles once draft legislation is available.

Change in Work Test for 65 to 74 year olds

From 1 July 2017, all members of superannuation arrangements under 75 years of age who wish to make contributions or have contributions made on their behalf will no longer have to demonstrate any participation in gainful occupation in order for trustees to be able to accept such contributions. This applies to all contribution types from this date.

For those 75 years and older, only mandated employer contributions may be accepted by trustees for those members gainfully employed. No other types of contributions for these members may be accepted by trustees.

Traditionally, the provision of and access to saving within the superannuation system has been linked to participation in the paid workforce. This link was partially broken from 1 July 2007, by removing this requirement for anyone under the age of 65 years who wished to contribute to superannuation. Trustees are able to accept contributions made by or on behalf of any member under this age from any source.

A work participation test continued to apply to those 65 years and older however. This test required that a member 65 or older demonstrate that they had been employed or self-employed for gain or reward in any profession, trade, employment, vocation and so on for at least 40 hours in 30 consecutive days in the financial year and prior to the contribution being made. This test applied to all contribution types.

This new proposal to apply from 1 July 2017, effectively breaks the remaining links between the ability to contribute to superannuation and work participation, at least for those under 75 years of age.

Issues to consider

Opportunities generally

From 1 July 2017, contributing to superannuation for those between the ages of 65 and 74 will be simpler and no different to members who are currently under 65 years of age.

This will have clear advantages in circumstances where any member under 75 years of age can make contributions to a superannuation arrangement, subject to contribution caps, where:

- They are engaging in employment or self-employment for gain or reward, whether regularly or on an ad hoc basis
- They have received a windfall gain, such as an inheritance
- They have downsized their principal residence and wish to place the surplus into super
- They have sold non-superannuation investment assets and wish to contribute the proceeds into super
- They are accessing the small business CGT concessions on sale of a business or business assets in a year in which they have not been otherwise gainfully occupied – typically where instalment payment arrangements have been agreed and the second and subsequent instalment payments are received in later years after retirement.

Other differences

The three year bring forward rule applicable to non-concessional contributions (NCCs) was generally not available to anyone 65 or older who wished to make NCCs to super. This difference in the treatment of members between 65 and 74 years of age has been removed in that it is proposed that the rules for maximum NCCs for all members will change and be limited to a lifetime cap of $500,000 as discussed in Part 1 of Technically Speaking on the Budget changes.

If successfully modified, the new NCC rules will apply equally to all members under 75 years of age.

Universal tax deduction for concessional contributions

From 1 July 2017, it is proposed that the requirement that an individual taxpayer be substantially self-employed, or not employed to any significant degree, before being eligible to claim a personal tax deduction for a contribution into super, is to be abolished.

The test known as the "10% rule" broadly requires that one prerequisite for personal deductibility for contributions individually made is that less than 10% of all assessable income derived, reportable fringe benefits received and reportable employer contributions made are attributable to employment activities for the purposes of the *Superannuation Guarantee (Administration) Act 1992* (SG Act). In other words, the individual taxpayer is substantially self-employed or deriving minimal assessable income from employment activities compared to the total assessable income derived from all sources.

The removal of this requirement for deductibility from 1 July 2017 represents a shift in policy away from the notion that for employees, deductibility of super contributions can only be achieved indirectly utilising salary sacrifice arrangements with employers who are willing to enter into such agreements with their employees. In the past, the responsibility for and timing of these salary sacrifice contributions has also resided with the employer not the employee.

While employees will be free to continue on with or enter into prospective salary sacrifice arrangements with their employers going forward, the removal of the 10% rule means that:

- The distinction between the different ways to derive personal exertion income and the different methodology for deductibility of contributions made to super is removed or substantially modified for the better
- Subject to other deductibility requirements discussed later, both employer and individual contributions made to super on behalf of an individual are tax deductible to the contributor up to the concessional contribution cap
- Employees will be able to make tax deductible top up contributions in a financial year directly themselves, in addition to any other super contribution arrangements in place
- Employees who wish to by-pass their employers when contributing to superannuation above the employers' obligations under the SG Act (for example, because of the temporary nature of the employment relationship) are able to do so directly and still access a tax deduction
- Predominantly self-employed individuals who take on paid employment in a particular financial year (either on a part-time basis or for part of the year) do not need to be concerned as to the level of employment income they derive and do not

need to worry about loss of deductibility of contributions already made to super during the year.

Issues to consider

Additional requirements for deductibility for individuals

When wishing to claim a tax deduction for personal contributions into super, the work test discussed above is not the only requirement for deductibility under section 290-150 of the *Income Tax Assessment Act 1997* (ITAA 97). It would appear that the current additional requirements of section 290-170 ITAA 97 will remain in place after 1 July 2017 and will also need to be complied with.

These additional requirements include:

- The provision of a valid notice, in an approved form, to the receiving trustee of the individual's intention to claim a tax deduction for a specified amount in the notice
- Provision of the notice prior to or on the day of lodgement of the annual return for the year in which the contribution was made, or the end of the next income year, whichever is the earlier
- Receipt by the individual of an acknowledgement of receipt of the notice by the trustee.

Until such time as this process is undertaken between the individual contributor and the trustee, and the other requirements of section 290-170 ITAA 97 are satisfied, no personal deduction is available to the contributing individual.

It is critical therefore that individuals wishing to claim a personal tax deduction for contributions they make to super under this change from 1 July 2017, are aware of the mandatory requirements necessary for their deduction to be available and follow them exactly. Failure to comply with any aspect of the strict requirements of the section will result in the deduction not being available.

All advisers should take care when outlining the availability of the deduction to ensure their clients understand the rules that apply.

Advisers should also counsel their clients in their capacity as trustees to ensure they deal with the superannuation account which received the contribution in accordance with the requirements of section 290-170 ITAA 97, so that deductibility is not lost for failure to comply with these particular rules.

Contribution must be eligible to be a concessional contribution

In order for a personal contribution made to super by an individual taxpayer to be treated as a concessional contribution for concessional contribution (CC) cap purposes, section 291-25 ITAA 97 requires that it be included in the assessable income of the receiving superannuation provider. In order for this to occur, the personal contribution must be deductible under section 290-150 ITAA 97, satisfying the requirements set out above.

There is one additional requirement of the tax legislation which impacts on the deductibility of a personal contribution into super and whether it therefore qualifies as a CC.

Section 26-55 ITAA 97 effectively states that a personal deduction claimed cannot create a carry-forward loss for tax purposes. The personal deduction is therefore limited to the available assessable income of the individual taxpayer. That is, the amount of the contribution which is eligible to be treated as a concessional contribution for all purposes, including CC cap purposes, is therefore limited to the amount of the contribution which is deductible against available assessable income of the contributing individual.

Any contribution made in excess of what is eligible to be treated as a CC cannot fall under the CC Cap and will most likely fall as a NCC. This has its potential problems given the proposed limitations and availability of that NCC Cap discussed in the last Technically Speaking.

It is important that individuals understand that assessable income must be available in the year of contribution for the personal deduction to be offset against, in order for the contribution to be treated as a contribution under the CC Cap available in that year.

Claiming unused carry-forward CC cap amounts

From 1 July 2017, it is proposed that any unused CC Cap in a financial year can be carried forward for up to 5 years, and used to make additional CC contributions to super in a later financial year.

The concession will be limited to those super members whose account balances in total do not exceed $500,000. Whether this threshold test will be made at the time of the actual contribution (which will be difficult for SMSFs where contributions are typically made throughout the year) or more practically, at the beginning of each financial year (which would rely on a member's opening account balance for the year prepared as part of the annual accounts) has not been specified. Confirmation as to the timing of the application of the proposed requirement is expected in draft legislation when released.

Only unused CC Cap amounts accruing on or after 1 July 2017 can be later accessed under this proposal.

It is expected that the current CC Cap for a particular financial year will need to be used in full first, before then accessing any earlier unused CC Cap amounts. This will also need to be confirmed in any draft legislation when released.

Issues to consider

Other contribution cap changes

This proposal may go some way for a limited group of taxpayers, in alleviating the proposed general reduction in the CC Cap for all taxpayers to $25,000 per annum from 1 July 2017 onwards.

While the higher CC Cap for older taxpayers is proposed to be removed, it is presumed that it is this group of taxpayers who are most likely to take advantage of the contribution catch-up proposal.

However, it is potentially this group who are most likely to fail the $500,000 threshold test as well.

Who is likely to benefit?

Clearly the most obvious category of taxpayer who will benefit at any age from this proposal are those who have not fully utilised the available CC Cap in financial years on or after 1 July 2017, because:

- they have not had the capacity to fully contribute due to low or no incomes in those financial years, or
- they have chosen to apply their income elsewhere, and
- have low account balances as a consequence.

Individuals with broken work patterns due to family commitments such as caring for young children at home or providing caring support for elderly and sick parents or other relatives are the obvious beneficiaries of this proposal.

While financial constraints may continue to hamper these individuals from utilising the proposal to its maximum extent, it is nevertheless an extremely positive proposal to address what is the very real and practical problem for women in particular who are most likely to have broken work patterns due to the above circumstances and therefore reduced account balances in super.

Beware of the technical constraints

In circumstances where a taxpayer returns to paid employment after a period of absence from the workforce and enters into prospective salary sacrifice arrangements with their employer which utilise any unused CC Cap which may have accrued, then application of the proposal should be straightforward.

However, the earlier discussion in relation to the importance of the eligibility for deductibility of contributions made can apply here equally in circumstances where the individual intends to claim a personal tax deduction for the catch-up contributions made directly by them into super.

They may choose to make the contributions directly themselves because they:

- wish to make a single catch-up contribution, once they have assessed their financial capacity to make additional contributions in any one particular financial year
- may be fully retired from the workforce and wish to contribute part or all of the proceeds from the sale of a non-superannuation investment
- only have the ability to assess the CC Cap due to the application of the proposed new NCC Cap rules restricting or ruling out access to that Cap.

Whatever the reason, the requirements around deductibility of the contribution in order for it to be eligible to be treated as a CC are critical here as well. Of these, the need for assessable income to offset the amount of the deduction claimed is the one requirement most likely to be overlooked. Remember the size of a CC deduction is limited by the assessable income available to offset it and that a deduction for a personal contribution cannot create a carry forward loss.

This will be highly relevant for individuals who may be retired and living on their pension income which is not assessable income for tax purposes. Should they inherit money which they wish to contribute to super for example, and they have no other sources of assessable income, then the catch-up CC Cap will probably not be available to them. Depending on their circumstances, an NCC Cap may provide the solution here for these taxpayers.

Combination of multiple proposals

Clearly, for the right client with the right circumstances, the catch-up contribution opportunity, coupled with the removal of the work test for all taxpayers under age 75, and the personal deductibility of contributions can combine for a very effective strategy to add to superannuation savings.

However, these opportunities will be limited to those with account balances of less than $500,000 (however this is to be tested) and who also have available CC and NCC Caps to utilise effectively.

Individuals with existing higher account balances may still utilise annual CC Caps and available NCC Caps to add to their super. Small business CGT contributions are unaffected by these rule changes and so can also offer opportunities to add to super account balances as well.

Many clients will find themselves in circumstances where they cannot contribute meaningfully to super any further however under these Budget proposals, and will need to seek out alternative savings arrangements.

Please click here to access the CPD quiz