



Sydney Community Foundation

Professional Adviser Workshop on Charitable Giving

"Pockets of Opportunity"

Working Notes

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Anti-detriment Payment

To recoup the contributions tax (15%), law allows a superannuation fund to increase a death benefit and claim a tax deduction, where the monies are paid in the form of a lump sum to.

- The death benefit is paid in the form of a lump sum;
- The superannuation death benefit is paid to a spouse, former spouse, child or the member's Estate;
- Where the benefit is paid to the deceased estate a tax deduction for the payment is only allowable to the extent the beneficiaries specified above are expected to benefit from the payment.

Formula provided via an ATO ID 2007/219

Tips/Trips

- Not all funds provide for it
- SMSF – use reserves to fund it, otherwise it's complicated
- Re-contribution strategy diminishes the amount

Case 1

Bob passed away on 14 December 2007 and left behind a superannuation balance of \$800,000. The components of his superannuation fund are as follows:

Taxable component	\$600,000
Tax free component	<u>\$200,000</u>
Total	<u>\$800,000</u>

Tax saving amount

Given his eligible service date is 1 July 1980, if we use the formula method, the tax saving amount is calculated to be

$$= \frac{(0.15 \times 7,105)}{(8,933 - 0.15 \times 7,105)} \times \$600,000 = \$81,280$$

Accordingly the trustee can increase the superannuation death benefit to his dependants by **\$81,280**.

Tax deduction

The trustee of the superannuation fund recoups the above additional lump sum payment by claiming a tax deduction as follows:

$$= \$81,280 / 0.15 = \$541,867$$

Therefore the deduction allowed to be claimed by the fund is \$541,867.



Directed Termination Payment

Simpler Super changed the tax treatment of employment termination payments. Where a client receives an ETP in excess of \$140,000 they are taxed at the top marginal rate. However there are transitional measures available for a person who was entitled, as at 9 May 2006, to such a payment specified under: a written contract; an Australian or foreign law (or an instrument under such a law), or a workplace agreement under the Workplace Relations Act 1996. This will encompass arrangements where the contract refers to the amount of the payment by way of a formula which can be objectively determined, or to payments made in kind (eg, shares).

Tips/Trips

- A 'transitional termination payment' (TTP) and will need to be paid by the 30 June 2012.

Case 2

On 9 May 2006 John was entitled to receive an ETP specified under a written contract. John receive a redundancy payment on 1 July 2008 at the age of 55 (preservation age) and is entitled to receive \$1,225,328. His eligible service date is 1 July 1980.

Step 1 Calculate tax free part = \$7,020 plus \$3,511 for each completed year of service (28) = **\$105,328** (can't be rolled into super)

Step 2 Of the remaining amount (\$1,120,000)¹, calculate tax free/taxable components

Tax free component = $\frac{3^2}{28^3} \times \$1,120,000 = \$120,000$

Taxable component = \$1,000,000

If he didn't qualify under the transitional arrangements John must take the amount as a lump sum

- a) be taxed on the \$1m payment at a rate of 15% on the first \$140,000, and highest marginal rate on the remainder.

As he qualifies under the transitional arrangements John will either

- b) take it as a lump sum and pay tax on the \$1m payment at a rate of 15% on the first \$140,000, 30% on the next \$860,000;
- c) roll the amount into super as a directed termination payment taxed at 15%

Tax saving amount

Scenario	Tax Paid	Net Proceeds
A – no transitional rules	\$423,000	\$802,328
B – transitional rules – lump sum	\$294,000	\$931,328
C – transitional rules - rollover	\$150,000	\$1,075,328

¹ \$1,000,000 less \$105,328 = \$894,672

² Total years of service prior to 1 July 1983. For exact calculation use no. of days

³ Total years of service. For exact calculation use no. of days.



Transition to Retirement strategy

Commence TTR income stream with monies from an existing superannuation benefit & enter into a salary sacrifice to super agreement with employer.

Case 3

Karen is age 55 and has a gross salary of \$150,000 pa. She has accumulated \$400,000 in her superannuation fund (all taxable). Karen does not make any additional super contributions on top of her employer superannuation guarantee contribution which is 9% of her salary. She is planning on retiring in five years time.

Scenario 1: Current position

Based on our assumptions (see below) if Karen maintains her current situation her income tax will be approximately \$49,350 (in year one) and her superannuation will grow from \$400,000 to \$648,888 in five years time.

Scenario 2: TTR income stream and salary sacrifice (age 55)

Let's assume Karen uses her entire \$400,000 to commence a TTR income stream and draws an income of \$40,000 pa. She also salary sacrifices \$46,068 pa (as this enables her to maintain her living expense requirements). The table below shows that her income tax in year one will be \$39,949 and her superannuation (including the pension fund supporting her TTR income) will grow to be \$700,533 in five years time.

Scenario 3: TTR income stream and salary sacrifice (age 60)

If Karen were 60, she would receive her TTR income stream tax free. This allows her to salary sacrifice a greater portion of her salary (in this case \$62,678) yet maintain her cash flow needs. The net result is the income tax payable will be \$23,339 (in year one) and her superannuation benefit after 5 years will be approximately \$787,509.

Income tax and super benefit

	Income Tax Payable* (Year 1)	Total Super Benefit ** (Year 5)
1. Current position	\$49,350	\$648,888
2. TTR income stream and salary sacrifice (age 55)	\$39,949	\$700,533
3. TTR income stream and salary sacrifice (age 60)	\$23,339	\$787,509

* 2007/2008 tax rates including Medicare levy of 1.5% used

** Assuming a superannuation return of 7.10% net of fees

It should be noted that other existing superannuation strategies which increase the tax free amount of a TTR income stream such as a re-contribution strategy, or varying the income level of the TTR income stream can significantly increase the end retirement benefit.



Small Business Capital Gains Tax concessions

Case 4

Mary started her business in January 2001 at the establishment cost of \$250,000. In January 2008 Mary, now aged 62, decides to retire and sells her business for a tidy profit – the total proceeds being \$5,500,000, so capital gain is \$5,250,000. The tax payable on this gain could be as high as \$1,220,625. However, with careful planning, Mary is able to access significant tax concessions by:

- Utilising the small business capital gains tax concessions;
- Funding her tax deductible superannuation contributions; and
- Bringing forward her planned charitable donations.

	Without Strategy Implementation	With Strategy Implementation
Capital Gain from sale of Widgets business	\$5,250,000	\$5,250,000
50% General Discount	(\$2,625,000)	(\$2,625,000)
<i>Small business 50% reduction</i>		(\$1,312,500)
<i>Small business retirement exemption</i>		(\$500,000)
Superannuation Contribution (taxable)		(\$100,000)
Donation	(\$60,000)	(\$60,000)
Future Donations Brought Forward		(\$440,000)
Taxable Net proceeds	<u>\$2,565,000</u>	<u>\$212,500</u>
Income Tax (46.5%)	(\$1,192,725)	(\$98,813)
Superannuation Contribution Tax (15%)		(\$15,000)
Total Tax Payable	(\$1,192,725)	(\$113,813)
Net Cash Flow	\$4,247,275	\$4,886,187



Life Insurance

Depending on the ownership structure of a personal life policy, the end benefit will vary. This case illustrates how a member's service period may impact on the tax paid by non-dependent beneficiaries.

Taxed and Untaxed Elements

If a death benefit paid from a super fund to non-dependent beneficiaries includes an insured benefit, the entire amount paid to the beneficiaries is split into a 'taxed element' and an 'untaxed element' based respectively on the deceased's 'service period completed' vs 'service period to retirement'.

The taxed element is taxed at 16.5% and the untaxed element is taxed at 31.5%. The reason for the differing tax rates is that the untaxed element is deemed to represent the part of the benefit upon which no contributions tax has effectively been paid, even though the method used to calculate it may not have any correlation to the actual amount of insurance.

Therefore, there will often be a discrepancy between the amount taxed at a higher rate and the actual insurance proceeds. This can work for or against the non-dependant beneficiaries depending on the amount of the total benefit, the service period, the age at death and the accumulated benefits in super.

NB: No tax is payable on a super death benefit if it is paid to a dependent (under the Tax Act).

Case 5

Ian is aged 57 and has \$600,000 in super (all taxable component). His existing (completed) service period is 24 years. He also has \$1 million in life insurance held within his super fund. For the purposes of this exercise, we will assume that Ian has no dependent beneficiaries.

What would happen on Ian's death?

Scenario 1: Assume Ian had placed his \$1 million in life insurance through a different super provider immediately prior to his death. As Ian would have had no accumulated benefit and no existing service period attached to the insured benefit, the results would be worse. Ian's accumulated superannuation (100% taxable component) no longer has any insurance attached, therefore it is taxed as a super death benefit to a non dependent beneficiary i.e. at 16.5%.

The insured benefit has no existing service period and 8 years of remaining service. Therefore it will be classified solely as an untaxed element and will be taxed at 31.5%.

16.5% on the accumulated benefit (\$600,000)	\$99,000
31.5% on the insurance - untaxed element (\$1,000,000)	<u>\$315,000</u>
	\$414,000
Net benefit	\$1,186,000



Scenario 2 Assume his policy and super were in one super account.

Ian's remaining service period is 8 years (i.e. he has a further 8 years of employment until retirement at age 65). The tax on the total death benefit (including Ian's accumulated balance) would be split into two components based on the split between Ian's existing service period and his remaining service period (in this case 24 years of service vs 8 years to serve i.e. 75 / 25).

Therefore, of the \$1.6 million total death benefit, \$1,200,000 is the taxed element and \$400,000 is the untaxed element. As noted earlier, the tax payable is 16.5% for the taxed element and 31.5% for the untaxed element. Therefore, the total tax payable on the death benefit would be:

16.5% on the taxed element (\$1.2 million)	\$198,000
31.5% on the untaxed element (\$400,000)	<u>\$126,000</u>
	\$324,000
 Net benefit	 \$1,276,000

Scenario 3: This time, we assume that immediately prior to his death, Ian rolled his accumulated super to a different provider and retained his \$1 million life insurance through the existing super provider.

This scenario provides the most beneficial results. Ian's accumulated superannuation (100% taxable component) has no insurance attached so it is taxed as a super death benefit to a non dependent beneficiary i.e. at 16.5%.

The insured benefit retains Ian's existing service period and 8 years of remaining service. Therefore it will be split into 75% taxed element and 25% untaxed element.

16.5% on the accumulated benefit (\$600,000)	\$99,000
16.5% on the insurance - taxed element (\$750,000)	\$123,750
31.5% on the insurance - untaxed element (\$250,000)	<u>\$78,750</u>
	\$301,500
 Net benefit	 \$1,298,500

Scenario	Total Death Benefit
1	\$1,186,000
2	\$1,276,000
3	\$1,298,500