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Tax bill for grieving families

Grieving families face being hit with a double death tax on the superannuation benefits of loved ones which can reduce inheritances by up to a quarter.

Self-managed super funds are affected with beneficiaries subject to both superannuation death taxes and capital gains tax. This position means that many people are withdrawing their total superannuation before they die, to avoid leaving a large tax bill for their beneficiaries.

Many individuals are of the view that it is only income which is subject to tax. However, the the capital value of the entire death benefit may also be subject to tax. The 16.5 per cent super death tax applies to all death payouts. It arises when money from a superannuation fund is left to anyone who is not classified as a "dependent" person. That includes adult children or grandchildren, friends or other relatives.

Any person receiving part of a superannuation death payout who is not financially dependent on the deceased will be required to pay tax on the inheritance at the rate of 16.5 per cent. The tax also applies if the super payout is paid out through the deceased person's estate through their will.

The tax burden is even greater if the fund is a self-managed super fund. In these circumstances the money may also be subject to capital gains tax. The problem is created when the last person in a self-managed fund passes away. Up to their death the SMSF is not required to pay capital gains tax.

However, the a SMSF loses this exemption they day they die. When a fund is closed and money distributed, the assets must be sold or transferred, triggering capital gains tax at a rate of 10 per cent.

With more than 2500 new self-managed funds set up every month people are unintentionally creating an unexpected tax bill of up to 26.5 percent for beneficiaries.

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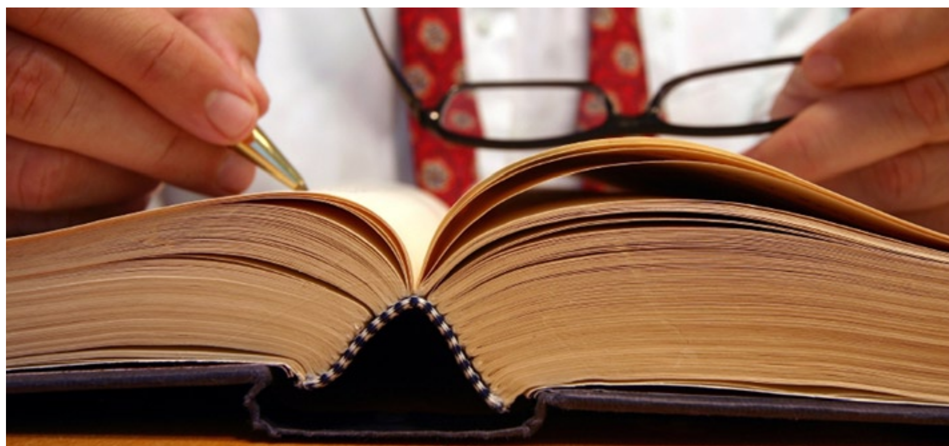
Risks of borrowing from an SMSF



Many small businesses are currently struggling and finance has become more difficult to obtain.

Some business owners have turned to a seemingly simple source of funding in the self-managed super fund (SMSF) of business owners. However, as a recent decision by the Administrative Appeals Tribunal (AAT) has shown, there are serious risks in using this source of funding.

The case involved a husband and wife who were trustees of a self-managed super fund. The fund extended loans to the husband's company (a "related party" of the fund) which was suffering from financial difficulties. The loans for $211,000 were greater than 95% of the fund's total assets and well in excess of the 5% in-house assets limit required by the superannuation laws. The auditor of the fund lodged a contravention report notifying the Tax Office that the fund had breached the in-house assets rules.

The trustees sought a review of the Commissioner's decision not to exercise his discretion under the superannuation laws to treat the fund as a complying fund despite the contravention of the in-house assets rules.

The AAT rejected the trustees' argument that the Commissioner had placed too much weight on 'the seriousness of the contravention' without having due consideration to the other relevant factors required under the law.

One of the consequences of a fund being non-compliant, is that it loses access to concessional tax treatment and its taxable income is assessed at the top marginal rate. In the year a previously complying fund becomes non-compliant, its income includes the assets of the fund less any undeducted contributions, absorbing all previously allowed tax concessions.

This is a significant penalty that anyone operating a fund must be aware of. A super fund that loses its complying status will generally become liable for tax at the rate of 45%.

The Commissioner stated the decision is a reminder to trustees to act on any breaches. The sole purpose of an SMSF is to provide benefits for members in retirement and should not be used to invest in related parties above the 5% in-house asset limit.

Anyone operating a self-managed super fund should take heed of the AAT's decision. Whilst the Commissioner has discretion available under the law to treat a fund as complying, even though it has contravened the law, trustees should not take it for granted as many other factors come into play.

The Tax Office has released a Practice Statement (PS LA 2006/19) on self-managed superannuation funds which details the factors that the Commissioner will take into consideration when determining whether a notice of non-compliance is issued to a fund. That Practice Statement indicates that a notice of non-compliance will not be given to a fund if the Commissioner accepts an undertaking by the trustee to rectify a contravention.

SMSFs must comply with similar requirements imposed on all regulated superannuation funds to maintain their complying fund status and benefit from concessional tax treatment. Funds which breach the strict regulatory requirements may lose their complying fund status with the fund potentially taxed as a non-complying fund at 45%, instead of 15%. In addition, SMSF trustees may be personally subject to a range of civil and criminal penalties in relation to any breaches of the law.

Running a self-managed super fund can bring great benefits, provided that trustees are aware of, and comply with, the rules.

SMSF contraventions on the rise

The number of SMSF trustees breaching compliance rules continues to rise despite efforts by the ATO to stop the trend.

The number of SMSF trustees breaching compliance rules is still rising despite efforts by the Australian Taxation Office (ATO) to bring a halt to the trend through education programs for new trustees and random risk audits.

This trend is partly a result of the overall growth in the number of new SMSFs set up each year. The increase is also likely to be the result of changes in the reporting requirements and guidelines the ATO provides to approved auditors.

The most common contraventions in the 2008 financial year included the provision of loans to members or relations, which made up almost 20 percent of all reported contraventions.

Other contraventions include breaches of in-house asset rules (approx. 16 percent) and assets not being registered in the name of the fund (approx. 14 percent.)

SMSF trustees must examine asset status

Some trustees are at risk because of a failure to understand in-house asset rules when transferring assets from related parties into a self managed superannuation fund (SMSF).

To meet the in-house asset exemption Superannuation Industry Supervision (SIS) Act, trustees must consider the status of an asset once it is in the fund. This ensures the contribution to a SMSF regarding a transferred asset from a related party satisfies the legal requirement.

Transferring assets such as artwork as a contribution to an SMSF are an example of how the exemption may not be satisfied. The important aspect of the exercise is how the asset is treated once it has been included as an asset of the fund.

An asset that represents less than 5 percent of a fund's assets, that is transferred into the fund and subsequently leased to a third party, is no longer going to be an in-house asset. That is because it is not an investment or lease arrangement with a related party. In this situation the asset could not be transferred into the fund because it would not meet the criteria to make it a legitimate superannuation contribution.

On the other hand, if the trustee's related company leased the asset back from the SMSF in question, the transfer would satisfy the necessary legal requirement.

Before transferring assets into a superannuation fund, trustees need to consider the entire transaction. That includes the percentage of the value of the asset, once in the fund and also the whether the use of the asset constitutes a genuine in-house asset.

ATO puts the wealthy at the top of hit list

The Australian Taxation Office has become increasingly concerned that the difficult economic environment may encourage many tax payers to attempt to inflate their tax claims.

The ATO has revealed part of its list of special targets for the 2009-10 tax year based on areas of greatest risk. Sales and marketing managers, electricians and truckies are among those firmly in the sites of the ATO.

Deductions for work-related expenses are one of the largest categories of claims made in tax returns. The ATO has said that they are concerned that the difficult times may tempt more people to exaggerate their claims. Work related expenses claimed by taxpayers have increased by 11% over the past two years. The growth in claims are much greater for some groups.

Many sales staff are claiming a living-away-from-home allowance without any substantiation from their employers that their role requires them to live away from home. A growing number of truck drivers have also placed themselves under fire for claiming costs associated with driving to the depot to pick up their trucks, on the basis that they had to carry bulky equipment to work.

Wealthy individuals have been ATO's perennial targets, and will face even greater scrutiny. Recently the ATO has concentrated on high net worth individuals with $30 million or more. Now it will chase taxpayers worth $5 million to $30 million.

Particular areas that will be scrutinised include dividends that are disguised as loans, the private use of company assets such as cars, boats and property and undeclared capital gains. The ATO will be particularly reviewing executives and their participation in employee share schemes. This was outlined in the 2009 Federal budget.

Behind many of these compliance programs will be the ATO's ever-improving data matching technology, which examines everything from car and boat ownership records, property records and health fund information to data on insurance, superannuation and welfare payments.

New ATO service for SMSFs

The Australian Taxation Office (ATO) has introduced a new service enabling trustees of self managed superannuation funds (SMSF) to receive product rulings.

The change has been made due to the increasing demand from SMSF trustees to establish a system for them and their needs that is similar to the binding income tax rulings issued to individual tax payers.

The rulings are not binding on the Commissioner as they relate to self managed superannuation funds, but they are still are administratively valid. This means that if a trustee invests in a specific product or proceeds with advice, as the Commissioners approved in those rulings it will be unlikely they will end up in an appeal with the ATO disbuting it.

The specific rulings for SMSFs can involve anything to do with the Superannuation Industry Supervision (SIS) Act as well as taxation matters.

The changes will be a welcome move for trustees, particularly given the increasing pressure on trustees to comply with ever increasing changes in superannuation rules.

Tax variations to improve cash flow

The ATO has the discretion to vary the amount a payer is required to withhold from a withholding payment, to meet the special circumstances of a particular case.

By completing a PAYG income tax withholding variation, property or other investors may be eligible to have investment deductions effectively refunded during the year through a reduction in tax withholding. Once the application is completed and approved, the ATO will authorise a payer or employer to make the necessary changes to withholding tax deductions.

The effect of this change is that end of year tax refunds are reduced as they are paid during the year in the form of lower tax payments. This additional money may be used to pay for those expenses as they arise or simply to offset interest payments.

PAYG income tax withholding variations are typically used to ease cash flow burdens during the financial year. Taxpayers need to be aware of a couple of other points in relation to variations:

- A new variation must be lodged each year.
- A change in employment means a new variation must be lodged; it does not transfer from employer to employer.

The Bookshelf

The Millionaire Next Door

Author: Thomas J. Stanley and William D. Danko
Published by Pocket Books

In 'The Millionaire Next Door,' Stanley and Danko summarise findings from their research into the primary determinants that explain how the elite club of millionaires have become 'wealthy.' Focusing on those with a net worth of at least $1 million, their results show qualities of this group that are opposed to today's earn-and-consume culture. This includes living below their means, allocating funds efficiently in ways that build wealth, ignoring conspicuous consumption, being proficient in targeting marketing opportunities, and choosing the 'right' occupation. It is evident that anyone can accumulate wealth, if they are disciplined enough, determined to persevere, and have the merest of luck.

In The Millionaire Mind, an excellent follow-up to the highly successful first analysis of how ordinary folks can accumulate wealth, the authors interview many more participants in a much more comprehensive study of the characteristics of those in this economic situation. The author structures these deeper details into categories that include the key success factors which define this group, the relationship of education to their success, their approach to balancing risk, how they located themselves in their work, their choice of spouse, how they live their daily lives, and the significant differences in the truth about this group versus the misplaced image of high spenders.

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