

## Think smart to avoid latest SMSF pitfalls

There are dangers aplenty under looming new rules

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SELF-MANAGED super fund specialist Martin Murden has advised at least a half-dozen clients during the past year not to proceed with proposed gearing of a property through their funds. "The numbers don't stack up as far as your fund is concerned," Murden, a director of financial services provider Partners Group in Melbourne, told his clients.

Murden gave this advice after considering the funds' ability to cope with gearing given the imminent halving of the standard concessional contributions cap for members over 50, rising interest rates and possible loss of a tenant.

"If 100 per cent of a super fund's investments are in a geared property, the loss of a tenant and the restrictions on contributions will make it extremely difficult for some funds to service their loans," he stresses.

Daniel Butler, managing director of self-managed fund specialist DBA Lawyers in Melbourne, says the next slashing of this contribution cap will "severely restrict" the capacity of many SMSFs to meet their loan repayments. The cashflow necessary to pay loan instalments often largely depends on the higher caps, he says.

Without doubt, the looming lowering of the standard cap on concessional contributions by members aged 50-plus is creating new superannuation traps.

Superannuation law unequivocally allows SMSFs to borrow to invest using instalment warrants or similar arrangements. Funds are legally required to hold a geared investment in trust until the payment of the final loan instalment and are barred from providing other fund assets as loan security.

Nevertheless, Sydney tax lawyer Robert Richards warns that members of a SMSF could still lose much of their retirement savings with geared investment if their fund defaults on a loan. This could occur, for instance, if a poorly diversified fund has spent most of its worth on making the initial loan instalment.

Richards, principal of Robert Richards

& Associates, says such a fund could forfeit any loan instalments to the date of the default plus any fees or interest owed to the lender.

Many SMSFs adequately diversify their investments so members' savings are not jeopardised by being overly reliant on the success of a single, high-cost investment.

### Double super strategy

SMSF specialist Meg Heffron says the feasibility of taking a transition-to-retirement pension while boosting salary-sacrificed contributions may depend in part on a member's age, among other factors, once the standard concessional contributions cap is cut. (Members under 55 are ineligible for these pensions.)

Heffron, co-principal of SMSF administrator Heffron, agrees that many members under 60 will have difficulty making

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higher contributions to offset the pension being withdrawn from super. Indeed, Heffron warns that some members in this age group may be worse off by taking a TTR pension.

The TTR pension/salary-sacrifice strategy has four fundamental tax features: salary-sacrificed contributions are taxed at 15 per cent; the taxable portion of the pension is taxed at marginal rates with a rebate of up to 15 per cent to age 60; the pension is tax-free from age 60; and, crucially, fund assets backing the pension payments are tax exempt.

Significantly, the outlook for the strategy generally appears much more positive for members over 60 than those aged 55 to 59 after their concessional cap is cut.

Heffron emphasises that whether or not the pension payments are tax-free can be a "deal-breaker" for some members. (As discussed, the pension payments are tax-free for those over 60.)

"Anyone over 60 who has not at least

thought about taking a TTR pension is mad," she adds. "Not everyone should do it; in some cases it doesn't stack up but those are rare."

Graeme Colley, national technical manager of financial services group OnePath, emphasises that despite the halving of the standard concessional caps for members over 50 from 2012-13, TTR pensions will remain highly rewarding for many members, including those with big balances. Much depends on individual circumstances.

In the accompanying table, Colley gives the case study of a fund member who uses \$1 million in super savings to begin a TTR pension at 55. Given certain assumptions, Colley calculates that the member will have \$99,724 of additional income in the fund after five years, solely because its assets backing the pension are tax exempt. (Assumptions include making concessional contributions of \$25,000 a year and taking the standard minimum annual pension.)

"In addition, the total balance in the fund [at age 65] will be \$2,034,257 after drawing down pensions totalling \$579,224 between ages 55 and 65," Colley says. "This confirms that it is worthwhile commencing a TTR pension in these circumstances."

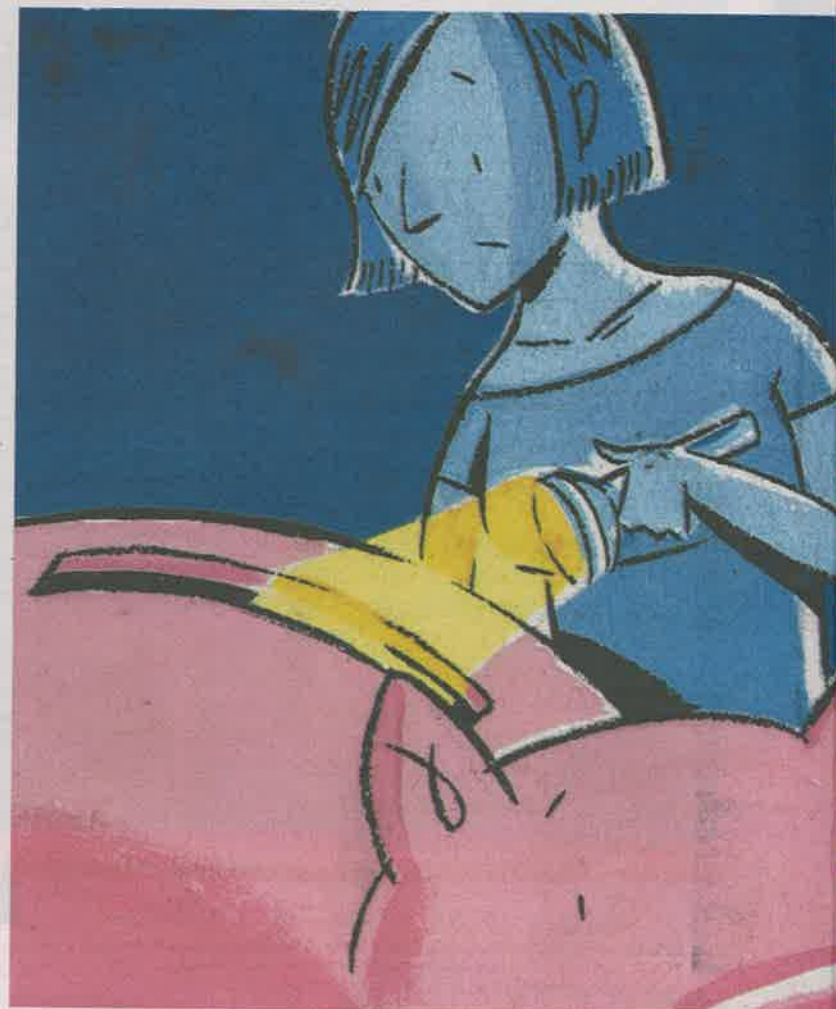
Colley points out that amounts taken as a TTR pension can be recontributed to super as non-concessional contributions, which have an annual contribution cap of \$150,000.

The making of non-concessional contributions will help minimise tax on any of your super death benefits eventually paid to non-dependants, including financially independent adult children. And, of course, such large contributions will increase super balances and earnings.

Fortunately, some members with lower super balances will still successfully make high salary-sacrificed contributions while taking a TTR pension in the future, if they can afford it. This is because the concessional cap for members over 50 with less than \$500,000 in super will remain at \$50,000 from July next year.

### Contribution race

This is perilous time for fund members over 50 who attempt to increase rapidly their contributions during the next 12



months before their standard concessional contributions cap is halved.

Like other tax and superannuation specialists, Murden has seen many instances in which the combination of salary-sacrificed contributions and an employer's payment of fund expenses have led to excess contributions.

Ways to minimise the possibility of excess contributions include closely monitoring salary-sacrificed and compulsory contributions credited to your super and checking the impact of any pay rises on employer contributions, he says.

Murden urges members not to overlook the payment of fund expenses by an employer. These payments, such as administrative fees and insurance premiums, count towards your concessional contributions cap.

Colley suggests fund members consider intentionally contributing about \$2000 dollars less than their concessional contributions cap as a safety buffer for unexpected contributions that could lead to overshooting the cap.

Fund members saving hard on the eve of retirement can be particularly vulnerable to incurring excess contributions

tax if they contribute a large inheritance or sell an investment.

Before making any large non-concessional contribution, such as from an inheritance, Murden says members should ensure that what is known as the bring-forward rule has not already been triggered. "You have to sit down and check the figures."

Under the bring-forward rule, members under 65 can average the annual non-concessional contributions cap of \$150,000 over three years. This allows contributions of up to \$450,000 in a single year, every three years.

Heffron gives this "classic scenario" of possibly disastrous tax consequences that can arise when the bring-forward rule is automatically triggered:

- \* In year one, the fund member unwittingly exceeds the concessional contributions cap by just \$100, plus makes a \$150,000 non-concessional contribution.
- \* In year two, the member, who may have sold an investment property, makes a \$450,000 in non-concessional under the bring-forward rule.

Heffron says the excess contributions

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**Meg Heffron**

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of \$100 in year one is counted towards the non-concessional cap, and triggers the bring-forward rule a year earlier than expected. This means the concessional cap has been accidentally overshot by \$150,100. "And a \$70,000 tax bill would appear in the mail," Heffron says.

### **Contribution splitting**

Many more super fund members are adopting contribution-splitting strategies in response to the next halving of the standard concessional cap, says Paul Banister, director of taxation for accountants and business advisers Grant Thornton in Brisbane.

The strategy has much more potential following the confirmation in the federal budget that members over 50 with balances under \$500,000 will continue to have a \$50,000 concessional contributions cap.

Under superannuation law, members are permitted to direct most of their concessional contributions into their spouse's super accounts.

Banister gives the example where each spouse has a super balance below the \$500,000 threshold. The partner with the larger balance might direct a large percentage of their concessional contributions to the spouse with the lower balance. (The cap of the member actually making the contributions applies.)

There are several variations to the super-splitting strategy.

Banister says the strategy may enable at least one spouse to remain under the threshold for longer. And the family can contribute more to super than otherwise possible.