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Superannuation 2008–09

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Economics Section

Executive summary

- Following is a technical document on the operation of the Australian superannuation system and its taxation.

Contents

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List of acronyms

ABN	Australian Business Number
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
GST	Goods and Services Tax
SG Act	*Superannuation Guarantee (Administration) Act 1992*
SGC	Superannuation Guarantee Charge
SMSF	Self Managed Superannuation Fund
TFN	Tax File Number

Introduction

From 1 July 2007 new taxation and preservation arrangements applying to Australia's superannuation system took effect. It is not too much to say that the change enacted by the government during the course of the 2006–07 financial year constitute the largest overhaul of Australia's retirement saving system since the advent of the compulsory superannuation system in the late 80 and early 90s.[1] While much of the superannuation system has remained unaltered by these changes, many aspects have been comprehensively altered, especially the taxation of the benefits when paid to the individual. The following paper outlines these and subsequent significant changes to Australia's superannuation system since 1 July 2007.

Australia's retirement income system

Australia's retirement income system is based on the so called three pillars:

1. compulsory superannuation contributions for all employees under the superannuation guarantee regime

2. voluntary superannuation contributions encouraged by tax concessions, and

3. a means tested social security age pension.[2]

This paper concentrates on the first two pillars, compulsory and voluntary superannuation contributions, and the payment of benefits from these sources for the year 2008–09.

Roles of various agencies

This document does not address the roles of the various government agencies that regulate the superannuation industry. However, it should be noted that taxation legislation and regulations, administered by the Australian Taxation Office (ATO), are directed at superannuation funds and their members to collect revenue for the Commonwealth of Australia. The ATO also administers the co-contributions, superannuation guarantee and choice regimes and regulates self managed superannuation funds (SMSFs). Prudential legislation and regulations, administered by the Australian Prudential Regulation Authority (APRA) (except in relation to SMSFs), are directed at safeguarding the assets of superannuation fund members and investors. Disclosure legislation and regulations, administered by the Australian Securities and Investments Commission (ASIC), are directed at ensuring that fund trustees provide relevant information to superannuation fund members to help them make informed decisions. The Australian Transaction Reports and Analysis

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1. Changes enacted mainly by the *Tax Laws Amendment (Simplified Superannuation) Act 2007*.

2. Treasury, *A Plan to Simplify and Streamline Superannuation - Detailed Outline*, May 2006, p. 1, See http://simplersuper.treasury.gov.au/documents/outline/default.asp (accessed 13 May 2006).

Centre (AUSTRAC) also now regulates superannuation funds in regard to their identification of members and reporting of any suspicious transactions.

What this paper covers

This paper, updated for the 2008–09 financial year is designed to provide readers with a summary of superannuation taxation, contribution, preservation and payment rules, and covers, amongst others, the following topics:

- the taxation of superannuation contributions and benefits
- the level of superannuation contributions that employers must make (Superannuation Guarantee) (SG)
- the ability of superannuation fund members to direct contributions and benefits to different funds, such as choosing the destination fund for the SG contributions made on their behalf (Choice rules)
- the government co-contributions scheme for low income earners
- the ability to split superannuation contributions with a person's spouse
- taxation of superannuation fund income
- the preservation rules that came into operation on 1 July 1999
- the application of the goods and services tax (GST) to superannuation, and
- self managed superannuation funds.

All figures in **bold** type are thresholds indexed in accordance with legislation governing the amounts that apply in a financial year, and are only current for the 2008–09 financial year. This document will continue to be updated at the beginning of every financial year.

Disclaimer

Superannuation law is detailed and comprehensive, and individual circumstances can drastically alter its general application. This paper has been prepared as a briefing and reference tool only and is not intended for use in providing financial advice. This paper should not be used for determining the tax liability attached to superannuation benefits in any particular case, especially in view of the limited number of considerations that are addressed in a summary document of this kind. Nor should it be used to make any decision on the level of contributions to make to a superannuation fund or any decision on the choice of any superannuation fund. **The authors, and those who have provided comments on this paper,**

disclaim any liability in relation to any financial decision taken which may be influenced by the content of this paper.

Superannuation contributions

This section explains how superannuation contributions are taxed, the maximum amount of tax-deductible contributions that an employer can make and the tax offsets that apply to certain superannuation contributions:[3]

- a 'superannuation contribution' is a payment to a superannuation fund which, if made by an employer, is generally concessionally taxed.
- a 'tax offset' is a reduction in tax liability that has the same value to all taxpayers independent of the taxpayer's marginal tax rate.

Acceptance of contributions

From 1 July 2007 a superannuation fund must not accept a member's contribution unless the member's tax file number (TFN) has been quoted to the fund's trustee. Contributions by a person that has not quoted their TFN to the fund trustee must be returned to the contributor within 30 days of the contribution being made.[4] A fund may still accept and employer's contribution made on the behalf of a member where the member's TFN has not been quoted. Some relief from this requirement is available in limited circumstances.[5]

Taxation of contributions

Generally, contributions to superannuation funds can be made in either one of two ways:

- before tax contributions that are tax-deductible to the payer (who can be an employer or a self-employed fund member). They are known as tax-deductible or concessional contributions, and
- after-tax contributions that are not tax-deductible to the payer (called non-deductible, non-concessional, un-deducted or personal contributions).

Tax-deductible contributions are included in the taxable income of complying superannuation funds and retirement saving accounts, and are taxed at a rate of 15 per cent.

3. 'Tax offsets' is the generic term used by the Australian Taxation Office to refer to tax offsets, tax rebates and tax credits.

4 Superannuation Supervision (Industry) Regulations 7.04(2)&(4).

5 Superannuation Industry (Supervision) Modification Declaration No 3 of 2007, applies only in relation to government co-contribution payments.

In some circumstances some of the tax paid on contributions may be claimed back on the death of a member (see Death Benefits below).

Generally, the personal superannuation contributions which an employee (or the self employed) may make out of his or her after-tax income are not eligible for a tax deduction and are not included in the income of complying superannuation funds or retirement saving accounts and are not subject to tax on entry into a fund.

See following sections for limits on contributions and tax applying to amounts over these limits.

Surcharge on contributions

With the passing of the *Superannuation Laws Amendment (Abolition of Surcharge) Act 2005*, the superannuation contributions surcharge ceased to apply on tax deductible contributions made after 30 June 2005. However, the surcharge will continue to be paid by two groups:

- those who made surchargeable contributions or who had surchargeable contributions made on their behalf between 1996–97 and 2004–05 and their superannuation fund has not yet paid the relevant surcharge on their behalf
- un-funded defined benefit fund members who are liable to pay the surcharge for the years between 1996–97 and 2004–05, when they take their benefit (if they have not paid their liability out of other funds at an earlier point), and
- a funded defined benefit scheme that received surchargable contributions must pay the surcharge if they have not already done so.[6]

No further surcharge is payable by the first group after the outstanding surcharge amounts have been paid.

Members of defined benefit funds, who are liable to pay the surcharge, do not pay it in the year in which the liability arises. Rather, the notional liability is calculated and kept as a charge against their superannuation benefits, when they are eventually paid. Defined benefit fund members also are able to pay out their liability before the benefit is paid in order to avoid the interest that accrues on their surcharge liability.

Tax offset for superannuation contributions made for a low income spouse

A person is entitled to receive an 18 per cent rebate for contributions made to the superannuation fund or retirement savings account of their spouse (up to a maximum of

6 A funded defined benefit fund is one where the benefits are fully backed by the asset of the scheme. An un-funded defined benefit fund is one where the benefit payable by the scheme is not full backed by the assets of the scheme.

$3000 in contributions per annum), provided the spouse has an assessable income plus reportable fringe benefits of $10 800 or less per annum. The spouse must be under 65 years in the week in which the contribution was made. The maximum rebate of $540 phases out on a dollar-for-dollar basis, and is not available when the low income spouse's assessable income plus reportable fringe benefits is $13 800 or more per annum.[7]

Contributions splitting

The superannuation contributions splitting rules allow a person to request the transfer of up to 85 per cent of tax deductible contributions made by their employer on their behalf and 100 percent of their personal contributions, made in the previous financial year, to a superannuation account in their spouse's name.[8] A superannuation fund trustee can refuse to action this request. From April 2007, members are no longer able to split untaxed contributions made on or after 5 April 2007.[9]

Non-deductible contributions

Limits on contributions

As noted above, non-deductible contributions are contributions made by individuals on an after tax basis. From 1 July 2008 the following annual limits apply:

- **$150 000**, or
- those under age 65 can make up to **$450 000** in non deductible contributions in one year as an average over a three year period.[10] If they make additional non-deductible contributions in that three year period over the **$450,000** limit the additional contributions are subject to a penalty rate of tax.
  - those aged over 65 have to meet a work test (see below) in order to make non-deductible contributions of no more than **$150 000** per year. Those over age 65 do not qualify for the **$450 000** limit for these contributions over 3 years.

These thresholds increase in $5000 increments if the annual increase in the Average Weekly Ordinary Time Earnings (AWOTE), as calculated by the Australian Bureau of Statistics,

7. *Income Tax Assessment Act 1997* (ITAA97) s. 290-230.

8. Subreg 6.41(1) & (2) Superannuation Industry Supervision Regulations 1994..

9 Subreg 6.41(3) & (4) Superannuation Industry (Supervision) Regulations 1994.

10. ITAA97 sections 292-20 and 290-85.

justifies such changes.[11] This method of increasing the threshold applied to many other superannuation related thresholds after 1 July 2007.

Both payments received for personal injury and certain small business CGT exempt amounts (see below) contributed to a superannuation fund are exempt from the above limits.[12]

Tax on excess non-deductible contributions

A tax of 46.5 per cent is imposed on the amount of a person's non-deductible contributions in excess of these annual limits.[13] In the case of an excess concessional contributions tax liability, the member has a choice of having all or some of the liability being released from their super account or they can simply pay the debt from other savings.

In circumstances where both concessional and non-concessional contributions are made during the one year, and they exceed the relevant limits on contributions, the rate of tax on excessive non-concessional contributions can be as high as 93 per cent.[14]

In the case of an excessive non-concessional contributions tax liability, the member must take the debt out of the super account.[15] They may then pay the tax liability with these funds.

Government superannuation co-contribution for low income earners

An employee for superannuation guarantee purposes, and the self employed, may be entitled to a Government superannuation co-contribution. These contributions are non-deductible contributions.

In the 2008–09 year of income, an employee with total annual income less than **$30 342** who makes personal superannuation contributions is eligible for a $1.50 contribution from the government for every dollar of eligible personal contributions made to a complying superannuation fund.[16] The maximum amount of eligible personal contributions that the

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11. ITAA97 s. 960-285. For the 2008–2009 years the increases in AWOTE did not justify an increase in this threshold. Australian Taxation Office, 'Key Superannuation rates and thresholds for 2008/09', 12 June 2008 (accessed 16 June 2008)

12. ITAA97 s. 292-90.

13. Sections 4 and 5 of the Superannuation (Excess Non-concessional Contributions Tax) Act 2007 and s.292-80 ITAA97.

14 See Australian Taxation Office, *Superannuation contributions – too much super can mean extra tax*, 20 December 2007.

15. Section 292-410 ITAA97.

16. 'Total income of a year of income' is defined in section 8 of the *Superannuation (Government Co-Contribution for Low Income Earners) Act 2003* as being the person's assessable income for the year of income and his or her reportable fringe benefits for the year of income. However, this definition will include superannuation contributions made by way of salary sacrifice from 1 July 2009.

government will match is $1 000. That is, the government will contribute $1500 if an employee with income less than **$30 342** makes $1000 in personal superannuation contributions.

In the 2008–09 year for an employee with a total income between **$30 342** and **$60 342**, the maximum amount of the government co-contribution is reduced by five cents for every dollar above **$30 342**. There is no entitlement to the co-contribution once an employee's total income is **$60 342** or more.[17] From the 2007–08 year of income, these thresholds are indexed in line with full-time adult average weekly ordinary time earnings. The following table sets out the levels of government co-contributions that may be paid, by total income and personal contributions made.

Table 1: Government Superannuation Co-contributions amount by income and personal contribution 2008–09

Personal Superannuation contribution(s) is	$1000	$800	$500	$200
Total Income				
$30 342 or less	$1500	$1200	$750	$300
$32 342	$1400	$1200	$750	$300
$34 342	$1300	$1200	$750	$300
$36 342	$1200	$1200	$750	$300
$38 342	$1100	$1100	$750	$300
$40 342	$1000	$1000	$750	$300
$42 342	$900	$900	$750	$300
$44 342	$800	$800	$750	$300
$46 342	$700	$700	$700	$300
$48 342	$600	$600	$600	$300
$50 342	$500	$500	$500	$300
$52 342	$400	$400	$400	$300
$54 342	$300	$300	$300	$300
$56 342	$200	$200	$200	$200
$58 342	$100	$100	$100	$100
$60 342	$0	$0	$0	$0

Source: ATO: Key Superannuation rates and thresholds for 2008–2009

The lowest amount of co-contribution payable is $20 per financial year. That is, if an employee contributes as little as $1 in personal contributions he or she will receive a co-contribution payment into their superannuation fund of at least $20 for the financial year.[18]

17. Australian Taxation Office, *Key superannuation rates and thresholds*, 12 June 2008.

18. Section 11, *Superannuation (Government Co-contributions for Low Income Earners) Act 2003*.

Changes in the definition of income for co-contributions purposes

For government superannuation co-contributions purposes the definition of income is annual tax assessable income plus annual reportable fringe benefits. From 1 July 2009 this definition will also include superannuation contributions made by way of salary sacrifice.[19]

As noted above these contributions are non-deductible contributions. This means they are not subject to contributions tax. However, the investment earnings of the fund on co-contributions amounts are subject to tax (see below).

Contributions for children

From 1 July 2004 any individual under the age of 65 may make non-deductible contributions to a superannuation fund. This includes children under the age of 18. However, issues relating to contractual capacity tend to limit the ability of children under 18 to establish a superannuation account outside of an employment arrangement. The special rules allowing a relative to contribute on behalf of a child have been replaced by the general principle that a fund may accept contributions made 'in respect of a member who is under age 65'.[20] These contributions do not qualify the child's superannuation account to receive a government co-contribution payment.[21]

The work test

Amendments made to the Superannuation Industry (Supervision) Regulations 1994, with effect from 1 July 2004, allow anyone under 65 years of age to make contributions to a superannuation fund without needing to meet any work test requirements. From 1 July 2007 only those meeting these requirements can make non-deductible contributions to a superannuation fund.

Between 65 and 75

A superannuation fund may accept contributions from a person in the following age groups:

- age 65 and over but not yet 70, if a person has been gainfully employed on at least a part time basis during the financial year in which the contributions are made (e.g. personal contributions, spouse contributions)

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19 The Hon. Wayne Swan MP, Treasurer, The Hon. Lindsay Tanner MP, Minister for Finance and Deregulation, *Budget Paper No. 2 2008–2009*, Canberra, 13 May 2008, p. 29.

20. Superannuation Industry (Supervision) Regulations reg 7.04(1).

21. Section 6, *Superannuation (Government Co-contribution for Low Income Earners) Act 2003*.

- age 70 and over but not yet 75 – only personal contributions (i.e. no spouse contributions) if the person has been gainfully employed on at least a part time basis during the financial year in which the contributions were made.[22]

For the purposes of these particular rules, being 'gainfully employed on a part time basis' during a financial year requires the person to have worked at least 40 hours in a period of not more that 30 consecutive days in that financial year. For example, a person who works 40 hours in a fortnight can make superannuation contributions (within the above contribution limits) for the rest of the financial year.[23]

If a person aged between 65 and 75 continues to work but does not meet the 'gainfully employed on a part time basis' test their superannuation fund may still receive mandated employer contributions made on their behalf (i.e. any award based contributions and SG contributions made by an employer, with the latter compulsorily payable up to age 70). The consequence of not meeting the work test within this age range is that the person themselves cannot make their own contributions to a superannuation fund.

Age 75 and over

If a person is aged 75 or more only mandated employer contributions (e.g. award contributions) can be accepted on behalf of the person by a fund.[24]

Capital gains tax (CGT) exempt contributions

A person can contribute an amount arising from the sale of a small business to a superannuation fund without incurring either CGT or a personal income tax liability.[25] This money is called a 'CGT Exempt Component' and is also exempt from contributions tax when it is placed into a superannuation fund. Rather, these contributions are treated as a non-deductible contribution for taxation purposes.[26]

The total of all CGT exempt amounts contributed to a superannuation fund in respect of an individual cannot exceed **$1 045 000** over that person's lifetime. This limit will be indexed in line with increases in the AWOTE in $5000 increments.[27]

Additional requirements apply where the asset is held through a company or trust structure, or jointly held with another in a partnership arrangement.

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22. Reg 7.04 Superannuation Industry (Supervision) Regulations 1994.
23. Reg 7.01(3) Superannuation Industry (Supervision) Regulations 1994.
24. Reg 7.04 Superannuation Industry (Supervision) Regulations 1994.
25. Section 152-310 ITAA97.
26. Section 292-90 ITAA97.
27. Section 292-105 & 960-285 ITAA97.

Personal injury payments

Contributions arising from personal injury payments are exempt from the non-deductible contributions limits, if no tax deduction is claimed. The payment must be in the form of a 'structured settlement', an order for a personal injury payment, or lump sum workers compensation payment to be exempt from these limits.[28]

Tax deductible contributions

Limits on tax deductible contributions

From 1 July 2008 the following annual limits apply on tax deductible contributions made by an employer on the behalf of an employee and by a self employed individual claiming these contributions as a tax deduction against their taxable income:

- **$50 000**,[29] or
- $100 000 for those aged 50 and over under special transitional arrangements
  - during the years 2007–08 to 2011–12 those over 50 years of age, in any of these financial years, will be able to have a total of $100 000 p.a. contributed to a superannuation fund as salary sacrifice contributions and/or contributions made on their behalf by their employer. Such contributions will not attract the excess contributions tax (see below). Employers can claim a tax deduction for amounts they contribute under these provisions.[30]

Tax on excess deductible contributions

A tax of 31.5 per cent is imposed on the amount of a person's tax-deductible contributions in excess of the above annual limits.[31] Amounts of concessional contributions made in excess of these limits cannot be returned to the contributor to avoid this tax. A member may withdraw an amount equal to the tax liability to be paid and pay that liability with these amounts.[32]

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28. Section 292-95 ITAA97.
29. Section 292-20 ITAA97. This threshold is also indexed to AWOTE in at least $5000 increments. AWOTE increases during the preceding year were not sufficient to cause this threshold to be raised for the 2008–2009 year.
30. Section 292-20, Income Tax (Transitional Provisions) Act 1997.
31. Sections 4 and 5 of the Superannuation (Excess Concessional Contributions Tax) Act 2007 and s.292-15 ITAA97.
32. Section 292-410 ITAA97.

Tax deductible contributions by the self employed

From 1 July 2007 the self-employed, under the age of 75, can claim all personal superannuation contributions as a tax deduction, but the work test has to be satisfied if the are over age 65.[33] The unemployed aged under 65 also can claim personal contributions as a tax deduction, assuming of course they had the financial capacity to make such contributions and taxable income to offset the contributions against.

These contributions can be claimed as a tax deduction if less than 10 per cent of a person's assessable income and reportable fringe benefits are attributable to employment as an employee.[34]

Regulation of superannuation contributions – the Superannuation Guarantee

Tax deductible contributions are paid by an employer under either an industrial award, or by an employer under the provisions of the superannuation guarantee (SG) legislation or directly by a self-employed individual. Employees can also arrange with their employer to have salary sacrifice contributions made on their behalf. Some employers also contribute more than the amount required by the SG provisions because they choose to do so.

Industrial awards

Details of the superannuation support that an employer is required to provide to employees can be prescribed under federal and state industrial awards in addition to the provisions of the Commonwealth's superannuation guarantee scheme. The provisions of the *Workplace Relations Amendment (Work Choices) Act 2005* allow for the superannuation provisions of various industrial awards to continue to have effect after 30 June 2008.[35]

Under award superannuation, the parties (unions, employer associations) are bound by an award to make superannuation contributions to a nominated superannuation fund or funds. Some awards allow for choice of fund. The level of support is normally not greater than 3 per cent of ordinary time earnings or some other notional earnings base defined in the award and permitted by the *Superannuation Guarantee (Administration) Act 1992* (SG Act).

The award based superannuation provisions may be replicated or modified in a workplace agreement; or an agreement may make reference to an award superannuation provision, possibly at a higher employer contribution rate.

33. Subsection 290-165(2) ITAA97.
34. Section 290-160 ITAA97.
35. Section 527 *Workplace Relations Act 1996*.

Superannuation guarantee scheme

The superannuation guarantee scheme requires all employers to provide a minimum of 9 per cent superannuation support in each financial year for employees (with limited exceptions).[36] From 1 July 2008 employers may only calculate the superannuation guarantee contributions with reference to an employee’s ordinary hours of work.[37] The ordinary time earnings of an employee is the lesser of:

- the total of the employee's earnings in respect of ordinary hours of work and earnings consisting of over-award payments, shift loading or commission but not including lump sum payments made on termination of employment in lieu of unused annual leave, long service leave or sick leave, or
- the maximum contribution base for the contribution period.[38]

Obligation to pay SG amounts

The requirement for an employer to pay Superannuation Guarantee (SG) amounts on behalf of their employees arises under the SG Act. The general operation of that Act is that all employers are liable for the Superannuation Guarantee Charge (SGC or the Charge). The amount of the Charge is reduced by the amount of SG contributions paid by the due date. If the employer does not make the required SG payments on behalf of their employees by the due date (28 days after the end of the relevant calendar year quarter) they are liable to pay the Charge.[39] Relief from paying some elements of the Charge is given if the SG payments are made within an additional 28 day period.

If an employer refuses to provide a superannuation guarantee statement or additional information to enable the assessment of their SG obligations they may be required to pay double the required SG charge.[40]

Further, in certain circumstances an employer may also be liable for a double payment of the SG charge if they make a late payment. Proposed changes to the SG legislation will eliminate this latter requirement for a double payment of the SG charge.[41]

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36. Section 19 *Superannuation Guarantee (Administration) Act 1992*.

37 Sections 5 to 7 *Superannuation Laws Amendment (2004 Measures No. 2) Act 2004* (No 93 of 2004) amending subsection 23(2) to (5) *Superannuation Guarantee (Administration) Act 1992*. These latter sections do not take effect until 1 July 2008.

38 Subsection 6(1) *Superannuation Guarantee (Administration) Act 1992*.

39. Section 16 *Superannuation Guarantee (Administration) Act 1992*.

40 Subsection 59(1) *Superannuation Guarantee (Administration) Act 1992*.

41 The Hon. Peter Dutton MP, Minister for Revenue and Assistant Treasurer, ‘Superannuation guarantee compliance made simpler for small businesses, media release, No 121, 2 October

Exemption from the superannuation guarantee charge

Following are the general circumstances where the employer is not liable to pay the SGC:

- when the employer makes the required SG payments by the due date
- where the employee's superannuation arrangements are via a defined benefit superannuation fund, and the employee's benefits are, at the time the SG contribution(s) are payable, are fully funded.[42]
  - a benefit is fully funded when the scheme holds enough assets to meet the payment of benefits for all of its members. The period during which this occurs and the employer is not required to make SG payments is known as a 'superannuation contributions holiday'
- where the employee is paid less than $450 per month in salary/wages[43]
- where the employee is under 18 years of age and is employed part time[44]
- where salary or wages are exempt from income tax under paragraph 23(s) of the *Income Tax Assessment Act 1936* or item 1.4 of the table in section 51-5 of the *Income Tax Assessment Act 1997*[45]
  - this exclusion refers to tax free wages and allowances earned by members of the military reserves, during their reserve service, and
- a person who is over 70 years of age.[46]

The above list is not exhaustive, but represents the major circumstances where an employer is not liable for the Charge and therefore does not have to make SG payments on behalf of these employees.

Maximum contribution base

Employers who do not make superannuation guarantee contributions are liable for the SGC. The SGC is made up of the employer's superannuation guarantee shortfall (the amount that

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2007. At the time of writing this measure was contained in Schedule 2 Tax Laws Amendment (2008 Measures No 2) Bill 2008. This bill is currently before the Senate.

42. Sections 22 and 23 *Superannuation Guarantee (Administration) Act 1992*.

43. Section 27(2) *Superannuation Guarantee (Administration) Act 1992*.

44. Section 28 *Superannuation Guarantee (Administration) Act 1992*.

45. Section 28 *Superannuation Guarantee (Administration) Act 1992*.

46. Section 27(1) *Superannuation Guarantee (Administration) Act 1992*.

the employee should have received in superannuation guarantee contributions), an interest (or penalty) component and an administration component (to recover costs incurred by the ATO). When calculating an individual employee's superannuation guarantee shortfall, the amount of an employee's salary or wages used to calculate their 'ordinary time earnings' in a contribution period is limited to the maximum contribution base, which is **$38 180 per quarter**.[47]

Quarterly superannuation guarantee

From 1 July 2003 employers have been required to make superannuation guarantee contributions on a quarterly basis.

Contributions that are not eligible for a tax deduction

Certain contributions are not eligible for a tax deduction. These contributions include:

- the roll-over of superannuation benefits
- a benefit transferred from an overseas superannuation fund[48]
- a directed termination payment paid into a superannuation plan by an employer under transitional arrangements that apply until 30 June 2012[49]
- a contribution made under the *Family Law Act 1975* to satisfy the entitlement of a former spouse (who may also be an employee)[50] and
- contributions paid in satisfaction of a superannuation guarantee charge obligation.[51]

Choice of superannuation fund

From 1 July 2005 employees have been required to choose the complying superannuation fund into which they want to have their superannuation guarantee contributions paid. Where an employee does not choose a superannuation fund, the employer may choose the complying superannuation fund, provided it is an 'eligible choice fund'. An 'eligible choice fund' is:

- a complying superannuation fund
- a retirement savings account

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47. Australian Taxation Office, *Key superannuation rates and thresholds*, 12 June 2008.
48. Section 290-5 ITAA97.
49. Section 290-1, *Income Tax (Transitional Provisions) Act 1997.*
50. Subsection 290-60(4) ITAA97.
51. Section 290-95 ITAA97.

- a fund presumed to be a complying superannuation scheme under section 24 of the SG Act, or
- a fund presumed to be a complying superannuation fund under section 25 of the SG Act.

However, the SG Act excludes various groups of employees from the coverage of the choice of superannuation fund legislation including:

- some employees who are members of defined benefit superannuation funds,
- employees under 'preserved' State Industrial Awards (as defined by cl 1 of Sch 7 to the *Work Place Relations Act 1996*) (Work Choices Act), and
- employees with superannuation entitlements under certain certified agreements or Australian Workplace Agreements.[52]

However from 1 July 2006, choice of superannuation fund has been extended to employees working for corporations that were previously under a State industrial award, but as a result of the Work Choices Act and associated regulations are now under the Federal workplace relations system.[53]

Portability

Briefly, portability allows superannuation fund members to transfer some, or all, of their superannuation fund balances to another superannuation account in their own name. Portability makes it easer to consolidate a person's multiple superannuation accounts.[54]

Taxation of superannuation fund earnings

The assessable income of a complying superannuation fund or retirement savings account, comprising of both the investment earnings and the contributions received, are taxed at a rate of 15 per cent. The capital gains tax discount for superannuation funds is one third of the capital gains included in a superannuation fund's assessable income.

The tax that a superannuation fund pays on its assessable income can be reduced through the use of imputation credits and other deductions such as those related to property investment.[55]

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52. Section 32, *Superannuation Guarantee (Administration) Act 1992*.
53. Schedule 17 Workplace Relations Amendment (Work Choices) (Consequential Amendments) Regulations 2006 (No. 1) (SLI No. 50 of 2006). This Schedule makes necessary amendments to the *Superannuation Guarantee (Administration) Act 1992* and associated regulations.
54. Division 6.5 Superannuation Industry (Supervision) Regulations 1994.
55. Imputation credits form part of the dividend imputation system. *The Australian Financial Review: Dictionary of Investment Terms*, 5th Edition, Sydney, 2000, p. 110,describes 'Imputation Credit' as Taxation credits which are passed onto shareholders who have received

In practice the average rate of tax on the earnings of a superannuation fund is about 7.1 per cent per annum.[56]

Funds which are made non-complying are taxed at a rate of 45 per cent on their assessable income, including realised capital gains and taxable contributions.[57] Superannuation funds can be non-complying either through choice or through failing to meet the necessary standards and conditions required under prudential legislation to qualify for tax concessions. All APRA regulated and licensed funds are complying funds.

Payment and taxation of superannuation benefits

This section describes the taxation arrangements that apply to superannuation benefits. A superannuation benefit generally is the amount of money in the superannuation fund or retirement savings account to which the fund member or retirement savings account holder is entitled. Most benefits are in the form of lump sums or are capable of being converted into a lump sum. However, some schemes, including those covering many Commonwealth public servants, pay a substantial part of benefits in the form of a pension. Most benefits are payable to the member only on retirement or satisfaction of another condition of release such as permanent disability and will often be subject to preservation (see 'Preservation rules' below).

These amounts should not be confused with employment termination payments which refer to amounts paid arising solely from the termination of employment. This latter class of payments are not further discussed in this document.

Background

From 1 July 2007 a superannuation benefit may comprise the following:

- a tax free component
- a taxable component which includes
  - an element taxed in the fund, and/or
  - an element untaxed in the fund.

The tax free component of a superannuation benefit is generally made up of contributions from a person's post-tax income and by amounts which represent the portion of a

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franked dividends in relation to their shareholdings. Imputation credits arising from the company tax paid by a company in relation to its profits.

56. Australian Government, *International Comparison of Australia's Taxes*, 3rd April 2006, p. 229.

57. Subsection 26(2) *Income Tax Rates Act 1986*.

superannuation benefit that accrued before 1 July 1983. The tax free component is exactly that - it is paid tax free; no matter whether it comes from a taxed or an untaxed source.

The taxable component of a superannuation benefit is the total value of the superannuation benefit *less* the tax free component. The taxable component is usually made up of tax deductible contributions made to the superannuation fund by the person and/or by the employer on the person's behalf, as well as earnings on all contributions. For most people the taxable component is entirely made up of an element taxed in the fund, that is, a part that has been subject to tax at the time that contributions were made and upon earnings.

The tax treatment of a taxable component also depends on whether or not it is drawn from an element which has been untaxed in a fund. Most members draw benefits from an element that has been taxed in a fund. In comparison, an element untaxed in the fund usually arises in public sector superannuation plans where tax has not been paid on contributions or earnings, or from unfunded schemes.[58] Only about 10 per cent of superannuation fund members belong to such schemes.[59] An element untaxed in the fund can also be relevant when a taxed fund pays out an insurance death benefit to a non-dependant such as an adult child.

Different taxation arrangements apply to the element taxed in the fund and the element untaxed in the fund. These arrangements are summarised in the following tables. The tax rates specified in the tables are maximum rates of tax. The Medicare levy (1.5% p.a.) is also payable upon any superannuation benefit where a tax rate greater than zero per cent applies.[60]

Table 2: Tax treatment of superannuation member benefits -taxed elements

Age when benefit received	Superannuation lump sum	Superannuation pension
Aged 60 and above	Tax Free	Tax Free
Preservation age to 59	0% up to **$145 000**, 15% on amount above this figure	Marginal tax rate but with 15 % tax offset
Below preservation age	20%	Marginal tax rate but no tax offset for most pensions (a)

Source: Explanatory Memorandum to Simplified Super Legislation[61] and ATO, Key superannuation rates and thresholds for 2008–2009

(a) A disability superannuation pension received below preservation age receives a 15 % tax offset

58. An 'unfunded' scheme is one where the benefits are contributed to the scheme only when the member claims those benefits. That is, the benefits are not funded by either the employee or the employer during the time of that person's membership.

59. Australian Government, A Plan to simplify and streamline superannuation – Detailed outline, May 2006, p. 45.

60. The Hon. Peter Costello MP, Treasurer, *Explanatory Memorandum to Tax Laws Amendment (Simplified Superannuation) Bill 2007* et al,7 December 2006, pp 45 and following.

61. ibid.

The superannuation pension offset and preservation age are further discussed below.

The following table summarises the taxation treatment of the benefits that are untaxed in the fund. These rates apply from 1 July 2007.

Table 3: Tax treatment of superannuation member benefits -untaxed elements

Age when benefit received	Superannuation lump sum	Superannuation pension
Aged 60 and above	15% on first **$1m** per superannuation plan. Top marginal rate on amounts over this	Marginal tax rates and 10 per cent of gross pension paid tax offset
Preservation age to 59	15% on first **$145 000**, 30% on amounts between this figure and **$1.045m** and top marginal rate on amounts above **$1.045m**	Marginal tax rates but no tax offset
Below preservation age	30% on amounts up to **$1.045m**, top marginal rate thereafter	Marginal tax rates but no tax offset

Source: Explanatory Memorandum to Simplified Super Legislation[62] and ATO, Key superannuation rates and thresholds for 2008–2009

Terminal illness

From 1 July 2007 tax free superannuation benefits may be paid to those suffering a terminal illness. The person may be below both their preservation age and age 60 when such a payment takes place.[63]

Pension tax offsets

From 1 July 2007 there are two main tax offsets applying to recipients of superannuation pensions:

- the 15 per cent tax offset. A tax offset equal to 15 per cent of the pension arising from the taxed source[64] for recipients aged between preservation age (currently 55) and 59, and
- a tax offset equal to 10 per cent of the pension paid from an untaxed source where the recipient is 60 years of age or over.[65]

62. Op. cit.

63 Schedule 7 Tax Laws Amendment (2008 Measures No. 2) Bill 2008, and The Hon. Peter Dutton MP, Minister for Finance and Assistant Treasurer, 'Australians with terminal illness will now be able to draw super tax free, *media release*, 11 September 2007.

64. Section 301-25 ITAA97.

65. Section 301-100 ITAA97.

Some pensions, such as those paid from the Commonwealth's Public Sector Superannuation Scheme (PSS), may contain payments from both a taxed and untaxed source, along with some tax free amounts representing return of own contributions. These pensions would qualify for both of the above tax offsets on the relevant components.

No compulsory payout of superannuation benefits

A member is able to leave their benefits in their superannuation fund indefinitely. They are able to withdraw as much, or as little, as they chose at any time after their preservation age provided that they have either retired or reached age 65.[66] The decision to leave benefits in a superannuation fund indefinitely is subject to the rules of the particular superannuation fund involved. However, investment earnings within the fund are tax free if the amount concerned is used to finance an income stream which meets the requirements of the legislation.

The ability to leave superannuation benefits in a fund indefinitely has a commencement date of 10 May 2006.[67]

Payment of income streams

From 20 September 2007 the following arrangements govern the payment of income streams from a superannuation fund:

- only the required payment of a minimum amount per year
- no upper limit on the annual amount paid (including cashing out the entire amount of capital backing the pension)
- no provision for an amount to be left over when the pension ceases, and
- the pension would be transferred only on the death of the recipient to their dependant(s), or cashed out as a lump sum to the dependant's estate. Such a pension cannot be paid to a child aged 25 and over unless the child is permanently disabled.[68]

The following table illustrates the minimum annual pension payment rates, by age; applying from 20 September 2007.

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66. Treasury, *A Plan to Simplify and Streamline Superannuation – Detailed Outline*, 9 May 2006, p. 20.

67. The Hon. Peter Costello MP, Treasurer, 'A Plan To simplify and Streamline Superannuation – Transitional Issues That Apply Immediately', *Media Release*, No 57 of 2006, 14 June 2006.

68. Treasury, *A Plan to Simplify and Streamline Superannuation - Detailed Outline*, 9 May 2006, p. 21.

Table 4: Required minimum superannuation pension payments

Age	Minimum payment percentage	Minimum annual payment for each $100 000 in the account
Under 65	4%	$4000
65-74	5%	$5000
75-79	6%	$6000
80-84	7%	$7000
85-89	9%	$9000
90-95	11%	$11 000
95 or more	14%	$14 000

Source: Schedule 7 – Superannuation Industry (Supervision) Regulations 1994

Say a person, aged 56, elected to take their superannuation benefit in the form of a pension. Further, that the benefit was worth $100 000 when they made this decision. The minimum amount to be paid in that financial year would be $4000. The person could decide to take a pension of $10 000 in that financial year if they so wished.

Proportioning

Since 1 July 2007 both lump sum and pension benefits paid from superannuation funds are divided into both taxed and tax free amounts. Partial payouts are also divided into these components, in the same proportion as the main benefit.[69] For example, if the main benefit was made up of 30 per cent tax-free and 70 per cent taxed components then any partial withdrawal would be similarly proportioned.

This rule does not impact the payment of benefits from a fully taxed source if the recipient is aged 60 or more. As noted above, such benefits are tax free in the hands of the recipient. However, this rule affects partial withdrawals made before that age, such as withdrawals under financial hardship or on compassionate grounds, particularly where the benefit contains a significant amount of non-deductible contributions (i.e. contributions made on an after tax basis).

Preservation rules

'Preservation' refers to the prudential regulatory requirement that certain superannuation benefits be maintained either in a superannuation or rollover fund or retirement savings

69. Section 307-125 ITAA97.

account until permanent retirement or after the member reaches preservation age.[70] Benefits may be paid on a member's death or invalidity prior to preservation age.

Preservation age

'Preservation age' is the age at which a fund member can gain access to benefits that have accumulated in a superannuation fund or retirement savings account, provided that the member has permanently retired from the workforce.

The government announced in the 1997 Budget that the preservation age would be increased from 55 to 60 years on a phased-in basis. By 2025, the preservation age will be 60 years for anyone born after June 1964, with the preservation age being reduced by one year for each year that the person's birthday is before 1 July 1964. This means that persons born before 1 July 1960 will continue to have a preservation age of 55. The following table summarises the phase-in schedule:

Table 5: Preservation ages by date of birth

For a person born	Preservation age (years)
Before 1 July 1960	55
1 July 1960–30 June 1961	56
1 July 1961–30 June 1962	57
1 July 1962–30 June 1963	58
1 July 1963–30 June 1964	59
After 30 June 1964	60

Source: Reg 6.01(2) Superannuation Industry (Supervision) Regulations 1994

Preservation rules from 1 July 1999

The preservation rules changed significantly from 1 July 1999. These rules provided that all superannuation contributions (including member contributions) and superannuation fund investment earnings, from that date forward, would be preserved until the member's preservation age. Pre-1 July 1999, non-preserved components of a member's superannuation entitlement generally retain their non-preserved status.

Prior to 1 July 1999, some monies held in a member's superannuation fund account were unpreserved benefits and could be accessed, subject to some restrictions, without having to wait until the member had reached the preservation age and retired from the workforce. An example is non-deductible (or member) contributions made from after-tax income prior to

70. These prudential regulatory requirements are set out in the *Superannuation Industry (Supervision) Act 1993* and Regulations 6.18 and 6.19 and Part 1 of Schedule 1 of the Superannuation Industry (Supervision) Regulations 1994.

1 July 1999, where the member is no longer working for the employer with whom they were employed when he or she made these non-deductible contributions.

From 1 July 2004, any employer eligible termination payment rolled over into a superannuation fund or approved deposit fund must be preserved until the member satisfies a condition of release that allows them access to their preserved benefits, such as retiring from the workforce once he or she has reached their preservation age. From 1 July 2007 the only employer termination payments that can be rolled into superannuation are those that were specified in existing employment contracts as at 9 May 2006 and are paid in before 1 July 2012.

Accessing superannuation before retirement

Preserved superannuation benefits can be accessed on compassionate grounds and severe financial hardship or as the result of permanent incapacity. The rules and procedures in regard to release on compassionate grounds or financial hardship are strictly prescribed in the legislation.

Transition to retirement pensions

From 1 July 2005 a person who has reached their preservation age may access their superannuation benefits in the form of a non-commutable income stream without having to retire or leave their current employment. Further, an allocated pension taken under these provisions can be stopped at any time and restarted at a later date.[71] These measures were designed to cater for more flexible working arrangements towards the end of a person's working life. These pensions are known as 'transition to retirement' pensions

For all new such pensions no more than 10 per cent of the account balance of a transition to retirement pension can be withdrawn as a pension payment in any one year.[72]

Departing Australia superannuation payments

From 1 July 2002, temporary residents who permanently depart Australia can gain access to their accumulated superannuation. To be eligible for a payment:

- the person must have entered Australia on an eligible temporary resident visa (New Zealand residents are excluded)

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71. Superannuation Industry (Supervision) Amendment Regulations 2005 (No. 2) and Retirement Savings Accounts Amendment Regulations 2005 (No. 1). Any type of income stream can be taken under these provisions, including allocated pensions or market linked pensions. However, they are non-commutable until the person has reached 65 and retired.

72. Treasury, *A Plan to Simplify and Streamline Superannuation – Detailed Outline*, 9 May 2006, p. 23.

- the person's visa must have expired or been cancelled, and
- the person must have permanently departed Australia.

The payment of superannuation benefits that qualify as Departing Australia Superannuation Payments are subject to special withholding tax rates to claw back the tax concessions the contributions received when originally paid into the superannuation. These rates are:

- tax free component – 0 per cent
- taxable component – 30 per cent, and
- untaxed component – 40 per cent.[73]

Future superannuation payments made on behalf of temporary residents (except those from New Zealand) will continue to be held by the relevant superannuation fund. However, if these benefits remain unclaimed 6 months after the departure of the former temporary resident these benefits will be paid to the Australian Government. Departed former temporary residents can then claim these benefits from the Australian Government (in practice the Australian Tax Office) at any time.[74]

Death benefits

Lump sums

Briefly, lump sum superannuation benefits paid to a dependant of the deceased are tax free.[75]

If a non-dependant receives a lump sum benefit, and it includes a tax-free component, this amount remains tax free in the non-dependant's hands. Further, capped tax rates on the lump sum of 15 per cent for the taxed element and 30 per cent for the untaxed element apply.[76]

Pensions

Taxation of superannuation pensions paid as a result of the death of a member to their dependant is complex; depending on the age of the member on death, and the age of the person receiving it.

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73. Section 5 *Superannuation (Departing Australia Superannuation Payments Tax) Act 2007*.

74. Senator the Hon Nick Sherry, Minister for Superannuation and Corporate Law, 'Government announces new approach for temporary residents superannuation, *media release*, no 50. Gold Coast, 8 August 2008.

75. Section 302-60 ITAA97.

76. Sections 302-140 and 302-145 ITAA97.

From 1 July 2007 a non-dependant cannot receive a superannuation pension as a result of the death of a superannuation pensioner after this date. A child aged 25 and over is generally regarded as a non-dependant. However, the non-dependant beneficiary in such circumstances may be entitled, to receive a superannuation lump sum based on the commutation (i.e. cashing out) of a pension paid to the deceased.

Pensions that commenced to be paid to a person as a result of the death of a member before 1 July 2007 will continue to be paid. Where such pensions are paid to a non-dependant they are taxed as if they were received by a dependant.

The following table summarises the tax treatment of superannuation pensions paid to a non-dependant as the result of the death of a primary pension recipient.

Table 6: Tax treatment of superannuation pensions paid to a dependant of a deceased superannuation pensioner after 1 July 2007.

Age of the deceased at time of death	Age of the recipient	Tax Treatment of pension income in the hands of the non-dependant recipient
60 or above	Any age	Income arising from a taxable component – tax free Income arising from an untaxed component – marginal tax rates but with access to the 10% tax offset
Below age 60	Above age 60	Income arising from a taxable component – tax free Income arising from an untaxed component – marginal rates but with access to the 10% tax offset
Below age 60	Below age 60	Income arising from a taxable component – marginal tax rates but with access to the 15% tax offset Income arising from untaxed component – marginal tax rates (no access to the 10% tax offset).

Source: Explanatory Memorandum to Simplified Super Legislation[77]

Who is a dependant?

From 30 June 2004, the definition of ‘dependant’ was widened to include people living in an interdependent relationship.[78] An ‘interdependent relationship’ exists where the two people involved:

- have a close personal relationship

77. The Hon. Peter Costello MP, Treasurer, *Explanatory Memorandum to Tax Laws Amendment (Simplified Superannuation) Bill 2007* et al,7 December 2006, p. 49.

78. This includes people in a same-sex relationship where they meet the definition of an interdependent relationship.

- 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.[79]

Same sex couples

The above definition of an interdependent couple includes members of a same-sex couple. However, changes now being considered by the Senate will enable the surviving member of a same sex couple to be classed as a dependant for superannuation purposes without having to satisfy the requirements of the above interdependent relationship definition.[80]

Death benefits paid to non-dependants of the military and police serviceman

From 1 July 2007 payments made to non-dependants of Defence Force personnel, Australian Protective Service officers and federal or state or territory police killed in the line of duty will be paid tax free.[81]

This treatment will apply from 1 January 1999. Ex-gratia payments will be made to those non-dependants who received superannuation payments between 1 January 1999 and 30 June 2007.[82]

Increased amount of death benefit payments

A death benefit lump sum, paid to a trustee of a deceased estate, spouse, former spouse or a child may be increased by part of the contributions tax paid on tax-deductible contributions paid into the fund since 1 July 1988. The superannuation fund can recover any appropriate increase in the amount paid through a tax deduction.[83]

This applies only where the person dies as a member of a superannuation fund and where the trustees of the fund concerned agree to increase the death benefit payment. As noted above, due to the recent change in superannuation law a person may remain a member of a fund irrespective of age or attachment to the workforce, and withdraw as much or as little as they like. This may lead to increased numbers of persons remaining members of their superannuation funds until they die.

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79. Reg 10A Superannuation Industry (Supervision) Regulations 1994, Section 302-200 ITAA97.

80 Relationships (Equal Treatment in Commonwealth Laws Superannuation) Bill 2008.

81. Subsection 302-195(2) ITAA97.

82. Schedule 4, section 5, *Tax Laws Amendment (2007 Measures No. 3) Act 2007*.

83 Section 295-485 ITAA97.

GST and superannuation

This section summarises how the GST is applied to superannuation funds.[84]

The GST is a broad–based, value–added tax of 10 per cent on most goods and services supplied in Australia. It has been fully effective from 1 July 2000. (some contracts entered into before 1 July 2000 are also affected by the GST). The GST is payable on transactions where goods and/or services are supplied for consideration (payment). No business is necessarily GST-free; only certain transactions may be classified as such.

In all countries that have a GST–type tax, financial services are given special treatment. This is because of the difficulty in valuing the service provided when there are sums of capital and interest and other earnings in most financial transactions. It is difficult to determine GST on transactions comprising both a fee for service and an interest charge. Accordingly, financial services are 'input-taxed'.

Superannuation funds are in the business of making 'financial supplies', meaning that the provision, acquisition, or disposal of an interest in or under a superannuation fund, scheme, approved deposit fund or retirement savings account or in or under an annuity or allocated pension, is a financial supply.[85] Accordingly, no GST is payable by superannuation funds in respect of contributed capital and related fees paid by members or employer sponsors.

Most of the services provided to members by superannuation funds are free of GST; that is, they are 'input taxed financial supplies'. This means that superannuation funds pay GST on many of their purchases (such as computers), do not levy GST on the supplies they make to their ultimate customers (that is, on benefits paid to fund members), and are input–taxed (that is, they are not able to obtain input credit for the GST levied on the goods or services they purchased).

Nonetheless, in some circumstances superannuation funds are eligible for reduced input tax credits. For example, superannuation funds if registered for GST purposes are eligible for reduced input taxed credits of the GST paid for administration and legal services. In addition, superannuation funds have to levy GST on their non-'input tax financial supplies', provided that the fund is registered or required to be registered for GST purposes. For example, superannuation funds are required to levy GST on the supply of premises to commercial property tenants. If a superannuation fund's turnover (which excludes input-taxed supplies) exceeds $75 000 per year, it must register with the ATO for GST purposes. The government is also encouraging people who manage their own superannuation funds to apply for an ABN

84. For more details, see the Association of Superannuation Funds of Australia and the GST Start–Up Office, *The Goods and Services Tax and the Superannuation Industry Workbook*, January 1999, website at: http://www.superannuation.asn.au/gst/rpm.cfm?page=workbk.

85. This is set out in regulation 40–13 of A New Tax System (Goods and Services Tax) Regulations 1999.

to assist with the administration of their fund. Possession of an ABN does not necessarily mean that a superannuation fund is registered for the GST.[86]

Self managed superannuation funds

This section summarises the main features of a self managed superannuation fund (SMSF).

General rules

A SMSF is a fund that:

- has a trust deed that meets the requirements of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)
- has no more than four members
- all the members are trustees of that fund
- the fund meets the normal residency requirements, that is it meets the definition of an Australian Superannuation Fund[87]
- no member of the fund is an employee of another member of the fund, unless they are related, and
- no trustee of the fund receives any remuneration for their services as trustee.

Because all the members of an SMSF are trustees, the fund is not subject to the full range of prudential regulation and supervision. However, trustees of SMSFs still have to meet a number of obligations:

- lodging an annual income tax return and superannuation fund annual return
- lodging a superannuation member contributions statements (MCS)
- reporting payments of member benefits
- appointing an approved auditor to complete the annual audit
- maintaining records for up to 10 years, and
- complying with investment restrictions.

86. See The New Tax System Advisory Board media release, *Self Managed Super Funds Should Apply for an ABN Now*, 28 May 2000.

87 *S*ection 295-95(2) ITAA 97.

Some of the SIS Act key compliance requirements applying to SMSFs include:

- meeting the sole purpose test
- formulating and giving effect to an investment strategy
- not accessing member's money without meeting a specific condition of release
- not providing loans or financial assistance to members or relatives, and
- not borrowing money to invest.

SMSFs are regulated by the ATO.

Payment of pensions from an SMSF

A SMSF may pay an allocated pension or a term allocated pension (sometimes called a 'market linked' pension) to its members.

However, there are restrictions on the ability of a SMSF to pay a defined benefit pension:

- if a SMSF was paying a defined benefit pension before 12 May 2004, or a specific entitlement to such a pension for a particular member of the fund existed before that date, it can continue to pay that pension or commence to pay that pension after 12 May 2004[88]
- under transitional rules, self managed superannuation funds can also pay a defined benefit pension to a person as long as:
  - the person was a member of the fund on 11 May 2004
  - before 1 January 2006, the person turns 65, or retires on or after turning 55
  - the person becomes entitled to the pension after 11 May 2004 and before 1 January 2006, and
  - the first pension payment is made within 12 months of the day the person became entitled to the pension [89]

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88. Reg 9.041 Superannuation Industry (Supervision) Regulations 1994. and ATO Fact Sheet, *Self Managed Superannuation Funds and Pensions*, 31 May 2005.

89. The Hon Mal Brough, Minister for Revenue and Assistant Treasurer, Press Release, *Extension of Transitional Arrangements for Small Funds*, No. 049, 6 June 2005 and Reg 9.041 Superannuation Industry (Supervision) Regulations 1994 and Superannuation Industry (Supervision) Amendment Regulations 2005 (No. 4), which amends Reg 9.041(3) to allow a SMSF to commence to pay a defined benefit pension in certain circumstances before 1 July 2006.

- a SMSF cannot alter its trust deed/governing rules to allow for the payment of a defined benefit pension on or after 12 May 2004, and
- no SMSF established on or after 12 May 2004 may pay a defined benefit pension.[90]

90. ATO Superannuation Determination, SD 2004/1, *Superannuation: can a self managed superannuation fund provide a defined benefit pension?*, at http://law.ato.gov.au/pdf/sd04-001.pdf, accessed 16 June 2005, and The Hon Mal Brough MP, then Minister for Finance and Assistant Treasurer, 'Outcome of the Review of Pensions in Small Superannuation funds, *media release*, 27 September 2005.