Super opportunities for business owners

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Make the most of super

While you've been building up your business, you may not have had the time to focus on your super.

But what if we told you that, in addition to the existing tax concessions, the Government has proposed all super benefits received at age 60 or over will generally be tax-free from 1 July 2007.

In this guide we outline six superannuation strategies that could make a serious difference to your retirement lifestyle.

But you need to act quickly, as the window of opportunity to make larger undeducted (after-tax) super contributions closes on 30 June 2007.

You should also seek financial advice to ensure you make the right decisions.

Important information

The information contained in this booklet applies to complying taxed super funds (not untaxed funds such as certain Government or public sector schemes) but does not apply to defined benefit interests. To use the strategies outlined in this booklet, you must be eligible to make super contributions (see page 19).

What type of business owner are you?

As a business owner, you will either be self-employed or an employee. For the purpose of this guide:

- **Self-employed** means you receive less than 10% of your assessable income (plus reportable fringe benefits) from eligible employment. If this is the case, you will generally be eligible to claim your personal super contributions as a tax deduction.

- **Employee** means you earn 10% or more of your assessable income (plus reportable fringe benefits) from eligible employment. While you generally won't be able to claim a portion of your super contributions as a tax deduction, you may be able to make salary sacrifice contributions instead.

  This distinction will help you determine which strategies are relevant to you and how they will apply (see *Strategies at a glance* on the opposite page).

Strategies at a glance

Strategy	Suitable for	Key benefits	Page	
1 Invest assets in your own name into super	All business owners	• Take advantage of the maximum tax rate of 15% on super fund earnings • Receive a more tax-effective retirement income	6	For non-business assets
2 Save on Capital Gains Tax (CGT) and make a larger super investment	Business owners who are self-employed, or are under age 65 and recently retired	• Reduce or eliminate capital gains tax on asset sales • Make a larger super investment	8	
3 Save more for retirement without reducing your income	All business owners aged 55 or over	• Take advantage of a tax-effective income stream investment while you're still working • Boost your retirement savings	10	
4 Invest money in your company into super	Business owners who run their business through a company	• Take advantage of the maximum tax rate of 15% on super fund earnings • Receive a more tax-effective retirement income • Use retained earnings more effectively	12	For business assets
5 Invest the sale of your business tax-effectively	All business owners planning to sell their business and retire	• Receive a more tax-effective retirement income • Retain more of your investment capital	14	
6 Invest the sale of your business sooner	All business owners planning to sell their business and retire	• Get more money into super sooner • Receive a more tax-effective retirement income	16	

Overview of super changes

In the 2006 Federal Budget, the Government announced a range of changes that will make super simpler and more tax-effective.

Unless otherwise stated, the following changes are scheduled to take effect on 1 July 2007.

Super will become even more attractive because:

- All super benefits will be tax-free if received at age 60 or over. You will also not be required to include the benefits in your annual tax return, which could reduce the tax payable on non-super investments.
- The tax treatment of super benefits received before age 60 will be simpler and, in some cases, more generous.
- The Reasonable Benefit Limits (restricting the amount of concessionally taxed super benefits you can receive over your lifetime) will be abolished. Instead, caps will limit the amount that can be contributed to your super each year (see below).

A cap on non-concessional contributions has been introduced

This cap applies to undeducted contributions and certain other non-concessional amounts, such as spouse contributions received (see page 19).

A transitional cap of $1 million is available between 10 May 2006 and 30 June 2007. After this date, the cap will reduce to $150,000 a year (or $450,000 in one year if you're under age 65 in that year and don't make further contributions in the following two years). Contributions exceeding your cap will be subject to a penalty.

You may also be able to take advantage of a lifetime limit of up to $1 million that can be claimed when contributing proceeds from the sale of small business assets. To qualify for the full limit, conditions apply (see page 21).

The age-based deductible contribution limits will be replaced

- Age-based limits currently restrict the amount of employer contributions (including salary sacrifice) and personal contributions that can be claimed as a tax deduction. Additionally, if you're self-employed (see page 2), you're limited to claiming the first $5,000, plus 75% of the balance up to your age-based limit.
- From 1 July 2007, the age-based limits will be abolished and employers/self-employed people will be able to claim a full tax deduction for their super contributions. However, these contributions and certain other amounts will count towards a concessional contribution cap (see page 20) and contributions exceeding the cap will be subject to a penalty.
- The concessional cap will be $50,000 pa or, if you're aged 50 or over, $100,000 pa for five years until 30 June 2012.

Age	Age-based limits (1 July 2006 to 30 June 2007)	Concessional contribution cap (From 1 July 2007)
Under 35	$15,260	$50,000 pa
35 to 49	$42,385	$50,000 pa
50 to 69	$105,113	$100,000 pa up to 30 June 2012 and $50,000 pa thereafter
70 to 74	N/A*	

* A tax deduction is only available for mandated employer contributions at age 70 or over.

Social security measures (from 20 September 2007)

- The Assets Test taper rate will be halved, making it easier to qualify for Age Pension benefits.
- The 50% Assets Test exemption will not be available for new income streams commenced from 20 September 2007.

Other key measures

- The conditions which determine eligibility for the small business capital gains tax concessions will be relaxed further (see page 20).
- You may qualify for a Government co-contribution of up to $1,500 if you make undeducted (after-tax) super contributions, you generate 10% or more of your income from a business and earn# less than $58,000 a year.
- All lump sum death benefits from super will be tax-free when received by a dependant^, and generally taxed at up to 16.5% if received by a non-dependant (eg an adult child).
- Transitional arrangements will apply to employer eligible termination payments (ETPs) received between 1 July 2007 and 30 June 2012. Under these arrangements, you will still be able to rollover~ the payment to a super fund (or receive it as cash) if the employer ETP was specified in your employment contract on 9 May 2006. If you're not eligible for the transitional rules, you will only be able to receive an employer ETP as cash from 1 July 2007 and a less generous tax treatment may apply to cash payments.

Includes assessable income plus reportable fringe benefits, but is reduced by amounts for which you're entitled to a deduction for carrying on a business.

^ Includes a spouse, minor child, interdependant or financial dependant.

~ To rollover an employer ETP, you must be eligible to contribute to super (see page 19).

Important information

At the time of printing (January 2007) the proposals outlined in this booklet had not been legislated and may change in the future. You should speak to a financial adviser before taking any action based on the information contained in this booklet.

Invest assets in your own name into super

If you currently hold an investment in your own name, you may want to cash it out and use the money to make an undeducted (after-tax) super contribution. This strategy can help you build a bigger nest egg and receive a more tax-effective retirement income.

Act before 1 July 2007 and you may also be able to take advantage of the transitional cap of $1 million that applies to undeducted contributions and certain other non-concessional amounts (see page 4).

How does the strategy work?

If you keep an investment in your own name, earnings will generally be taxed at your marginal rate of up to 46.5%*.

But if you cash out your investment and make an undeducted contribution, investment earnings in a super fund are taxed at a maximum rate of 15%.

Also, if you're eligible to access your super and start an income stream investment (such as an allocated pension):

- No tax will be payable on earnings within the fund.
- Any taxable income payments will attract a 15% tax offset between age 55 and 60.
- No tax will be payable on income payments received at age 60 or over from 1 July 2007.

This strategy can be particularly powerful if your money is currently invested in a term deposit or other asset where you don't have to pay capital gains tax (CGT) on withdrawal.

But even if you have to pay CGT on assets like shares, investment properties and unit trusts, the benefits of investing in super could more than compensate for your CGT liability.

Note: Super benefits are 'preserved' in the fund and cannot be accessed until you satisfy a condition of release (see Glossary).

* Includes a Medicare Levy of 1.5%.

Strategy #

01

The benefits

- Reduce tax on investment earnings by taking advantage of the maximum tax rate of 15% in super.
- Receive a more tax-effective income in retirement by using your super to commence an income stream investment.

Case study

Rosemary (aged 50) earns a taxable income of $80,000 pa from her business. She has a share portfolio worth $600,000, including a taxable capital gain of $100,000*.

She sells the shares, keeps $43,000 to pay CGT and makes an undeducted super contribution of $557,000 before 1 July 2007.

While CGT reduces the amount Rosemary can invest in super, in this example, her investment will be worth an extra $25,671 when she retires in 10 years. This is because the lower tax rate on investment earnings in super more than compensates for her CGT liability.

* This figure is after the 50% CGT discount and assumes Rosemary has no capital losses to offset her taxable capital gain.

Value of investment (in today's dollars)	**Keep shares in own name**	**Redeem shares and invest in super**
Now	$600,000	$557,000
In 10 years	$959,551	$985,222

If Rosemary needs an after-tax income of $80,000 pa in retirement, by using her super to commence an income stream, she will have an extra $558,275 in remaining assets (in today's dollars) after 20 years in retirement.

Value of investment (in today's dollars)	**Keep shares in own name**	**Use super to commence income stream**
After 20 years in retirement	$442,474	$1,000,749

This is because, in addition to starting retirement with a larger investment, she will be over age 60 and won't have to pay any tax on her income stream payments. Conversely, earnings from her share portfolio will still be taxable at her marginal rate.

Assumptions: The shares, superannuation and income stream earn a total pre-tax return of 8.5% pa (split 3% income and 5.5% growth). All investment income is franked at 75%. The after-tax income from the share portfolio is re-invested prior to retirement and used to meet living expenses thereafter. Rosemary's taxable income prior to retirement and after-tax income goal in retirement ($80,000 in year one) are indexed at 3% pa. Where the share portfolio doesn't generate sufficient income in retirement, withdrawals are made on a monthly basis throughout the relevant year with CGT payable. No other sources of taxable income are received in retirement. Where applicable, the final figure at year 30 is after CGT.

Note: The results from this strategy will depend on factors such as your marginal tax rate, the CGT payable on the sale of your non-super investment, your timeframe and the investment returns.

Tips and traps

- If you meet certain conditions, you may be able to offset the taxable capital gain on the sale of an asset by claiming a portion of your super contribution as a tax deduction (see Strategy 2).
- There are other ways to reduce CGT on the sale of an asset. These could include using capital losses, selling in a low income year or selling the assets progressively.
- It could take longer to get the money into super if you wait until after 30 June 2007 before cashing out your non-super investment. This is because the transitional cap of $1 million that applies to undeducted contributions and certain other non-concessional amounts expires (see page 19).

  After this date, you can contribute only $150,000 a year (or $450,000 in one year if you're under age 65 in that year and don't make further contributions in the following two years). You may also find you're no longer eligible to make super contributions (eg because you reach age 65 and are no longer working).
- Make sure you don't exceed the relevant cap on non-concessional contributions in any year, as excess contributions will be taxed at 46.5%.
- If the sale proceeds exceed your non-concessional contribution cap, your spouse could consider making an undeducted super contribution into their super account.
- If you're a member of a self-managed super fund, or discretionary master rust, you may be able to transfer certain non-super investments (such as shares) into super as an '*in-specie*' contribution. However, CGT and stamp duty may be payable.

Save on CGT and make a larger super investment

Selling an investment, paying capital gains tax (CGT) and making an undeducted (after-tax) super contribution can be a powerful strategy – as shown in Strategy 1.

However, if you're self-employed, you may want to claim a portion of your super contribution as a tax deduction. By using this strategy, you may be able to reduce (or eliminate) your CGT liability and make a larger super investment.

How does the strategy work?

To use this strategy, you must be eligible to contribute to super (see page 19). You also generally need to receive less than 10% of your assessable income (plus reportable fringe benefits) from eligible employment.

As a result, this strategy can usually only be used if you're self-employed. However it may also be available if:

- you're under age 65
- have recently retired, and
- do not receive any super contributions from an employer in the financial year you sell an asset and invest in super.

If you meet these conditions, you may be able to claim a portion of your super contribution as a tax deduction up to certain limits (see page 5). The tax deduction can then be used to offset your taxable capital gain and reduce your CGT liability.

While the tax-deductible portion of your super contribution will be taxed at 15% in the fund, the net tax savings can still be quite significant, as the following case study illustrates.

Strategy #

02

The benefits

- Reduce or eliminate CGT on the sale of a non-super investment by making a deductible super contribution.
- Make a larger superannuation investment.

Case study

Joe (age 50) is self-employed. Like Rosemary from Strategy 1, he earns a taxable income of $80,000 pa and has a share portfolio worth $600,000, including a taxable capital gain of $100,000*.

If he sells the shares, he could invest $557,000 in super as an undeducted contribution before 1 July 2007, after allowing for his CGT bill of $43,000.

But if he claims $100,000# of his super contribution as a tax deduction, he could offset his taxable capital gain and eliminate his CGT liability.

While the $100,000 deductible contribution will be taxed at 15% in the super fund, this strategy will still allow him to invest an extra $28,000.

* This figure is after the 50% CGT discount and assumes Joe has no capital losses to offset his taxable capital gain.

\# The deduction of $100,000 is within Joe's age-based deductible contribution limit of $105,113 in 2006/07 (see page 5) and is based on a minimum contribution of $131,667.

	Without claiming deduction	With claiming deduction
Value of shares prior to selling	$600,000	$600,000
Less capital gains tax payable on sale	($43,000)	Nil
Less tax on deductible super contribution	Nil	($15,000)
Net super investment	$557,000	$585,000
Additional super investment		**$28,000**

By making a larger initial investment in super, Joe can receive an extra $49,527 when he retires in 10 years. If he then uses his super to commence an income stream, he will have an extra $165,969 in remaining assets (in today's dollars) after 20 years in retirement.

Value of investment (in today's dollars)	**Without claiming deduction**	**With claiming deduction**
Super fund at retirement in 10 years	$985,222	$1,034,749
Income stream after 20 years in retirement	$1,000,749	$1,166,718

Assumptions: Joe's after-tax income goal in retirement ($80,000 in year one) is indexed at 3% pa. Any income received above Joe's requirements is invested in a unit trust. The superannuation, income stream and unit trust investments earn a total pre-tax return of 8.5% pa (split 3% income and 5.5% growth). All investment income is franked at 75%. No other sources of taxable income are received.

Tips and traps

- This strategy could also be used when selling an investment property, unit trust or other investment where CGT is payable by you.
- To offset a capital gain, the super contribution needs to be made and the tax deduction claimed in the same financial year in which the investment is sold.
- To reduce the tax payable on other income sources (eg from self-employment) you may want to claim more of your super contribution as a tax deduction (subject to the limits outlined on page 5).
- While undeducted contributions will be received tax-free by all your beneficiaries, in the event of your death, personal deductible contributions will form part of the taxable amount and are generally taxed at 16.5% if received by non-dependants (eg adult children).

Save more for retirement without reducing your income

If you're aged 55 or over, there's a way you could save more for your retirement without reducing your current income.

This strategy involves:

- sacrificing part of your prospective pre-tax salary directly into a super fund
- investing some of your existing super in a 'Transition to Retirement Pension' (TRP), and
- using the regular payments from the TRP to replace the income you sacrifice into super.

Note: This strategy could also be used if you're self-employed (see page 2). However, rather than making salary sacrifice contributions, you will need to invest some of your business income in super as a personal deductible contribution.

How does the strategy work?

By using this strategy, it's possible to accumulate more money for your retirement. This is due to a range of potential benefits, including:

- Less tax on contributions, as salary sacrifice (and other deductible) super contributions are generally taxed at up to 15%, rather than marginal rates of up to 46.5%*.
- Less tax on investment earnings, as earnings in a TRP are tax-free, whereas earnings in a super fund are taxed at a maximum rate of 15%.
- Less tax on income, as taxable income payments from a TRP will attract a 15% tax offset between age 55 and 60, and no tax will be payable on income payments at age 60 or over from 1 July 2007.

A TRP is a special type of income stream that enables you to access your preserved super benefits when you've reached your preservation age (currently 55).

When you invest in a TRP, limits apply to the amount of income you can receive each year and lump sum withdrawals can only be made in certain circumstances.

But despite these restrictions, combining salary sacrifice with a TRP could add thousands of dollars to your retirement nest egg over time.

* Includes a Medicare Levy of 1.5%.

Strategy #

03

The benefits

- Take advantage of a tax-effective income stream while you're still working.
- Build more wealth for when you retire.

Case study

Craig (aged 55), is an employee who earns a salary of $100,000 pa and receives the standard 9% Superannuation Guarantee (SG) contributions. From 1 July 2007, he sacrifices $70,000 pa into his super fund and reduces his pre-tax salary to $30,000 pa. To receive the same after-tax income he commences a TRP and elects to receive taxable income payments of $55,034 in the first year.

	Before strategy	After strategy
Salary	$100,000	$30,000
TRP income	Nil	$55,034
Total pre-tax income	$100,000	$85,034
Less tax payable*	($29,350)	($14,384)
After-tax income	$70,650	$70,650
SG contributions#	$9,000	$9,000
Salary sacrifice contributions	Nil	$70,000

* Takes into account the Mature Age Worker Tax Offset.

\# Assumes Craig continues to receive 9% SG contributions, even when he sacrifices $70,000 into super.

While the after-tax income and SG contributions are exactly the same in both scenarios, this strategy has the potential to increase Craig's retirement savings.

This is partly because Craig will invest more money in super each year than he will withdraw from his TRP.

For example, in the first year, Craig will receive $55,034 from the TRP, while investing a net amount of $59,500 in his super fund (ie $70,000 less 15% contributions tax = $59,500). That's an extra $4,466 in the first 12 months alone.

Also, earnings in the TRP are tax-free, versus tax at up to 15% applying to earnings accumulating in the accrual phase in super.

If we assume Craig has $600,000 in super (consisting entirely of the post-June 1983 component) and invests this amount in a TRP, the next table shows the value added by this strategy over various time periods.

After year	Value of investments		Value added by strategy
	Before strategy (Super only)	After strategy (Super and TRP)	
1	$655,713	$663,665	$7,952
5	$926,562	$972,791	$46,229
10	$1,405,417	$1,560,040	$154,623

Assumptions: Both the super and TRP investment earn a total pre-tax return of 8% pa (split 3% income and 5% growth). All investment income is franked at 25%. Craig receives a tax-free income from the TRP from age 60. Salary doesn't change over the 10-year period. Neither the super nor TRP investment are cashed out.

Tips and traps

- When using this strategy, you need to consider the following:
  - To replace large salary sacrifice contributions, you may need to invest a significant amount of super in a TRP (see below).
  - If the salary sacrifice (and other deductible) contributions exceed certain limits (see page 5) the excess amount will generally be taxed at 46.5%.
  - If your SG contributions are based on your reduced salary amount, this strategy could erode your wealth.
- A TRP could also be used to top-up your salary when reducing your working hours.
- The Australian Taxation Office (ATO) has confirmed straightforward arrangements involving a TRP and salary sacrifice shouldn't result in adverse tax consequences and penalties under the general anti-avoidance provisions. However, if the strategy is artificial or contrived, it is likely to attract ATO attention.
- To commence a larger TRP investment, you may want to redeem non-super investments (see Strategy 1) or get money out of your company (see Strategy 4) and use the proceeds to make an undeducted super contribution.

Invest money in your company into super

If your private company has surplus capital, you may want to use the money to make an undeducted (after-tax) super contribution. This strategy can help you build a bigger nest egg and receive a more tax-effective retirement income.

Act before 1 July 2007 and you may also be able to take advantage of the transitional cap of $1 million that applies to undeducted contributions and certain other non-concessional amounts (see page 4).

How does the strategy work?

There are generally two steps involved when using this strategy.

First, your company may need to sell the investment. If a taxable capital gain is made on the sale, your company will need to pay tax on the gain at a rate of 30%.

Second, your company needs to distribute the money as a dividend, which will be taxed at your marginal rate, after allowing for any franking credits.

While these steps usually apply regardless of when you get the money out of your company, you may be better off over the longer term if you do it now.

This is because when you invest the net proceeds in super, earnings will be taxed at a maximum rate of 15% rather than the company rate of 30%.

Also, if you use your super to commence an income stream investment (eg an allocated pension), you can receive an unlimited tax-free income from 1 July 2007, if you're age 60 or over.

Note: Super benefits are 'preserved' in the fund and cannot be accessed until you satisfy a condition of release (see Glossary).

Strategy #

04

The benefits

- Reduce tax on investment earnings by taking advantage of the maximum tax rate of 15% in super.
- Receive a more tax-effective retirement income.
- Use retained earnings more effectively.

Case study

Roger (aged 52) operates his business via a company and is the only shareholder. He receives a taxable income of $100,000 pa and the company has $800,000 in retained earnings invested in a Cash Management Trust (CMT).

The company redeems the CMT (which will not crystallise any capital gains tax) and pays Roger a fully franked dividend* of $800,000. After Roger pays income tax on the dividend, he invests a net amount of $613,929 in super as an undeducted contribution before 1 July 2007.

After ten years, the CMT is worth more than the super investment. But after the company redeems the CMT and pays Roger a fully franked dividend, he will receive a net amount of $863,457.

Conversely, because Roger will be over age 60, he will not need to pay tax on his super and will receive the full benefit of $929,570. By getting the money into super, Roger will have an additional $66,113 to meet his living expenses in retirement.

* Assumes there are enough franking credits in the company's books to pay a fully franked dividend.

		Keep CMT in company name	Redeem CMT and invest in super
Now	Value of CMT	$800,000	$800,000
	Less tax payable on dividend	N/A	($186,071)
	Net value of investment	$800,000	$613,929
In 10 years	Value of investment	$1,128,479	$929,570
	Less tax payable on dividend	($265,022)	N/A
	Net value of investment	$863,457	$929,570

If Roger needs an after-tax income of $65,000 pa in retirement, the next table shows the value of his remaining investments (in today's dollars) after a further 20 years. This assumes he uses his super to start an income stream and invests the net proceeds received from the company outside super.

By commencing an income stream, his investment will be worth an extra $254,124. This is because, in addition to starting retirement with more money, he will be over age 60 and won't have to pay any tax on his income stream payments. Conversely, earnings from his non-super investment will be taxable at his marginal rate.

Value of investment (in today's dollars)	**Invest proceeds from company outside super**	**Use super to commence income stream**
After 20 years in retirement	$28,276	$282,400

Assumptions: The CMT and superannuation investment earn 5% pa until Roger retires. The after-tax income from the CMT is reinvested. When Roger retires, the income stream and non-super investment earn a total pre-tax return of 8% pa (split 3% income and 5% growth, with all investment income franked at 25%). Roger's after-tax income goal in retirement ($65,000 in year one) is indexed at 3% pa. Where the non-super investment doesn't generate sufficient income in retirement, withdrawals are made on a monthly basis throughout the relevant year with CGT payable. No other sources of taxable income are received in retirement. Where applicable, the final figure at year 30 is after CGT.

Note: The results from this strategy will depend on factors such as your marginal tax rate, any CGT payable on the sale of the company investment, the level of franking attached to the dividend, your timeframe and the investment returns.

Tips and traps

- It could take longer to get the money into super if you wait until after 30 June 2007 before using this strategy. This is because the transitional cap of $1 million that applies to undeducted contributions and certain other non-concessional amounts (see page 19) expires.

  After this date, you can contribute only $150,000 a year (or $450,000 in one year if you're under age 65 in that year and don't make further contributions in the following two years). You may also find you're no longer eligible to make super contributions (eg because you reach age 65 and are no longer working).
- Make sure you don't exceed the relevant cap on non-concessional contributions in any year, as excess contributions will be taxed at 46.5%.
- If you're likely to exceed your non-concessional contribution cap, your spouse could consider using some of the after-tax amount withdrawn from your company to make an undeducted contribution into their super account.
- Your company may be able to make employer super contributions (subject to the cap on concessional contributions outlined on page 5) rather than, or in addition to, paying a dividend.

Invest the sale of your business tax-effectively

If you're selling your business to retire, you need to decide where to invest the proceeds.

If you invest in your own name (outside super), earnings will generally be taxed at your marginal rate of up to 46.5%*.

However, if you make an undeducted (after-tax) super contribution and use your super to start an income stream investment, you could receive a more tax-effective income to meet your living expenses.

Act before 1 July 2007 and you could also potentially make undeducted contributions of up to $2 million.

* Includes a Medicare Levy of 1.5%.

How does the strategy work?

If you make an undeducted contribution and use your super to start an income stream (such as an allocated pension):

- No tax will be payable on earnings within the fund.
- Any taxable income payments will attract a 15% tax offset between age 55 and 60.
- No tax will be payable on income payments received at age 60 or over from 1 July 2007.

To make the most of these tax concessions, you should aim to sell your business and make the undeducted contribution before 1 July 2007. This helps you utilise:

- The transitional cap of $1 million, which applies to certain non-concessional amounts until 30 June 2007 (see page 4), and
- The lifetime limit of $1 million, which can only be claimed when you contribute the proceeds from the sale of a small business into super and meet certain conditions (see page 21).

By using both limits before the end of this financial year, you may be able to make a total undeducted contribution of up to $2 million and maximise your income stream investment.

Note: Super benefits are 'preserved' in the fund and cannot be used to commence an income stream investment until you satisfy a condition of release (see Glossary).

Strategy #

05

The benefits

- Receive a more tax-effective income to meet your living expenses.
- Retain more of your investment capital.

Case study

Mike (aged 60) is selling his small business, which he has owned for over 15 years. He expects to receive $2 million in June 2007 (after claiming the 15 year CGT Exemption – see page 20). When the sale is completed, he plans to retire and estimates he'll need an after-tax income of $100,000 pa.

If Mike invests the $2 million outside super and the investment generates a total return of 7.5% pa (of which 3.5% or $70,000 is income), he will need to withdraw $43,192 in capital in the first year to receive $100,000. This takes into account tax payable at his marginal rate on income and realised capital gains from his non-super investment.

An alternative is to invest the $2 million in super as an undeducted contribution (UDC) in June 2007 and start an income stream. Because he is 60 he will not pay tax on his income stream from 1 July 2007. If the income stream also generates a total return of 7.5% pa (including an income of $70,000), he will only need to draw $30,000* in capital in the first year to meet his living expenses.

Year-one income position	**Invest outside super**	**Make UDC and start income stream**
Taxable income	$70,000	$70,000
Capital drawdown required	$43,192	$30,000*
Less tax payable	($13,192)	(Nil)
Total amounts received	$100,000	$100,000

* This amount could be received as part of the regular income payments from the income stream or by making lump sum withdrawals.

By drawing less capital from his income stream, he will retain more of his investment and have an extra $816,394 left over (in today's dollars) after 20 years in retirement.

Value of investment (in today's dollars)	**Invest outside super**	**Make UDC and start income stream**
After 20 years in retirement	$1,033,279	$1,849,673

Assumptions: Mike is eligible to claim the 15 year CGT Exemption on the sale of his business (see page 20) and utilises the full $1 million lifetime limit when making an undeducted super contribution (see page 21). The non-super and income stream investment earns a total pre-tax return of 7.5% pa (split 3.5% income and 4% growth). Both investments commence on 1 July 2007. All investment income is franked at 20%. Mike's after-tax income goal ($100,000 in year one) is indexed at 3% pa. Any income received above Mike's requirements is invested in a unit trust. No other sources of taxable income are received. Where applicable, the final figure at year 20 is after CGT.

Note: The benefits of this strategy may not be as great if you receive a smaller amount from the sale of your business and/or require a smaller after-tax income to meet your living expenses.

Tips and traps

- On 1 July 2007, the transitional cap of $1 million that applies to undeducted contributions and certain other non-concessional amounts will expire (see page 19). After this date, it will only be possible to contribute $150,000 a year (or $450,000 in one year if you're under age 65 in that year and don't make further contributions in the following two years).
- If you receive more than $2 million from the business sale, you may be able to make additional undeducted super contributions after 30 June 2007, and/or contribute for your spouse.
- If you receive less than $2 million, you should generally utilise the transitional $1 million cap before claiming the lifetime limit of $1 million. This may enable you to use the remaining lifetime limit if you decide to start another small business later.
- You need to notify your super fund if you want any undeducted contributions counted towards the $1 million lifetime limit.
- There are a range of other concessions that could be used to reduce capital gains tax (CGT) when selling small business assets (see page 20).
- You may want to defer the sale of your business until after 30 June 2007. This is when the basic conditions determining whether you qualify for the small business CGT concessions will be relaxed further.
- If you don't sell your business this financial year, you may want to take out a short-term loan to take advantage of the transitional $1 million cap before it expires on 30 June 2007 (see Strategy 6).

Invest the sale of your business sooner

If you're selling your business to retire, it can be very tax-effective if you invest some of the money in super as an undeducted contribution and start an income stream investment (see Strategy 5).

If you don't expect to receive the sale proceeds until after 30 June 2007, you may even want to take out a short-term interest-only loan before this date. This could enable you to take advantage of the transitional cap of $1 million that applies to undeducted contributions and certain other non-concessional amounts (see page 4).

How does the strategy work?

Regardless of when you receive the proceeds from the sale of your business, you may be able to make an undeducted super contribution using the lifetime limit of up to $1 million (see page 21).

But, if you complete the sale after 30 June 2007 and expect to receive more than the available lifetime limit, you generally have two choices.

1. Drip-feed the additional money into super using the reduced cap of $150,000 a year (or $450,000 in one year if you're under age 65 in that year and don't make further contributions in the following two years). However, when you reach age 65 and are no longer working, you won't be eligible to make additional super contributions. As a result, you may not get all sale proceeds into the superannuation system. Also, earnings on any money held outside super will be taxed at your marginal rate of up to 46.5%*.
2. Use a short-term interest-only loan to take advantage of the $1 million transitional cap before 1 July 2007 and repay the loan when you sell your business. By using this approach, you get more money into super sooner. You may also be able to make a larger income stream investment and receive unlimited tax-free income payments at age 60 or over from 1 July 2007.

* Includes a Medicare Levy of 1.5%.

Strategy #

06

The benefits

- Get more money into super sooner.
- Receive a more tax-effective income to meet your living expenses.

Case study

Sally (aged 63) is selling her small business. Like Mike (from Strategy 5), she:

- has owned the business for over 15 years
- expects to receive $2 million (after claiming the 15 year CGT Exemption – see page 20)
- plans to retire when the sale is completed, and
- needs an after-tax income of $100,000 pa.

The difference is she doesn't expect to receive the sale proceeds until 1 July 2008.

To take advantage of the transitional cap, she takes out an interest-only loan and makes an undeducted super contribution of $1 million on 30 June 2007. Over the next 12 months, she pays the loan interest of $75,000 (which is not tax deductible) from her surplus cash flow. When she receives the sale proceeds on 1 July 2008, she repays the loan and makes a further $1 million undeducted contribution, using the lifetime limit.

If she waits until the sale is completed, she can still utilise the lifetime limit of $1 million. However, because she will be aged 64 by then, she will only be able to make an additional undeducted contribution of $450,000. This leaves her with $550,000 from the business sale to invest outside super, along with the $75,000 she saves by not having to make loan interest payments.

Break-down of investments made	**Doesn't use short-term loan**	**Uses short-term loan**
Superannuation	$1,450,000	$2,000,000
Non-super	$625,000	Nil
Total	**$2,075,000**	**$2,000,000**

Assuming she invests her super in an income stream in July 2008, the next table shows the value of her investment (in today's dollars) after 20 years in retirement.

Value of investments (in today's dollars)	**Doesn't use short-term loan**	**Uses short-term loan**
After 20 years in retirement	$1,853,723	$2,004,799

By using the short-term loan to get more money into super, she will have an extra $151,076 left to meet her future living expenses or provide an inheritance. Because no tax is payable on the income stream payments, she won't use as much capital to meet her living expenses.

Assumptions: Sally is eligible to claim the 15 year CGT Exemption on the sale of her business (see page 20) and utilises the full $1 million lifetime limit when making an undeducted super contribution (see page 21). The loan interest rate is 7.5% pa. The non-super and income stream investment earns a total pre-tax return of 7.5% pa (split 3.5% income and 4% growth). All investment income is franked at 20%. Sally's after-tax income goal ($100,000 in year one) is indexed at 3% pa. Any income received above Sally's requirements is invested in a unit trust. No other sources of taxable income are received. Where applicable, the final figure at year 20 is after CGT.

Note: The results from this strategy will depend on factors such as your marginal tax rate, the loan interest rate, how long you borrow for and the investment returns.

Tips and traps

- When taking out a loan, make sure you have enough surplus cash flow to make the interest payments.
- You need to notify your super fund if you want any undeducted contributions counted towards the $1 million lifetime limit.
- This strategy may not be as effective if you don't sell your business when you expect to, or you receive less than you anticipate.
- Make sure you don't exceed the relevant cap on non-concessional contributions in any year, as excess contributions will be taxed at 46.5%.
- If the sale proceeds exceed your non-concessional contribution cap, your spouse could consider making an undeducted super contribution into their super account.
- You could also use this strategy if you plan to sell a non-super investment (such as an investment property), but don't expect to receive the money until after 30 June 2007.
- There are a range of other concessions that could be used to reduce CGT when selling a small business (see page 20).

Other super opportunities

Here are some other opportunities you may want to consider.

Bring forward concessional super contributions

If you're aged 50 or over, you should consider making larger salary sacrifice contributions or personal deductible super contributions as soon as possible. This will enable you to take advantage of the transitional limit of $100,000 pa from 1 July 2007 before it reduces to $50,000 pa from 1 July 2012.

Purchase life insurance in super

If you purchase life insurance in super, your dependants* may be able to receive unlimited tax-free lump sum payments from 1 July 2007 in the event of your death.

You could also take advantage of tax concessions when making contributions to pay for the insurance premiums. For example:

- If you're eligible to make salary sacrifice contributions, you may be able to purchase insurance through a super fund with pre-tax dollars.
- If you're self-employed, you can generally claim your super contributions as a tax deduction up to certain limits (see page 5) regardless of whether the contribution is used by the super fund to purchase investments or insurance.

Purchase a term allocated pension (TAP) before 20 September 2007

If you invest some of your super in a TAP before 20 September 2007, you will be eligible for an ongoing 50% social security Assets Test exemption. This could help you get under the relevant Assets Test threshold and receive greater Age Pension benefits.

Roll over an employer ETP before 1 July 2007

If you don't qualify under the transitional rules (see page 5), you may want to retire or terminate employment before 1 July 2007. This will allow you to roll over the ETP to super, or pay less tax on larger lump sum payments. If you receive the payment from 1 July 2007, and you want to invest the after-tax proceeds in super as an undeducted (after-tax) contribution, the reduced cap on non-concessional contributions will apply (see page 4).

To find out more about these opportunities, speak to your financial adviser.

* Includes a spouse, minor child, interdependant or financial dependant.

Essential facts

Who can contribute to super?

Subject to the fund rules, contributions to your super account in 2006/07 are allowed in the circumstances outlined in the table below:

Your Age	Allowable contributions
< 65	• Personal contributions (both deductible and undeducted), mandatory employer contributions, voluntary employer contributions (including salary sacrifice) and spouse contributions.
65–69	• Personal contributions (both deductible and undeducted), voluntary employer contributions (including salary sacrifice) and spouse contributions, provided you have worked at least 40 hours over a consecutive 30 day period during the financial year. • Mandatory employer contributions.
70–74	• Personal contributions (undeducted only), provided you have worked at least 40 hours over a consecutive 30 day period during the financial year*. • Mandatory employer contributions.
> 75	• Mandatory employer contributions.

* The Government has proposed from 1 July 2007, you can also make personal deductible contributions and receive voluntary employer contributions (including salary sacrifice) up to and including age 74 (provided you have worked at least 40 hours over a consecutive 30 day period during the financial year).

An existing super benefit can be rolled over at any time.

You will also need to satisfy these conditions if you want to roll over an employer eligible termination payment or the proceeds from the sale of a business.

Which contributions are counted towards the non-concessional cap?

The main contributions included in this cap are:

- Personal after-tax (undeducted) contributions.
- Spouse contributions received.
- Employer contributions that exceed the age-based deductible contribution limits between 10 May 2006 and 30 June 2007 (see page 5).
- Amounts exceeding the concessional contribution cap from 1 July 2007 (see page 5).

Which contributions are counted towards the concessional cap?

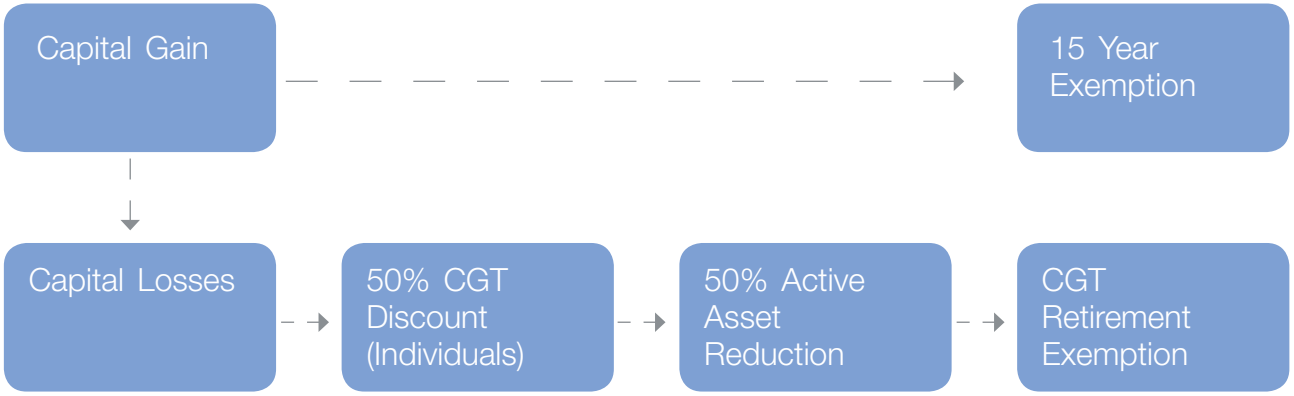
The main contributions included in this cap are:

- Employer contributions, including salary sacrifice.
- Personal deductible contributions.
- Employment Termination Payments rolled over to super between 1 July 2007 and 30 June 2012 exceeding $1 million*.

* The $1 million is reduced by all other transitional Employment Termination Payments received between 1 July 2007 and 30 June 2012 (including those taken in cash).

What are the small business capital gains tax concessions?

If you're a small business owner, you may be able to take advantage of a range of capital gains tax (CGT) concessions when disposing of active business assets such as land, buildings or goodwill. To qualify, you need to have net assets less than $5 million* in the 2006/07 financial year and satisfy other conditions. The concessions are usually applied in a set order, as summarised in the following diagram.



If eligible, you will normally claim the **15 year CGT Exemption**. This exemption enables you to disregard 100% of the capital gains and you don't need to use up any current year, or carried forward capital losses (ie these losses can be used to offset capital gains from non-active CGT assets). To qualify for this concession, the active assets must be owned for at least 15 years and need to be disposed of for retirement purposes. You also need to be at least 55 years of age or incapacitated.

Assuming you don't qualify for the 15 year CGT Exemption, there are **up to** four different steps you could take to reduce (or eliminate) a CGT liability.

Step 1	You should always offset any current year and carried forward **capital losses** against the capital gain.
Step 2	Individuals and trusts should claim the **general 50% CGT discount** on assets held for 12 months or more. This exemption must be claimed before any of the other concessions described below and is not available to a company.
Step 3	After applying steps 1 and 2 (if available), you may then want to claim the **Active Assets Reduction** and reduce the taxable capital gain on active assets by a further 50%.
Step 4	Finally, if you have disposed of the active business assets for retirement purposes, you may be able to claim the **CGT Retirement Exemption** up to the unindexed lifetime limit of $500,000 per person. If you're under 55 years of age, you must roll over the proceeds to a super fund and you can't access the money until you meet a condition of release (see Glossary). If you're aged 55 or over, you can take the proceeds as cash, roll over to a super fund or commence an income stream investment.

Given the complexities involved, you should speak to your accountant to determine the taxable capital gain and verify which concessions are available.

* From 1 July 2007 the conditions determining whether you qualify for the small business capital gains tax concessions will be relaxed. For example, your net assets will need to be less than $6 million (currently $5 million). Other changes have been proposed by the Government. See your accountant for more information.

How much can be contributed to super using the $1 million lifetime limit?

The lifetime limit of up to $1 million is available when investing amounts from the following sources in super as an undeducted contribution:

- Capital proceeds from the disposal of assets that qualify for the 15 year CGT Exemption (see above), including capital proceeds that would have qualified for the 15 year CGT Exemption except that the disposal did not result in a capital gain or capital loss.
- Capital gains from the disposal of assets that qualify for the CGT Retirement Exemption (see above) up to a limit of $500,000 per person.

Glossary

Allocated pension – An account in which you invest your super savings in exchange for a regular and flexible income.

Assessable income – Income (including capital gains) you receive before deductions.

Assets Test – A test on your assets to determine your social security entitlements. Under this test, there is a certain amount of assets you can have before your full entitlement to social security is reduced or cuts out. The level at which your pension begins to reduce varies depending on whether you're single or married and whether you own your home.

Capital gains tax (CGT) – A tax on the growth in the value of assets, payable when the gain is realised. If the assets have been held by an individual, trust or super fund for more than one year, the capital gain receives concessional treatment.

Condition of release – Circumstance upon which you can withdraw your super benefits, such as:

- Retirement after reaching your preservation age (55 to 60).
- Leaving your employer after age 60.
- Attaining age 65.
- Permanent incapacity (specific requirements apply).
- Death.
- Severe financial hardship (the amount is restricted and you must have received Commonwealth income support for six months consecutively or nine months cumulatively if aged 55 or over).
- Compassionate grounds (must be approved by APRA/ATO).
- Upon permanent departure from Australia for certain temporary residents holding a specific class of visa.
- Leaving the service of your employer who has also contributed into your super fund – restricted non-preserved benefits only.

A transition to retirement pension may also be commenced with preserved benefits if you have reached your preservation age (55 to 60).

Note: You can access unrestricted non-preserved benefits at any time.

Contributions tax – A tax of 15% applied to personal deductible and employer contributions made to a super fund.

Discretionary master trust – A type of super fund offering similar investment flexibility to a self-managed fund without the burden of having to be a Trustee.

Eligible employment – Broadly any work that classifies you as an employee for Superannuation Guarantee purposes.

Eligible Termination Payment (ETP) – A lump sum super benefit or a payment made by an employer on termination of employment (eg golden handshake). For tax purposes, ETPs are split into various components, each of which is taxed differently.

Fringe benefit – Certain benefits provided by an employer in respect of employment.

Income stream – An investment that provides a regular income, such as an allocated pension or Transition to Retirement Pension (TRP).

***In-specie* contribution** – The contribution of an asset into super rather than cash. It is achieved by transferring ownership of the asset to the super fund. Only certain types of assets can be transferred.

Mandatory employer contributions – Super contributions an employer is required to make on your behalf by law. Includes Superannuation Guarantee (SG) contributions and employer contributions required under an industrial award or certified agreement.

Marginal tax rate – The stepped rate of tax you pay on your taxable income.

Post-June 1983 component – Part of an ETP relating to employment service or fund membership after 30 June 1983.

Pre-July 1983 component – Part of an ETP relating to employment service or fund membership before 1 July 1983.

Preserved benefits – Benefits that must be kept in a super fund and cannot be withdrawn until you meet a condition of release.

Reasonable Benefit Limit (RBL) – The maximum amount of concessionally taxed super and employer ETP benefits you can receive in your lifetime.

Restricted non-preserved benefits – Non-preserved benefits that can only be withdrawn from the super system when you meet a condition of release (such as when you leave your employer who has made contributions to your super fund on your behalf).

Rollover – When you move your super benefits directly to a super or rollover fund.

Salary sacrifice – An arrangement made with an employer where you forgo part of your pre-tax salary in exchange for receiving certain benefits (eg superannuation contributions).

Self-managed super fund – A super fund with fewer than five members, where generally all members are Trustees of the fund and all Trustees are members.

Superannuation Guarantee (SG) contributions – The minimum super contributions an employer is required to make on behalf of eligible employees (generally 9% of salary).

Tax deduction – An amount that is deducted from your assessable income before tax is calculated.

Taxed super fund – A super fund that pays tax on contributions and earnings in accordance with the standard super tax provisions.

Tax offset – An amount deducted off the actual tax you have to pay (eg franking credits).

Term allocated pension (TAP) – A type of income stream, with certain access restrictions, allowing you to obtain a 50% Assets Test exemption or qualify for the Pension Reasonable Benefit Limit (RBL).

Transition to Retirement Pension (TRP) – An income stream purchased with preserved super benefits after reaching your preservation age (55 to 60). This generally cannot be cashed out until you meet another condition of release.

Undeducted contributions – Amounts you contribute to a super fund after 30 June 1983 that have not been claimed as a tax deduction.

Unit trust investment – Generally a type of investment where your money is pooled with other investors to form a large fund, which is professionally managed.

Unrestricted non-preserved benefits – Benefits that have met a condition of release and therefore can be withdrawn from a super fund at any time.

Voluntary employer contributions – Include salary sacrifice contributions and contributions made by an employer that are discretionary.

Notes

Notes

To make the most of the new super rules
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