Avoiding concessional contributions limits

TONY NEGLINE

Basic tax planning often involves bringing expenditure forward to claim deductions as early as possible and trying to delay earning income or capital gains so tax is paid in later income years.

One attractive tax break is concessional super contributions that are personal and employer super contributions that are claimed as a tax deduction.

The problem with concessional contributions is they're severely limited and often can't be brought forward to an earlier financial year.

If you were aged at least 49 on June 30, then the maximum concessional contribution that can be made this financial year is $35,000. For everyone else the concessional contribution cap this financial year is $30,000.

Ordinarily you can make concessional contributions above this threshold but those excess contributions will be taxed at your marginal tax rate and possibly other penalties. This will be paid by your super fund if you elect to keep those excess contributions in the fund or in your name if you elect to withdraw those contributions within Australian Taxation Office determined time limits.

However, there is a little known strategy you can apply that allows you to claim concessional contributions above your cap this financial year and not face any tax penalties.

How does it work? You or your employer make concessional contributions up to your contribution cap in a financial year. Then sometime later than June 3 in that financial year, you or your employer make another concessional contribution to your super fund for some or all of next year's concessional cap.

All these contributions are claimed as a tax deduction in the year they're made.

There are catches with this strategy that you have to understand, otherwise it will fail:

1. Under the super laws all contributions have to be allocated to a member's account within 28 days of the contribution being made. You specifically ask that the June contribution not be allocated to your account until after June 30.

2. It's important the super contribution that will be allocated to your member account next financial year isn't made in conjunction with any other contribution.

3. Before this contribution is allocated to your member account, your fund will hold it in an "unallocated contribution account", which is an account in your fund's financial accounts, not a special bank account. Your fund can put the money into this account only if your fund's trust deed permits this. In simple terms you may need to amend your fund's trust deed to perform this transaction.

4. You or your employer can claim all contributions made in the current financial year. If the contributions have been made to a self-managed superannuation fund then you need to fill out a special ATO form, which the tax office suggests you should submit when you send in your SMSF and personal or employer annual tax returns.

5. After June 30 your trustee moves the contribution from the unallocated contribution account to your member account. Once allocated to your member account your super fund reports this concessional contribution to the ATO in that year, which means it'll be taxed that year.

6. If you or your employer need or intend to make concessional contributions in the second financial year then you need to factor this into the amount of additional concessional contributions that have been made before June 30 in the first financial year.

7. As you'll have noted you can use this strategy for personal and employer contributions. As employers get a full tax deduction for all concessional contributions they make there seems no reason they wouldn't help an employee take advantage of this strategy.

Finally, at a practical level, it's much easier to do this strategy in a SMSF, which may create a problem for those who don't use or don't want to use this type of vehicle.

There is no reason this can't be done in an Australian Prudential Regulation Authority regulated fund but it may not have the administration systems and processes to cater for this strategy.

Tony Negline is author of The Essential SMSF Guide 2015-16.

Looking to fix your interest

Mackay Shields' John Akkerman wants to bond with Aussies

ANDREW MAIN

What's going to lift the fixed-interest allocation of DIY funds to anything like the levels needed?

It's certainly not by entering the bond markets in a traditional manner.

John Akkerman, the New York-based executive managing director of fixed-interest specialist MacKay Shields, puts his cards on the table by saying that now's not the time to load up on high-priced, low-interest-paying government bonds.

With prices high and yields barely at 2 per cent, there's only one way prices can go when US interest rates start to move up later this year, and that's down, he says.

The traditional bond portfolios most people were invested in represented the greatest risk to fixed-income investors in a generation.

Most investors did not understand how a government guaranteed bond could lose money because they didn't see through to how bond values are determined.

"There's a problem we're here to fix," Akkerman said in Sydney last week.

Which makes it clear that bonds are not a buy and hold proposition.

However, Akkerman and his colleagues would like Australian investors to know they could well have been picking up a 7 per cent-a-year total return, fully hedged, if they had been able to access MacKay Shields' unconstrained bond fund. Total return includes capital movement, up or down, as well as yield.

Hitherto Australian investors haven't been able to access the $US5 billion fund that allows itself to rove across the entire fixed-interest universe to get low-risk returns. "We go anywhere, any time," smiles Akkerman.

MacKay Shields invests some $U94bn or well over $110bn, altogether among seven core strategies, although the unconstrained fund is its fastest growing fund.

Ross Youngman, head of institutional business at local fund manager Ausbil, explained that Ausbil and MacKay Shields shared a common parent in the New York Life company, which owns all of MacKay Shields and since February last year has owned about 70 per cent of Ausbil. The balance is held by local staff.

To date, Ausbil has been best known for Australian equities.

"We're setting the fund up in such a way that Australian investors can get access to it either around Christmas time or early next year," he said.

"We can take direct investors and we will also take investment through platforms."

He said the organisation hoped to make it possible for Australian retail investors to get on board with a $20,000 minimum investment when it became available.

So how does an unconstrained bond fund work?

Robert Kinsey, managing director global fixed income at McKay Shields, says it varies between managers, but "the first notion is unfettering, to some degree, your portfolio manager so they can access the greatest opportunity set possible".

"Our returns from the unconstrained fund since we began in 2010 have been almost 7 per cent, annualised, before fees, for each and every year" Kinsey says.

"We've been pursuing a very high conviction strategy that has tried to blend attractive investments in a variety of corporate and non-corporate bonds outside America.

"The credit risk is non-investment grade. but the interest rate risk is very low.

"We're embracing credit risk and avoiding interest rate risk, so one offsets the other.

"If you want to achieve some sort of returns you have to embrace some kind of risk."

Kinsey says the MacKay Shields unconstrained portfolio currently held, in descending order of yield, 46.8 per cent in US high-yield corporate paper, "plus 10 per cent in investment-grade corporate debt, which is rated BBB or better, and 19 per cent in senior bank loans".

He says the senior bank loan market alone in the US is worth just short of $US1 trillion.

"We have very minor exposures to emerging market debt."

He says it is possible to access floating rate notes issued by companies such as tyre manufacturer Goodyear, where the interest rate will rise in line with US official rates.

That is at odds with most US corporate debt, he says, which is issued at fixed rates.

"So it's another avenue in the market that you can access that, again, helps to protect investors."

BRITTA CAMPION

Rob Kinsey, left, and John Akkerman of New York-based fixed-interest specialist group Mackay Shields

FLOAT WATCH

Big pharma getting on board

Adherium

ASX CODE: ADR
SHARES ON OFFER: 70 million
LISTING PRICE: 50c
MARKET CAPITALISATION: $70 million
LISTING DATE: August 26

TIM MORRIS

How wasteful is Australia's healthcare system?

Relative to the scale of our economy, the nation's expenditures on healthcare compare favourably to those of our international peers.

It accounts for 9.5 per cent of gross domestic product, below the OECD average of 12 per cent, and 16 per cent for North America.

However, the nation has not been immune from a trend of increasing healthcare spend versus GDP, which has troubled developed countries over the past decade, apart from a handful of OECD members.

Sub-optimal medicine use is estimated to account for approximately $500 billion of avoidable healthcare expenditures across the world. To a small degree, sub-optimal medicine use incorporates overuse of antibiotics and prescription errors, although non-adherence by patients is the major driver.

The coming listing of Adherium aims to address sub-optimal medicine use in chronic disease. The technology company has developed the Smartinhaler platform which incorporates a range of medical devices and integrated software.

Founded in 2001, the company's SmartTouch device for asthmatics is approved for sale in the US, the EU, Australia and New Zealand.

Initial marketing has focused on demonstrating the technology's efficacy via clinical projects and partnerships with major inhaler manufacturers. The strategy has piqued industry interest, with sales rising 20 fold during the 2015 financial year, delivering revenue of $2.9 million.

Proceeds from Adherium's initial public offer are scheduled to support marketing of the Smartinhaler platform and development of new products that could leverage the technology.

Primary risks surround Adherium's ongoing capital demands. Existing sales are promising but not yet sufficient to eliminate the company's reliance on external funding.

However, it's worth noting that one of Adherium's existing commercial partners, AstraZeneca, is one of the world's biggest pharmaceutical companies.

Moreover, with AstraZeneca committing to invest $US3m ($4.14m) in the IPO, the opportunity to expand marketing further downstream appears significant.

Tim Morris is an analyst at wise-owl.com.

All in the timing: finer points of meeting ATO's 'work test' to make super deposits

MONICA RULE

I've had a paradigm shift! Just when I thought I could confidently predict the ATO's view on meeting the work test to make contributions, they have come back and surprised me!

Let me explain. I have been assisting a client with her excess contributions case. The ATO wants to charge her excess contributions tax. My client is over 65 and at the time she made the contribution, she had not met the work test. My argument was that as she had not met the work test at the time she made the contribution, the trustee should not have accepted the contribution. However, the ATO has said that as she has an SMSF and is self-employed, she would have known that she would satisfy the work test at a later date in the financial year. I did not see that coming!

You see, the timing of contributions has caused a great deal of confusion for SMSF trustees, members and industry professionals. This is because the superannuation law states that once an SMSF member is aged 65 or over but is less than 75, they can only make superannuation contributions into their SMSF if they are gainfully employed on at least a part-time basis during the financial year in which the contributions are made.

The definition of "gainfully employed" under the superannuation law means to be employed or self-employed for gain or reward in any business, trade, profession, vocation, calling, occupation or employment. The concept of gain or reward envisages receipt of remuneration such as a salary or wages, business income, bonuses, commissions, fees or gratuities, in return for personal exertion. It does not include the passive receipt of income such as the receipt of rent or dividends. Therefore, if a member only receives passive income such as trust distributions or dividend income, then they would not meet the gainful employment test. Unpaid work also does not meet the definition of gainful employment.

The term "part-time" means to be gainfully employed for at least forty hours in a period of not more than thirty consecutive days in a financial year. So if you work ten hours per week in one month or ten hours over four days that would be sufficient.

The paid work condition only has to be met once in each financial year you make the contribution, after turning 65. So this means, once you have met it, you do not need to be gainfully employed for the rest of the financial year or need to meet the work test again each time you make a contribution into your SMSF.

Based on the ATO's interpretation of my client's case it would seem that when the work test needs to be met, depends on whether you are making contributions into an SMSF or a public superannuation fund and also whether you are self employed.

If you are making contributions into a retail superannuation fund, regulated by the Australian Prudential Regulation Authority, then you must meet the work test before making your first contribution after turning 65. This is because the trustee of the APRA fund will need to be satisfied that you have met the work test in order to allow you to contribute into the fund.

If you plan on making contributions into your SMSF, then it seems that as long as you have met the work test once in the financial year after you turned 65, you can contribute. This is especially important for members who are self-employed. If you know that you will be in part-time paid employment at some time during the year, after turning 65, you can make contributions into your SMSF even though you may not have worked part time at the moment you make the contribution. Of course, if you assumed that you will work that year (after turning 65) and then fell ill and were unable to work at all, then the contribution would need to be returned to the member within thirty days of the SMSF trustee becoming aware of the member's illness.

I'm not sure if the ATO's decision on my client's case has wider applications, but it seems to me that if you have an SMSF, as long as you meet the work test in the financial year that you make a contribution, it is not a contravention; regardless of whether the contribution was made before or after you satisfied the test.

Monica Rule is an SMSF specialist and author.

www.monicarule.com.au