Reform gives super control to people

JAMES KIRBY
WEALTH EDITOR

Australia's overhauled superannuation system is now well into its first financial year and with Financial Services Minister Kelly O'Dwyer announcing there will be "no further changes" both investors and advisers are adjusting rapidly to the new rules.

Moreover, though, there is a significant chance that an ALP election win may change investment rules once more. The key changes are likely to be in the areas of negative gearing and capital gains tax rather than super.

On that basis alone it is worth knowing what actually emerged from the controversial overhaul introduced on July 1 which was actually useful and progressive.

In fairly typical fashion the government has managed to promote some of the more obscure enhancements to the system such as the variation on non-concessional caps for downsizing homeowners.

At the same time the government has downplayed the outstanding positive change in the new reforms — the ability to do your own salary-sacrifice contributions.

The nitty gritty

Here's how it works: salary sacrifice — the nation's second-most popular tax break for salary earners after negative gearing — used to be linked to the co-operation of your employer.

Unless you were running a small business then to take advantage of the concessional (pre-tax) arrangements — where you can put money into super from your pre-tax salary — your employer had to do the paperwork.

Some employers could not be relied upon to do this either properly or efficiently — but under the new rules you can simply put in your pre-tax contribution — to a maximum of $25,000 into your super account and then claim a full tax deduction on the contribution ... your employer is cut out of the picture.

"The ability to do your own contribution really is a great move — it's arguably the best things to happen in super for years," says Doug Turek of Professional Wealth (Turek was recently ranked sixth in *The Australian*'s Top 50 Financial Advisers list.)

Financial Planners Association CEO Dante De Gori

"It means you no longer have to rely on someone in your pay office to do the right thing. Importantly, it also means you control the timing. This has been a long-running problem where contributions could easily fall into the wrong financial year depending on the quality of payroll processes ... thankfully all that is over," Turek explains.

Better still, the new system should cut abuse of superannuation entitlements by rogue employers who have been capitalising on the previous process to either reduce super payments or in the most extreme cases withhold entitlements completely. "It's a very useful development and it should lift standards across the system," says Dante De Gori, chief executive of the Financial Planners Association.

DIY deductions

Here's how the new system deters unpaid super scandals: an employer can cut superannuation guarantee payments owed to an employee by the amount of the salary-sacrifice contribution if they wish to do so. It is hard to believe this is legal but it stands as a loophole in superannuation law.

This rogue practice has been regularly reported in employment disputes though the total amount involved on a nationwide basis is very difficult to estimate.

At its most extreme employees who are unfortunate enough to salary sacrifice at companies which later collapse can also be denied the money they voluntarily contributed.

Crucially, under the new system starting this financial year if an employee chooses to act autonomously and do their own tax-deductible contribution without involving their employer the potential for abuse is sidestepped.

The arrival of DIY super deductions should also be a boon for the increasingly large number of people in the so-called "gig" economy engaged in part-time or contract work.

Earlier this week Association of Superannuation Funds of Australia CEO Martin Fahy told *The Australian* ASFA was concerned about a potential worsening engagement with super by self-employed workers. On top of the existing population of consulting professionals across Australia, it has been estimated that more than 100,000 Australians make a living from pitching for work on new app-based platforms such as freelancer.com

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>
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> PROFESSIONAL WEALTH

Turek says the main issue is that investors who move to DIY super contribution tax deductions watch their cashflow so that they can actually get to make contributions inside the financial year.

In other words you need to accumulate the money first and then seek the tax deduction inside the appropriate financial year.

The maximum amount salary earners can contribute from July 1 is $25,000 — and that amount includes the employer's superannuation guarantee payments of 9.5 per cent of salary.

Borrow for the house, not the dining table

The rules governing borrowing by super funds are complex

MONICA RULE

In 2007, the law was amended to allow superannuation funds to borrow to acquire large assets such as a residential or commercial property. Prior to the law change, superannuation funds were only able to borrow in very limited circumstances, such as to pay a benefit to a beneficiary.

The amount that could be borrowed was limited to 10 per cent of the market value of the superannuation fund's assets and the borrowing period was restricted to seven days for the settlement of securities and 90 days for the other circumstances.

Superannuation funds can still borrow for the traditional purposes of settling affairs with beneficiaries or dealing with superannuation surcharges. However, the borrowing provision was broadened to allow the purchasing of large assets in 2007 which was referred to as "instalment warrants". Then in 2010, the instalment warrants law was amended and renamed "limited recourse borrowing arrangements".

Ten years later we see this aspect of superannuation has become increasingly important: in Wealth recently Graham Moroney from the SMSF Association showed how allocations among DIY funds to LRBAs now represent about 4 per cent of total holdings.

Under a LRBA, a self-managed superannuation fund can borrow to acquire real property. The mechanism of the LRBA is to ensure that the risk of borrowing is quarantined to the specific asset that is acquired via borrowings. This protects the remaining assets of the SMSF in the event the SMSF is unable to repay the loan.

LRBAs can only be used to purchase a single acquirable asset. This means the SMSF trustee will need to ensure that the property is on a single title.

If the property is on more than one title, it will be treated as a single asset only if there is a unifying physical object, such as a fixture, attached to the land that is permanent in nature, cannot be easily removed and is significant in value relative to the property.

Under the law there is a difference between fixtures and chattels like furniture, which can be removed

> A self-managed superannuation fund can borrow to acquire real property

If there is a requirement under a law of a state or territory that the two assets must be dealt with together, then it could also be treated as a single asset. If the fixture is temporary in nature or otherwise able to be relocated or removed relatively easily then it cannot be treated as a single asset.

One area SMSF members need to be aware of is that the sale of some residential properties can sometimes include a furniture package as part of the property acquisition. Where the contract of sale includes furniture, the acquisition will not comply with the legal provisions of the LRBA. This is because each item of furniture would be considered a separate asset. A contract for the acquisition of the property alone would be acceptable, whereas, the inclusion of a furniture package in the same contract would not. One solution would be to have the SMSF borrow to acquire the property without the furniture and use the SMSF's own money to purchase the furniture package under a separate agreement.

Fixtures, on the other hand, are treated differently. These comprise part of the title so would not be considered separate assets if they are permanent in nature and cannot be easily removed.

Chattels such as furniture packages can be picked up and removed and are separate from the property and each in themselves is a single asset. If the chattels are to be acquired, an SMSF will need separate LRBAs for each chattel!

While LRBAs provide SMSFs with the opportunity to acquire large assets, SMSF members must be careful to structure them correctly and follow legal provisions.

Failure to do so could result in a costly mess for their SMSF.

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My mother passed away recently. My father and mother had purchased some Australian shares prior to September 1985. My dad died in 2002. I don't have a copy of his will but I believe they owned them jointly, and when he died my mum was the beneficiary. My mother had sold her shares last year. The accountant who the estate executor appointed has said they are subject to capital gains tax. Is this correct?

Broadly, a capital gain is calculated by taking the difference between the sale proceeds you receive and the cost base of the CGT asset.

The cost base of a CGT asset is typically what you paid for it, together with some other costs associated with acquiring, holding and disposing of it.

Assets acquired prior to September 20, 1985 are generally exempt from CGT.

However, when you inherit assets and subsequently dispose of the asset, the CGT treatment will vary depending upon when the asset was originally purchased.

For assets originally acquired before September 20, 1985, the cost base of the asset will be set to the value of the asset at the time of death if the assets are retained by the beneficiary.

For assets originally acquired on or after September 20, 1985, the cost base of the asset will continue to be the original purchase price (including transaction costs) paid by the deceased.

> The key to managing capital gains is to keep good records

While death itself will not trigger CGT, a capital gain will be assessed when the assets are sold either by the estate or the beneficiary. The tax liability is determined based on the relevant tax return.

Based on the information you have provided, it appears that your mum would have inherited your father's jointly held shares following his death. The cost base for these shares she inherited would have been reset to the applicable market value at the date of his death.

As she sold these shares, and presumably triggered a capital gain based on the cost base established in 2002, the capital gain on this portion of shares would be assessable.

However, the cost base for your mum's original shares (that is, her initial 50 per cent interest) should have remained unchanged following your dad's death.

That is, they should have retained the exemption because they were bought before September 20, 1985.

As such, any capital gain made on this portion of the shares sold by your mum should not have been assessable.

The key to managing capital gains is to keep good records of when assets were acquired, by whom, at what price and with what related costs.

Likewise for when assets are inherited and ultimately when they are sold.

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