Advanced Income Tax Law

Chapter 6

Superannuation Funds

Overview

A superannuation fund is a particular type of *trust fund* established specifically to provide retirement or death benefits for members of the fund or their beneficiaries.

Superannuation funds, although classified as trusts, have special taxation arrangements.

Overview

For taxation purposes, a superannuation fund is a scheme for payment of superannuation benefits upon death or retirement of a fund member.

Legislation

Superannuation funds which comply with the:

- Superannuation Industry (Supervision) Act 1993 (SISA),
- Financial Sector (Collection of Data) Act 2001, and
- Corporations Act 2001.

receive concessional tax treatment on their income, whilst superannuation funds that do not comply with the legislation are taxed at a higher rate.

Legislation

The legislation requires that superannuation funds seeking tax concessions comply with a number of standards, the main elements being:

- The fund must be solely for superannuation purposes.
- The fund must be controlled by a trustee board with representation by members/employees.
- The fund must meet disclosure and reporting requirements.
- The fund must protect of members’ interests and ensure the provision of retirement income.

Legislation

The legislation is administered jointly by the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).

APRA also supervises regulated superannuation funds, other than Self-Managed superannuation funds which are supervised by the ATO.

Role of the APRA and ASIC

APRA and ASIC jointly monitor the compliance or otherwise of superannuation funds and Approved Deposit Funds to the prescribed standards of the legislation.

These bodies are empowered to:

- give written notice to the trustee of a fund stating whether it is a complying or non-complying superannuation fund for the year of income specified.
- advise the ATO of the particulars of any notice given to a superannuation fund.
- impose penalties on trustees of superannuation funds who provide false information on returns.

Trustee's Responsibility

The trustee of a superannuation fund must lodge a Fund Income Tax Return with the ATO each year.

A trustee of a superannuation fund must:

- act honestly in all matters affecting the fund.
- exercise the same degree of care and diligence as an ordinary person in managing the fund.
- act in the best interests of all beneficiaries of the fund.
- keep fund assets separate from other assets (i.e. the trustees' personal assets).

Trustees Responsibility

A trustee of a superannuation fund must:

- retain control over the fund.
- develop and implement an investment strategy.
- not enter any contracts, or do anything else, that would prevent the trustee from properly performing or exercising their functions and powers.
- allow members to access information about the fund and their benefit.

Investment Restrictions

Sole Purpose test

The sole purpose test applies to all superannuation funds and requires that a fund is established and maintained for the sole purpose of providing benefits to members upon their retirement, or to a member's beneficiaries in the event of their death.

Trustees must ensure that any decision made in relation to the acquisition, use or sale of assets relates solely to the provision of retirement benefits (sole purpose test).

Investment Restrictions

"Arm's Length" rules

All investments by a superannuation fund must be made and maintained on a strict commercial (i.e. arm's length) basis.

"In-house asset" rules

The in-house asset rules limit a superannuation fund from undertaking certain transactions with related parties in order to limit risk and to ensure that funds are being maintained for genuine retirement purposes.

Categories of Superannuation Funds

In the superannuation industry in Australia, there are five main types of superannuation funds:

- Industry superannuation funds.
- Retail superannuation funds.
- Corporate or Employer superannuation funds.
- Public sector superannuation funds.
- Self-Managed Superannuation Funds (SMSFs).

Categories of Superannuation Funds

Complying Superannuation Funds

A superannuation fund can only be classified as a complying fund if it:

- is a regulated superannuation fund that is an Australian superannuation fund at all times during the income year, and,
- complies with the regulatory requirements of the SISA, the Financial Sector (Collection of Data) Act 2001, and the Corporations Act 2001.

Categories of Superannuation Funds

Complying Superannuation Funds

If APRA is satisfied that the legislative conditions are met, then it will give written notice to the trustees of the superannuation fund and the ATO advising of complying superannuation fund status for the year.

The fund will retain its complying status for tax purposes until it is notified that its status has changed.

Categories of Superannuation Funds

Non-complying Superannuation Funds

A non-complying superannuation fund:

- is not a resident of Australia, or
- has been issued with a *Notice of non-compliance* because it does not comply with the SISA provisions.

Categories of Superannuation Funds

Non-complying Superannuation Funds

Where APRA decides that a superannuation fund has not satisfied the legislative conditions, it will give written notice to the Funds' trustees (and to the ATO) setting out the reasons for the decision not to issue a Notice of Compliance.

The fund will then be classified as a non-complying fund for the year.

Non-complying superannuation funds do not receive concessional tax treatment on taxable income.

Calculation of Taxable Income

Assessable income

All superannuation funds can derive assessable income from a variety of investment sources like any other taxpayer.

e.g. interest, foreign source income, capital gains, dividends and rental income.

Assessable Income

Contributions

❑ Complying Superannuation Funds

Contributions received from:

- a contributor (employer) on behalf of another person (employee)
- an individual on their own behalf for which the contributor is entitled to a deduction
- amounts transferred from a foreign superannuation fund

are assessable income of complying superannuation funds.

Assessable Income

Contributions

- **Complying Superannuation Funds**

Contributions received from:

- government co-contributions
- a person on behalf of their spouse
- on behalf of temporary Australian residents
- Undeducted contributions

are not assessable income of complying superannuation funds.

Assessable income

Contributions

- **Non-complying Superannuation Funds**

Contributions received from:

- a contributor (employer) on behalf of another person (employee)

are assessable income of non-complying superannuation funds.

Assessable Income

Capital gains

❑ Complying funds

When calculating a capital gain, a complying fund may choose to use:

- an indexed cost base (but frozen at 30 September 1999),

  or
- apply a $33^{1}/_{3}\%$ CGT discount (instead of the 50% discount available to individuals and trusts).

Assessable Income

Capital gains

- **Non-complying funds**

are also subject to the capital gains tax provisions like any other taxpayer.

However, non-complying funds are not eligible for the $33^1/_3$% CGT discount.

Instead, they are entitled to the usual 50% discount.

Assessable Income

Special CGT provisions

❑ Complying funds

The general CGT provisions apply to an asset of a complying superannuation fund even if the asset was acquired before 20 September 1985 (i.e. before the normal commencement date of CGT provisions).

Assessable Income

Special capital gains

- **Non-complying funds**

The special CGT provisions do not apply to non-complying funds.

Calculation of Taxable Income

Deductions

All expenditure incurred in gaining or producing assessable income is generally deductible.

s.295-45 specifically *disallows* a deduction for benefits paid to members of superannuation funds.

Deductions

Only complying superannuation funds are allowed a deduction for the following:

- Insurance premiums paid to provide death or disability cover for fund members.
- "Detriment" payments made after the death of a fund member.

Exempt Current Pension Income (ECPI)

Complying superannuation funds receive an exemption on any income derived from segregated assets used to pay a current pension liability.

Non-complying superannuation funds are not exempted on such income.

Summary - Taxable Income

	Complying funds	Non-complying funds
Assessable income		
Ordinary capital gains	Assessable $33^1/_3$% discount	Assessable 50% discount
"Special" capital gains	Assessable $33^1/_3$% discount	Not assessable
Income from segregated current pension assets	Exempt	Assessable
Deductions		
"Detriment" payments	Deduction	Not deductible
Death or disability cover insurance premiums	Deduction	Not deductible

Taxation of Superannuation Funds

Complying Superannuation Funds

Complying funds are taxed at the concessional rate of 15% flat on the *low rate component* of their taxable income and at 45% flat on the *non-arm's length component.*

Non-complying Superannuation Funds

Non-complying funds are taxed at 45% flat on all of their taxable income.

Tax Payable

Low tax component

The low tax component is equal to *"taxable income less the non-arm's length component"*.

Non-arm's length component

The non-arm's length component is *"non-arm's length income less any deductions attributable to that income"*.

Tax Payable

Non-arm's length component

The three types of non-arm's length income are:

- *excessive private company dividends.*
- *non-arm's income derived by the superannuation fund.*
- *certain trust distributions.*

Summary – Tax Payable

Complying	Non-complying
Concessional tax rate	No concession
Low tax component 15% flat Non-arm's length component 45% flat	45% flat on all of taxable income

SMSF Annual Return Obligations

All SMSF's are required to lodge a SMSF annual return with the ATO after the fund has been audited.

The SMSF annual return is a combined reporting form including both the tax return and the regulatory return required for the fund each year.

SMSF Annual Return Obligations

As a general guide lodgement with the ATO is required by:

31 October	SMSF's with one or more prior year returns outstanding at 30 June of the financial year. A newly registered SMSF not lodging through a tax agent.
15 January	Non-complying SMSF's. SMSF's with either an annual total income more than $10m or investments of more than $50m, or both.
28 February	A newly registered SMSF that is lodging through a tax agent. A SMSF not lodging through a tax agent, that didn't have to lodge earlier.
31 March	SMSF's with total income over $2m in the last year lodged, but aren't large/medium taxpayers, can have a 31 March due date if an earlier date doesn't apply.
15 May	15 May is the due date for SMSFs lodging through a tax agent, where one of the earlier due dates doesn't apply.
5 June	SMSFs with a due date of 15 May may receive a lodgement concession to 5 June under certain circumstances such as: • Return lodged by a registered tax agent. • Were non-taxable or received a refund as per latest year lodged. • Are non-taxable or will receive a refund in current year.

Supervisory Levy

Each superannuation fund is required to pay an annual supervisory levy to the regulator of the fund (the ATO).

For the 2019/20 income year, the ATO Supervisory Levy is $259. It is deductible in the year of payment.

The supervisory levy is included in the tax payable calculation for the superannuation fund.

Contributions Made to Superannuation Funds

Mandated employer contributions

Mandated employer contributions are contributions made by an employer under a law or industrial agreement for the benefit of a fund member.

They include superannuation guarantee contributions.

Contributions Made to Superannuation Funds

Non-mandated employer contributions

- contributions made by employers over and above their superannuation guarantee or award obligations (such as salary sacrifice contributions).
- member contributions – these are contributions made by or on behalf of a member, such as:
  - personal contributions
  - superannuation co-contributions
  - eligible spouse contributions
  - contributions made by a third party, such as an insurer

Tax on Contributions

Concessional Contributions (before tax super contributions)

are deductible to the contributor and are assessable income of the superannuation fund.

- include contributions from Superannuation Guarantee, salary sacrifice and tax-deductible contributions made by an individual.
- taxed at concessional rate of 15% up to the concessional contributions cap amount, and at 30% where the contributor’s adjusted taxable income is over $250,000.

Tax on Contributions

Concessional Contributions (before tax super contributions)

An annual concessional contributions cap of $250,000 regardless of age took effect from 1 July 2017.

Tax on Contributions

Excess Contributions Tax

Superannuation contributions exceeding the concessional cap are included in an individual's assessable income and taxed at their marginal tax rate, plus an excess concessional contributions charge applies (ECC).

As part of the assessment process, the ATO applies a 15% non-refundable tax offset of the excess concessional contributions.

Contributions Received By Complying Superannuation Funds

Non-concessional contributions (after tax super contributions)

- are not deductible to the contributor and are not assessable income of a superannuation fund.
- Include Government superannuation co-contributions, personal contributions not claimed as a deduction.
- the non-concessional contribution cap in 2019/20 is $100,000.

Contributions Received by Complying Superannuation Funds

Non-concessional contributions

Bring-forward rule

Australians under 65 years old may be eligible to make non-concessional contributions in a single year of up to three times the non-concessional contributions cap. This is known as the “bring-forward” option.

The “bring-forward” rules are not available to Australians aged 65 or over.

Summary of Types of Contributions

Contribution type	Concessional	Non-concessional
Description	Contributions from before-tax income, or for which a tax deduction has been claimed.	Contributions from after-tax income.
Includes:	Compulsory employer contributions. Salary sacrifice contributions. Contributions for which a tax deduction has been claimed.	Personal contributions that have not been claimed as a deduction. Spouse contributions. Contributions which exceeded your before-tax cap.