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Like it or lump it, tax is a deadly stalker
By Helen Matterson

RETIREMENT NEWS

Beware of strategies that try to avoid, rather than manage, an excess reasonable benefit limit, writes Helen Matterson

AS superannuation balances grow, many Australians' retirement nest egg is fast becoming the second most significant asset after their family home.

The long-term nature of the investment should see many ride out prevailing low or negative returns.

Increasingly, workers are contributing extra funds on top of the 9 per cent compulsory superannuation guarantee which employers pay on their behalf. Many are spurred into making contributions when they realise they may not be able to count on old-age social security entitlements in the future.

While it makes sense, therefore, to save as large a retirement nest egg as possible, the growth can create tax problems, too.

In many cases, individual super fund balances will be pushed beyond the point at which concessional tax treatment cuts out.

This point, known as the reasonable benefit limit (RBL), will depend on how you choose to take your money at retirement -- as a lump sum or pension.

The Government would prefer us to take the latter route in the hope we'll be less inclined to blow our money early before falling back onto whatever government pension there is (so-called double-dipping). That's why the pension reasonable benefit limit, at \$1,124,384, is twice the size of the lump sum RBL (\$562,195).

To qualify for the higher limit you must allocate as much as half of your retirement savings to a complying pension. With the lump sum RBL you are free to invest your retirement savings as you please.

Both RBLs increase each year when they are indexed to the average weekly ordinary time earnings (AWOTE) in July.

But for a growing number of Australians, these limits (but particularly the \$562,195 lump sum cap) will fall short of their retirement savings. And minimising the extra tax to be paid on the excess is becoming a real issue.

Financial services lawyer and partner with the Argyle Partnership, **Peter Bobbin**, says successful retirement planning virtually guarantees a superannuation excess RBL failure. ``Excess RBL management has become the new mantra for those advisers with high-earning clients'' Bobbin says. ``However, some of the strategies now being employed simply do not work."

One that's become increasingly common is the use of ``forfeiture".

This involves setting up a self-managed super fund so that any excess portion of one person's super benefit can be transferred to another member, such as a husband or wife. Such a strategy, in theory, would see the retiree avoid paying 48.5 per cent tax on the excess on payout. The only cost would be a 15 per cent surcharge on the forfeited amount credited to the other fund member.

Normally, those within their RBL would receive a 15 per cent rebate as the money was drawn down.

But Bobbin warns the costs could be much greater.

For a start, the Australian Taxation Office has the power, under part IV A anti-avoidance provisions, to claw back the tax thought to have been "avoided".

This could see the retiree forced to repay the original excess RBL tax, plus penalties -- but worse, the super fund could also be deemed non-compliant. This could see the entire balance of the fund -- not just the excess -- face taxes exceeding 60 per cent.

Even ignoring the ATO's anti-avoidance provisions, Bobbin says the use of forfeiture goes against a whole raft of legal and superannuation principles.

These include rules which say that if the super is vested in one person's name, the trustee of the fund cannot give it to another member.

"Forfeiture is not as easy as people think," Bobbin says. "It may be that a trust deed simply does not allow it." He urges investors to think twice about forfeiture techniques suggested by accountants and financial planners, and to consider alternative ways of managing an excess RBL.

It may not be possible to get rid of an excess benefit entirely, but there are legitimate strategies that can reduce it.

Something to consider, says technical strategy manager at financial planning firm RetireInvest Jennifer Brookhouse, is to time the super drawdown and the annual indexation of the RBL to the retiree's advantage.

By waiting until July, for example, when the RBL is increased, it may be possible to reduce the excess.

The accompanying table of workings shows how the strategy helps our sample retiree, Nicole, save \$32,822 by electing to draw down (via allocated pensions) part of her super when she retires in March and the remainder in July.

Keep in mind, however, that money can be left in the accumulation phase of super only by those aged under 65 or, if older, those working at least 10 hours a week.

Other strategies include directing the excess into an income stream, such as an allocated pension or allocated annuity.

Those who take this route won't receive the 15 per cent rebate but will avoid paying 48.5 per cent in tax that would apply if they withdraw their money in a cash lump sum.

If avoiding the 15 per cent surcharge is a priority, using a complying pension can help. This sees the super balance assessed against the higher pension RBL.

However, Brookhouse cautions that investors need to weigh up losing flexibility with a complying structure.

While it can provide the retiree with a regular income stream for life, investments (outside of an SMSF) tend to be in lower-returning fixed interest vehicles.

Further, there may be limitations for estate planning provisions, such as not always being able to transfer what's left of the pension to a family member when you die.

Reducing RBL through timing

At 62, Nicole was about to retire with superannuation of \$700,000. In March 2002, she decided to create an income stream using \$529,373 of her super, investing across two allocated pensions - benefiting from growth and value fund manager styles. A Lump Sum

Reasonable Benefit Limit assessment was triggered in the 2001/2002 financial year, as follows:

RBL assessment (two allocated pensions) \$529,373
Lump Sum RBL (2001/2002 financial year) \$529,373 *

There was no excess benefit limit as the amount invested in the allocated pensions was within the Lump Sum RBL at the time. The remaining \$170,627 was left in the accumulation phase of super.

In July 2002, Nicole's Lump Sum RBL was indexed to the Average Weekly Ordinary Time Wage, which for the 2002/2003 financial year increases to \$562,195. At that time Nicole started another allocated pension with her remaining super money. The RBL assessment was:

Original assessment (March 2002) \$529,373 *
New assessment \$170,627
Total RBL assessable benefits \$700,000
Lump Sum RBL (July 2002) \$562,195
Excessive benefit \$137,805

* The commencement of the first two allocated pensions was a benefit previously received within the past 12 months, therefore weren't indexed.

Benefits received more than 12 months ago were indexed to AWOTE.

* By waiting for the indexation of the Lump Sum RBL before she took the remaining amount held in the accumulation phase of superannuation, Nicole reduced her excess benefit by \$32,822. Instead of it being \$170,627, it ended up being \$137,805.

Source: RetireInvest

Caption: Mantra: Peter Bobbin says think twice about forfeiture

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