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Please stop super whining

Some advisers are getting too excited about tax avoidance issues.

Dear industry, will you please stop running to the regulators when you feel a headache coming on. You have to realise you will only get the answer that you expect, so why ask?

Take the superannuation issue of the day as an example. There has been a lot of discussion about the transition to retirement strategy (TTRS) that has evolved from the recent round of government changes to super. This initiative allows people to access their super as an income stream, even when they continue working past the age of 55. The changes allow people who have reached their preservation age to access their super in the form of a non-commutable income stream without the need to retire.

In the words of the Australian Taxation Office, this strategy provides “more financial options so people can retire when they are ready”. It fits the government’s policy of encouraging a self-sufficient retirement: a person is able to retire from their job or profession and commence their superannuation pension but at the same time continue to accept work opportunities and thereby supplement their own pension. The price for adopting this strategy? Simply the acceptance of a non-commutable superannuation income stream. However, the industry is resourceful and opportunistic. It was not long after the TTRS was announced that the deep salary-sacrifice strategy (DSSS) was developed, recommended and embraced by some within the industry.

It goes like this: the client commences a non-commutable superannuation pension consistent with TTRS and thereby enjoys a tax-rebated income with a maximum potential tax rate of 33.5 per cent – but a probable average tax rate on that income of 15.5 per cent. But they haven’t retired. They haven’t even partially retired: they are still working full-time. They have simply deep salary-sacrificed their income into super contributions – perhaps the whole of their income, or at least up to the maximum deductible super contribution limits, which for the over 50s is \$100,587.

Instead of a basic annual income tax liability of \$35,280, the DSSS income suffers a superannuation “contributions tax” of only 15 per cent – a personal tax saving of \$20,218! Sound exciting? Some believe it is. In fact, some believe that it is so exciting they argue the ATO can apply its anti-tax avoidance powers under Part IVA. The ATO should draw some comfort and amusement from the fact that the Part IVA argument is being raised more often by industry than by the ATO itself. Just what is all the fuss about? Can Part IVA apply? The TTRS is deliciously simple. However, the simplicity lies not with the development of the strategy but with the deliberate governmental policy change that has given birth to it.

It is wrong and naïve to believe that Part IVA can have general

application. It is true there has been a swing in favour of the application of the ATO’s anti-tax avoidance powers, and with it has come some confusion as to the application of these principles. Nevertheless, it is important to properly understand how these principles may apply, even if only to avoid the press prophecies of a few that result in a general climate of fear surrounding what should otherwise be an acceptable policy strategy.

Now let’s look at whether Part IVA can apply to the TTRS.

Part IVA’s chance of application is entirely dependent on how excited the adviser gets about taxation matters.

The client’s dominant purpose in adopting TTRS is not to gain a tax advantage, it is to establish a series of income streams.

It should not apply, but if the adviser is of the type who gets too excited about tax their statement of advice may condemn their client to explaining to the ATO that the excitable TTRS tax-advantage comments expressed in the statement of advice belong to the adviser, not to them. The ATO can employ Part IVA where it is of the view that a taxpayer has adopted a particular course of action with the dominant purpose of obtaining a taxation benefit. When making this assessment, the eight matters listed in section 177D of the 1936 Income Tax Assessment Act must be taken into account.

The legal view of Part IVA is assisted by the 1996 High Court decision of Federal Commissioner of Taxation v Spotless Services Ltd. Of some importance is the view of Justice McHugh that the necessary conclusion as to a dominant purpose of obtaining a tax benefit “will seldom, if ever, be drawn if no more appears than that a change of business or investment has produced a tax benefit for the taxpayer”. When introducing Part IVA into the law in 1981, the then treasurer John Howard recorded that it was “to give effect to a policy to strike down blatant, artificial or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs”.

What is the client’s dominant purpose in adopting TTRS? It is not to gain a tax advantage; it is to establish a series of income streams that will provide them with the highest income security in retirement, usually for themselves and their spouse. Where this is clearly expressed there will be no room for Part IVA to apply.

SHOULD PART IVA APPLY?

Again, no it should not. High income earning Australians are unlikely to utilise TTRS since their superannuation is already

overfunded or their income too high for the DSSS to be effective.

Lower to middle-income Australians can certainly gain from the combination of these strategies: it may be the only way for them to extend their superannuation income in retirement. These are the clients I most worry about. The TTRS was designed for them. They are the ones who will most benefit from being able to extend their retirement income by continuing to work in whatever form available.

It may be true that there is a small percentage of Australians who will gain marginally from being able to sacrifice a large amount of their salary into superannuation and yet live off their pre-retirement income. But what must be most obvious about them and the lower to middle-income earners is that they don't have enough super! They certainly don't have enough to retire on, at least in the context of the living standards that they desire.

If a person can afford to salary sacrifice the whole of their salary while living off their non-commutable income, it is unlikely that they have much in super. And what is the goal of making large salary-sacrificed superannuation contributions? For their future retirement – this is why Part IVA cannot and should not apply.

ANYWAY, WHAT IS THE ATO'S VIEW ABOUT DSSS?

This is simple. Just look on the ATO website at its "Employees' guide to salary sacrificing for superannuation", issued on May 17. The tax office has clearly stated that if there is an agreement with the employer that exists before the work is performed, and before entitlement to payment (although you can renegotiate a salary

sacrifice arrangement at any time), and the superannuation contributions are made to a complying superannuation fund, there is no limit on the benefits that can be sacrificed if there is no limit in a relevant industrial law, award, workplace or similar agreement.

SO THE DSSS IS OK

Let's return to the problem. There are some in the industry who are undermining TTRS when combined with DSSS by claiming that Part IVA can apply. They have even rushed to the ATO to seek its comment. Stop it. You do not need to do this. Anyway, you are presenting the wrong view: yours. You who are excited by the apparent tax-arbitrage have forgotten the most important person, the client.

Why would a client embrace these combined and clearly sanctioned strategies? Not to gain a tax benefit, but to secure a confident income in retirement.

At best, these people should take such a combination of strategies to the ATO, explain how it works, what the income in retirement value will be, and the fact that it will most benefit lower and middle-income Australians within the confines of their incomes and needs.

Will you please stop running to the regulators when you feel a headache coming on. You may just get the answer that you expect but it will be ill informed. So why ask?

What is far more effective, for all of us, is for the financial services industry to set the benchmarks. After all, we are much closer to the Australian in the street who is just looking for a financially secure life in retirement.

Asset



Like to go back on the tools?

The other day one of my key advisers left. I was going to offer an opportunity to become a part owner. Now I'm a key adviser short, back working in the business and with a new competitor. I can't afford for it to happen again.

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GROWING OR GOING?