



27 March 2003 – Money Management

LOVE THOSE EXCESS BENEFITS **By Peter Bobbin**

In 1994 the Labor Government introduced among the last of its changes to superannuation, the universal RBL. No longer would Australians enjoy individual superannuation recognition. The old arrangements which took account of your ability to succeed in your chosen career were replaced with a universal and flat common denominator for all Australians aged less than 45. The lump sum RBL was set at \$400,000, the pension RBL at \$800,000. Both were indexed to annual movements in *average* weekly ordinary time earnings.

Only 9 years later, we are beginning to see the result of this universal RBL as the tip of the excess benefits crisis begins to emerge. Over that period the universal RBL has risen 32%. In the same period Australian property has risen everywhere by at least 55%. According to the RBA the Australian Share Price Indices for same period lifted in the range of 60%. Even interest rate returns would have seen cash growth of 57%.

Successful retirement planning virtually guarantees a superannuation excess RBL failure.

As for all financial matters, where there is risk of financial failure the financial planning industry identifies new planning opportunities. Excess RBL management has become the new mantra for those advisers with high net wealth or high earning clients. However, in my view some of the strategies that are now being employed simply do not work.

The most common strategy to emerge in recent times for excess RBL management is the use of forfeiture. The mechanism is quite simple. A self-managed superannuation fund is established into which the excess RBL superannuation fund member transfers his or her superannuation. Once inside the fund, they forfeit the excess portion of their superannuation benefits, that is, the trustee reduces their accumulated balance. The trustee of the superannuation fund then applies the forfeited amount to other members within the same superannuation fund who have a much lower accumulated superannuation. Commonly these other superannuation members who receive the credit are the spouses of the excess members.

The magic wand is waved and the excess RBL has disappeared. The family retirement plans are significantly increased by the significant reduction in excess benefits tax.

There are costs on this path to excess RBL enlightenment, the most notable of which is a superannuation surcharge on the forfeited benefit amount credit to the other superannuation fund member. However, this 15% cost is far more palatable than the 48.5% that would be imposed on the excess benefit if it were paid out as a lump sum to its former owner. And the Howard Government's promise of a reduction in the rate of the superannuation surcharge has promised a reduction in the pain of this cost and introduced another strategy consideration to the excess RBL funding plan: delay the application of the benefit forfeiture to the other member until the superannuation surcharge rate falls.

Does it sound simple? Does it sound too good to be true? The answer to both questions is yes. The forfeiture based excess RBL management explained above does not work. The Taxation Office has LEVEL 22, 1 MARKET STREET, SYDNEY NSW 2000 DX 876 SYDNEY TEL: 61 2 8263 6600 FAX: 61 2 8263 6633

ample power under the Part IVA anti-avoidance provisions to claw back the tax thought to have been avoided.

But there is more, please pay careful attention to the next point. A failed excess RBL strategy of the simple type expressed above will not only lead to the imposition of the original excess RBL tax and probable penalties but it will also result in the complete complying status failure of the superannuation fund. This will result in effective superannuation taxes exceeding 60% on the whole of the superannuation interests, not just the excess. Even the concessionally taxed portion of the super benefits will now be in jeopardy.

In dealing with a forfeiture of excess benefits attention must be given to SIS Regulation 13.16.

This Regulation provides a prohibition on the reduction of a member's *accrued benefits* unless this is with the consent of the Commissioner, the member or otherwise in accordance with the terms of the Regulation. A forfeiture of excess benefit other than in accordance with SIS Regulation 13.16 is a breach of a Superannuation Standard that would result in non-complying status and potentially a loss of half of the value of the Superannuation Fund to taxation. Where the motivation to adopt a forfeiture of excess benefits is driven by a desire to limit the taxation treatment of the excess, a far more disastrous situation can arise where the result is a failure to comply with Regulation 13.16.

For SMSF's, failure to comply with a SIS Regulation results automatically in non-complying status under Section 42A of the SIS. A failure of complying status results in Section 288A of the Tax Act causing the assets of the superannuation fund (other than for undeducted contributions) to be deemed to be income and wholly taxable at the top marginal rate. In short, up to half of the superannuation fund is lost to taxation.

The application of SIS Regulation 13.16 turns on your understanding of the phrase "accrued benefits".

In superannuation context the phrase seems to have a variety of meanings. Actuaries have applied a meaning when seeking a minimum amount to be transferred from a defined benefit to an accumulation fund. Commonly this has been a factor of past service, future service and final average salary. Others argue that the bundle of superannuation rights, both present and future, represents accrued benefits.

A third view which would suit those who wish "to transfer" their excess benefits, is that accrued benefits represent the total sum of amounts vested. That is, any amount not vested is not part of accrued benefits and is not subject to Regulation 13.16.

Whilst this view has some support in law, it is apparently not a view shared by the Tax Commissioner or APRA.

I am sorry to drag out the old Tax Office chestnut of Part IVA but with such current interest in excess RBL management techniques, the financial planning industry has to be reminded that the Tax Office has power to deal with strategies that have as their major objective the obtaining of a taxation benefit. If a client is going to drag an advisor through an excess RBL management strategy analysis, the advisor needs to ensure that they do not become part of the problem.

At the risk of repeating the operative parts of Part IVA, this anti-avoidance power can be applied where the scheme (the sequence of superannuation forfeiture events) results in a tax benefit (excess benefits tax is not paid and the spouse or child of that person receives or becomes entitled to concessionally taxed superannuation derived from the first) and the obtaining of the tax benefit was the dominant objective.

If a planner's file notes or recommendations concerning treatment of an excess RBL is fundamentally directed at the saving of the tax, clear proof of the objective of gaining a tax benefit under Part IVA will exist.

Notwithstanding the potential application of Part IVA we are all aware that with a tax cost that exceeds 60%, there will be clients who will accept the risk and run the Part IVA gauntlet. From the planner perspective, ensuring that the language adopted in any advice minimises or entirely avoids an implication of the purpose of obtaining a tax benefit can reduce the client's Part IVA risk.

However, if this was all there was to the issue, it would be manageable, but it is not. Assuming the Part IVA issue can be overcome, there is a fundamental error being adopted in the above benefit forfeiture strategy, which leads to a problem significantly greater than a fear of just Part IVA.

The Superannuation Industry Supervision Act requires trustees to treat member accounts and further contributions as fully vested. Regulations 5.05 and 5.06 effectively provide for a presumption that the total amount standing to the credit of a member is vested in them unless the trustee is on notice of conditions to the contrary. This same regulation recognises the need for minimum vesting of SCG and member contributions etc but extends the vesting principle to all monies unless the trustee is specifically on notice of a lower vesting scale.

Moving from Regulation 5.05 and 5.06 to Sections 52 and 55 and also section 62 of the SIS Act we recognise that the trustees of a superannuation fund must also protect member benefits. It is impossible to reconcile these SIS Act principles with the forfeiture of vested benefits. Where the excess RBL forfeiture strategy fails to limit itself to only the non-vested portion of a superannuation fund member's account, the trustees of the superannuation fund will have engaged in a breach of the SIS Act. Because it is most usual that an excess benefit funding strategy involves an SMSF, the operation or effect of Section 42A of the SIS Act is to deem the SMSF to be non-complying. Now the whole superannuation fund assets are at risk of the top marginal rate of tax, not just the excess benefit amount.

Even if the trustee was sufficiently aware of the need to only recognise a forfeiture of non-vested amounts, the question has to be asked as to whether the trust deed allows the trustees to cause a member benefit to be forfeited. Many modern trust deeds are written without knowledge of superannuation principles that emerged in the 80's and early 90's. A blind adherence to SIS principles usually results in a trust deed that, strictly speaking, does not allow forfeiture. Why? Because it requires all benefits to be vested.

Some attention also needs to be put to the principles expressed in the 1992 Federal Court (Bankruptcy Division) of *Re: Alan Bond Ex Parte: Robert Eastaugh Ramsay*. Yes, once again we can thank Alan Bond for yet another development of our understanding of the law.

Robert Ramsay, as the trustee of the bankrupt estate of Alan Bond, asked the Federal Court for an order that the trustees of the superannuation fund that held Alan's money pay to him such benefit as is found to have vested in him. The trustees of the super fund refused to do so on the basis that Alan's super had been forfeited. Sound familiar? Any professional that has come across a forfeiture of superannuation who has not taken this Federal Court decision into account is not serious in their approach to the issues.

The Court was very willing to recognise that circumstances may require a vested interest to be defeated, to be treated as taken away, but in the context of Alan's superannuation the forfeiture power of the trustees was found to be ineffective and therefore void.

Excess benefits are a factor of the Government attitude of maintaining a universal RBL system; it is something that we all now live with. The temptation to deal with the issue in an aggressive way will

4.

remain whilst ever the tax payable is itself at an aggressive rate. If you do find yourself involved in such strategies, take great care.