CASE STUDY

Session 1: Superannuation Taxation Strategies

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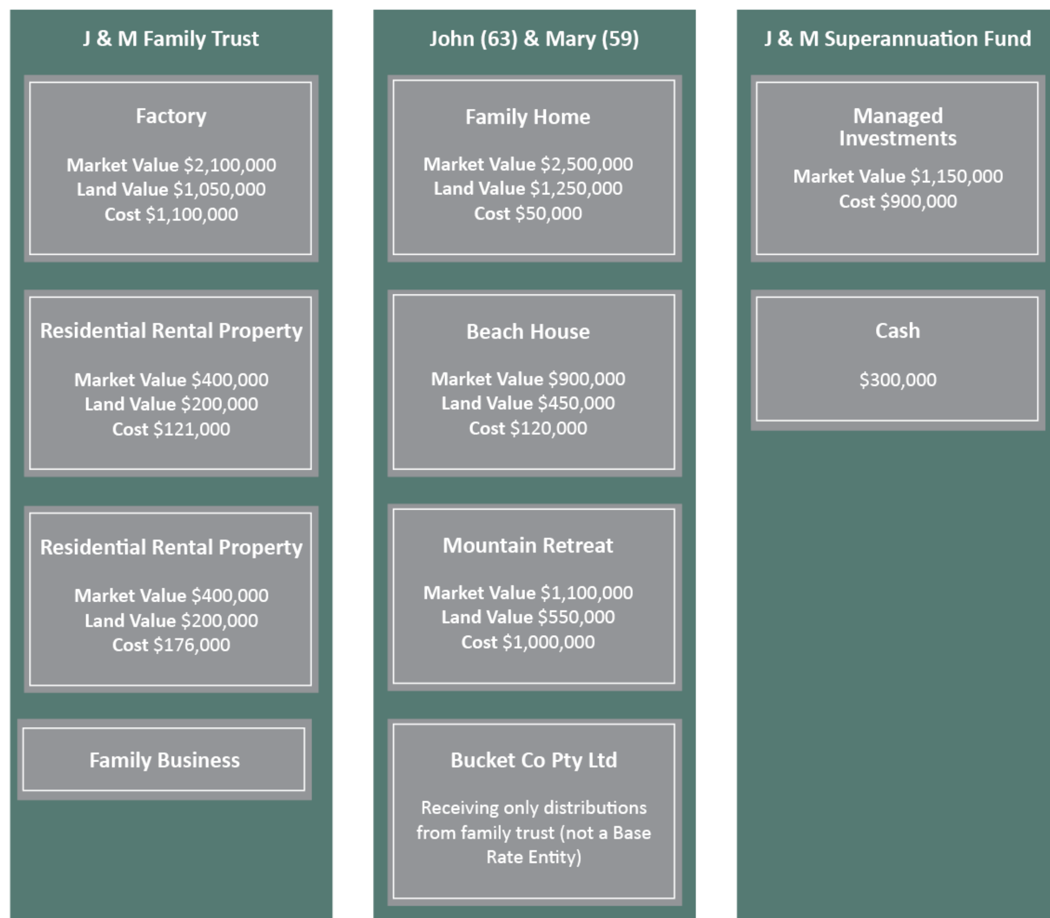
Background

On 28 February 2023, after running the family business for 10 years, John decided that it was time to retire and decided to meet with his advisor to ensure they are structured correctly for the future, therefore also ensuring their combined tax is minimised. John's wife Mary decided she would rather keep working for the foreseeable future as she cannot see herself playing golf or bowls. Through previous strategic planning John and Mary have not been taking a wage from the business and are paid dividends instead.
In previous years, John and Mary sought the advice of their advisors who recommended they establish an SMSF. Some restructuring of the business had taken place at that time, given future expectation of growth and a Small Business Capital Gains Tax (SBCGT) contribution had been made.



Their current superannuation balances are invested in cash and managed funds. Their balances are as follows:

Member (age)	Account	Amount	Tax-free%
John (63)	Accumulation	$1,000,000	45%
Mary (59)	Accumulation	$450,000	0%

Land Tax Issues

John has noticed how their Land Tax bill has been increased significantly in the prior year. He believes that they are possibly paying more land tax than they should be, as the amount is now representing approximately 8% if the income that they are generating from the properties compared with 6% in the prior year.

He asks his advisor for a review of the land tax which he is paying to see if they can reduce or manage this better.

Current Land Tax situation:

J & M Family Trust			
Property	**Land Tax**	**Surcharge**	**Total Land Tax**
Factory	4,761.21	3,729.67	8,490.88
Rental Property 1	906.90	710.41	1,617.31
Rental Property 2	906.90	710.41	1,617.31
Trust Total			**11,725.50**
Prior year total cost			8,200.00

John and Mary Personally			
Property	**Land Tax**	**Surcharge**	**Total Land Tax**
Beach House	1,338.75	-	1,338.75
Mountain Retreat	1,636.25	-	1,636.25
Personal Total			**2,975.00**
Prior year total cost			1,875.00

Total Land Tax across the group			
Property	**Land Tax**	**Surcharge**	**Total Land Tax**
J & M Family Trust	6,575.00	5,150.50	11,725.50
John and Mary	2,975.00	-	2,975.00
Trust Total	**9,550.00**	**5,150.50**	**14,700.50**
Prior year total cost			10,075.00

Jot down your thoughts on potential solutions / actions to take:

John requests his real estate agent to appraise the value of all their properties, and the valuations are in line with those provided by the State Revenue Office for land tax purposes.

The advisor reviewed the current land tax and determines that if the factory in South Melbourne is moved from the Family Trust, into the superannuation fund, John and Mary would save $6,562 per annum in land tax.

Total Land Tax across the group (after moving property to super fund)				
Property	**Family Trust**	**Personal**	**Super Fund**	**Total Land Tax**
Before transfer	11,725.50	2,975.00	-	14,700.50
After transfer	1,788.50	2,975.00	3,375.00	8,138.50
Land Tax Saving				**6,562.00**

Before going back to John, the advisor reviews whether any other costs (such as capital gains tax or stamp duty) would apply if the property were to be transferred to the fund.

Capital Gain on Transfer of Property

The advisor estimates the capital gain on the property to be $1,000,000. Because John and Mary have owned the property for more than 12 months and it was owned by the Family Trust, he advises that John and Mary will also be entitled to a 50% discount on the gain, therefore reducing the capital gain to $500,000. He advises them that $250,000 of capital gain will be included in each of their tax returns, as taxable income. All John can think about is a huge tax bill (around $88,000 each or more – a total of around $177,000), so asks the advisor if there is anything that can be done to reduce their taxable income.

Superannuation Contributions

Concessional Contributions

The advisor explains that if they were to make a contribution to the super fund of $25,000 as they can claim this as a personal concessional contribution each – this is likely to save them around $23,500, however the Super Fund will still need to pay 15% tax on the concessional contributions received – therefore the NET tax benefit is $16,000. Whilst this is a good start the amount of tax is still a significant concern to John.

Catch-Up Contributions

The advisor reviews the Tax Agent's Portal and finds out that Mary has not made any concessional contributions since 1 June 2018 and that she has available catch-up contributions of $100,000 (4 years' worth of $25,000), in addition to her concessional contribution limit of $25,000 for the current year. This will create a net saving of a further $32,000. Now we are getting somewhere says John – keep going!

As John's balance was over $500,000, even though he had not made his full $25,000 allotment of superannuation contributions over the past 5 years, he is not able to make any catch-up contributions.

Reserving Strategy

The advisor then explains the concepts of the "reserving strategy" which essentially means making a superannuation in the month of June (separate to any other contributions being made (in this case an additional $25,000) but then not allocating this to the members involved (John and Mary) until the following financial year (within 28 days of the contribution being made). Therefore, this allows us to make an additional concessional contribution, but it will not count towards their $25,000 limit until the following financial year. This will allow them a further tax saving of $16,000.

Division 293 Threshold

If the taxable income for either John or Mary PLUS their concessional superannuation contributions goes over the Div 293 threshold of $250,000 then there will higher levels of tax levied on the superannuation contributions made. Therefore if there was any other income that was to go in their names this was most certainly going to trigger this higher level of tax on the superannuation elements and therefore risk eroding away some of the savings come up with noted above.

The advisor also determines that no dividends should be paid to John and Mary in this financial year to ensure their income does not exceed the Division 293 threshold.

Timing of Property Transfer

1 March 2023	1 May 2023	30 June 2023	3 July 2023
- Property transferred from family trust to John and Mary	- $200,000 transferred as NCC's for J and M - $1,300,000 purchased by SMSF - $150,000 cash contributed to the fund as Personal Concessional Contributions	- $50,000 cash contributed to the fund as Personal Concessional Contributions to be reserved	- $600,000 transferred as Non-Concessional Contributions

The advisor decides that to make effective use of the Non-Concessional Contributions Cap, that the property should be moved in four parts to the fund:

1. Property first transferred from the Family Trust out to John and Mary personally (1 March 2023);
2. a portion contributed from John and Mary to the SMSF on 1 June 2023;
3. a portion purchased by the SMSF on 1 June 2023; and
4. the remainder contributed from John and Mary to the SMSF on 3 July 2023.

The advisor calculates the Stamp Duty on the portion of the property that will be purchased by the fund (not contributed). He calculates that the stamp duty will be $71,500.

Quantify the Benefits

The rent received by the SMSF will be net $105,000 per annum – so is likely to be a tax saving on an ongoing basis of around $15,750 per year, and even more when they are both drawing pensions from the superannuation fund.

The savings on the Land tax has already been calculated to be around $6,562 per year. Therefore, the total between these two measures is $22,325 per annum.

The total tax paid on the capital gain and contributions made have resulted in some significant savings and the total tax cost would now be $120,714 (down $55,000) plus the Stamp Duty on the transfer of around $71,500 makes the total cost of this transaction $192,214. This means a payback period to 8.5 years, however, allows John & Mary to get $1,000,000 into their superannuation fund and does not factor in further capital growth the property would incur.

Whilst a reasonably long pay-back period, John and Mary decide that the strategy is a good idea, as factories within the South Melbourne area have been selling to developers at inflated values and they believe that their property will benefit in the long-term, from being held in the super fund.

The advisor discusses with John and Mary and they agree that John should commence an account-based pension with his accumulation balance when the property is in the fund. Currently, he has a balance of $1,442,500. This will save a further $9,350 per annum in tax within the Fund – and therefore would reduce the payback period further to 6 years.

John and Mary are very happy with this overall solution.

What other options might they have explored?

5 years later (July 2028)… John now aged 68 – Mary 64

Whilst John has enjoyed his retirement and his golfing handicap has come down to 7, he feels like something is missing from his life, so decides to return to work and gets a job at Bunnings.

Mary on the other hand has decided that she is sick of her job and with John now going to be out of the house, can retire herself. Their account balances at 30 June 2028 are as follows:

Member (age)	Account	Balance	Tax-free%
John (68)	ABP	$1,439,910	59%
Mary (64)	Accumulation	$1,671,730	24%

Prior to the accounts being prepared Mary obtained a valuation from an agent for the property in April 2028. The valuation came back at $2,600,000.

John and Mary believe the property is likely to be re-zoned in the coming years and approach their advisor to discuss what options exist for them.

The advisor discusses with Mary and John and they determine that it is in their interests to commence a pension for Mary, as she is now retired. Mary can commence a pension with her entire balance, as the Transfer Balance Cap has indexed up from $1,600,000 to $1,700,000.

Benefit and Re-contribution Strategy

He then proceeds to discuss with them the possibility of doing a benefit and recontribution strategy. He advises Mary that because of her Total Superannuation Balance, she could recontribute $100,000 of non-concessional contributions to the fund, and in doing so, would save her estate $12,932 in death taxes, based on her balance as at 30 June 2028. Mary undertakes the withdrawal and recontribution on the same day.

The adviser and accountant ensure that the withdrawal is treated as a lump sum commutation so that Mary can commence a new pension when it is contributed to the fund. Transfer Balance Account Reports (TBAR) are prepared and lodged with the ATO as follows:

- Pension Commencement on 1 September - $1,671,730 – due 28 October 2029
- Pension Commutation on 10 September - $100,000 – due 28 October 2029
- Pension Commencement on 10 September - $100,000 – due 28 October 2029

Have you thought about? What happens if Mary undertakes the benefit and recontribution strategy before commencing the pension?

Offer to Buy the Factory

In October, John and Mary have had an offer from a developer willing to pay $4,200,000 for the property. At the time of meeting with the advisor, they had not accepted the offer, but are extremely tempted!

John and Mary tell the advisor they have decided to wait a little longer before they accept the offer on the property, they need to think about how this will fit into their future plans.

Have you thought about? What happens if Mary waits to undertake the benefit and recontribution strategy until the following June/July?

With Mary having commenced a pension on 1 September 2028, the fund is now fully in pension phase. On Friday 19 November 2028, Mary receives a phone call from the developer wishing to purchase the property. They are now willing to offer John and Mary $4,500,000 and a contract is signed on 2 December 2028.

As the fund is 100% in pension mode, there is no tax to pay on the capital gain of $2,400,000.

Have you thought about? What would have been the tax payable if Mary had commenced her pension after the property was sold?

Purchase of Investment Property in Fund

With the contract signed on the sale of the factory, John and Mary decide to get away for a few days to celebrate. They head down to the Mornington Peninsula and stay at the Moonah Links Golf Club. Whilst there, they came across a lovely home overlooking the golf course and John remarks how one day he would like to live there permanently. They talk it over and discuss how it would be worthwhile to purchase it now, rent it out and then move into it in the future when the time is right for them.

Mary quickly calls their trusted advisor who reviews the situation and advises Mary, that since they are going to run it as a rental property for the foreseeable future and considering the large amount of cash now in the fund, why not purchase the property in their fund. John and Mary like this idea, so they purchase the new property for $932,000 in their superannuation fund and begin renting it out.

Sale of Investment Property in Personal Names

Shortly after purchasing the new property, John receives a call from their real estate agent in Bright, who tells him that the Mountain Retreat (which they own in their personal names) they had been renting out through Air BnB since they left the area 15 years ago, has received an offer of $1,300,000, if they wish to sell.

John and Mary decide that they will sell the Mountain Retreat without discussing this with their advisor first, as the offer is too good to refuse. Settlement day arrives with no issues, and John and Mary receive the proceeds from the sale. Since 30 June is now fast approaching, John decides that perhaps they should receive some tax advice from their accountant, so books an appointment for John and Mary to meet with them.

In preparation for the meeting in May, the accountant asks Mary to send through their current income data for the year. Mary calculates that the capital growth on the Mountain Retreat since they left Bright is $300,000 and sends that through. She advises that John returned to work in August and she has been retired since August. John advises that his gross income from Bunnings will be $20,000 for the year.

Reserving Strategy and Capital Gains Tax

During the meeting with John and Mary, the accountant learns that John has received $2,000 in Superannuation Guarantee for the year. The accountant quickly calls their advisor into the meeting and discusses with John and Mary the possibility of repeating the contributions reserving that they did when they moved the factory into the fund. The quick-thinking accountant determines that the tax saving for John and Mary will be approximately $15,675 (he makes sure to take into consideration the SGC that John would receive from Bunnings in the following year). Mary does not need to meet a work test as the age threshold for this test has been increased to 67.

Downsizer Contribution

When the meeting is over, the advisor reviews the discussions and notes that the Mountain Retreat property was once their main residence. The advisor asks the accountant what the date of settlement was and finds out that it was 40 days ago. It is now June and Mary has just celebrated her 65th birthday.

Purchased Left Bright	Sold
	$300,000 Growth

The advisor requests for the accountant to provide them with the transfer balance cap reports for John and Mary and is surprised to find that John has an available limit of $167,343.75. This is because the transfer balance cap has indexed up since John commenced his pension in 2022.

Quickly swinging into action, the advisor reconvenes a meeting with John and Mary for 10 days later, to discuss further contributions being made to the fund that they may be eligible for. John and Mary advise that they have only $350,000 in available funds to make any possible contributions, as the proceeds from settlement have been invested into term deposits and they cannot access them without 30 days' notice to the bank. This will give them a few days spare to get the money into the fund.

Due to the time sensitive nature of making the downsizer contribution, the advisor recommends that John and Mary provide notice to the bank that they wish to redeem the term deposits. Once redeemed, use these funds to contribute $350,000 and commute $250,000 from Mary's first pension account (the one which has a taxable component) and recontribute to the fund.

This enables John and Mary to fully utilise the downsizer contribution of $300,000 each, and saves Mary's estate $32,330 in death taxes. A new account-based pension is commenced for John with the available balance of his transfer balance cap. Once again, as Mary's withdrawal is treated as a lump sum commutation, she will have the available limit on her transfer balance cap to commence a new account-based pension with the $250,000 downsizer contribution.

2 Years Later

John has now had enough of working for Bunnings and has decided to give up work to spend more time with Mary, who is now unwell.

In between his caring duties to Mary, John once again goes back to playing lots of golf and is spending more and more of their money on accommodation for golfing trips on the Mornington Peninsula.

Transferring Investment Property out of Fund to Personal Names

On 4 March 2031, John seeks guidance from his advisors who discuss with him the possibility of bringing forward their plans of transferring the property at Moonah Links out of the fund and into their personal names, seeing as he is enjoying playing golf so much and always paying for accommodation. John likes this idea, so requests his advisors to determine what the best method for removing the property from the fund would be.

The property is now worth $950,000 and the fund's value is now:

Member (age)	Account	Balance	Tax Free %
John (70)	ABP	$2,658,000	59%
John (70)	ABP	$166,000	100%
John (70)	Accumulation	$180,000	74%
Mary (66)	ABP	$2,126,000	24%
Mary (66)	ABP	$152,000	100%
Mary (66)	ABP	$260,000	100%
Mary (66)	Accumulation	$53,000	94%
Total		**$5,595,000**	

The advisors return and give him the following options:

Option 1: full property transfer in-specie

John is advised that he could take the property as an in-specie transfer from the fund. He asks whether this could just be a pension payment for him or Mary (as he knows there is no maximum on their pension limits). The adviser states that this cannot be done, as they are not permitted to take a pension payment in-specie.

The adviser suggests commuting some of the pension accounts back to accumulation, and then transferring the property out in-specie. He considers using the two small accumulation balances, and then commuting the smaller pension balances, and the remaining balance up to $950,000, to come out of the larger pension balances. He figures this will "clean-up" the accounts, so that John and Mary are left with one pension account each.

He recommends commuting the pensions on 31 March and undertaking the in-specie transfer on 1 April. He advises that the following costs will result from the transaction:

- Capital gains tax $72
- Stamp duty $0

He advises that from an estate planning perspective, John and Mary's children will be worse off, because the proportion of the fund that is tax-free will reduce from 51% of the fund, to 43% of the fund. He explains that any benefit passing to the children or the estate, will incur 17% tax on the taxable component. If they were comparing similar balances (i.e. not factoring in the $950,000 withdrawal), this would result in an additional $73,900 in death taxes.

The other downside to this strategy, is that $950,000 of their retirement savings would be leaving the superannuation fund environment, and based on their account balances, would be unable to be put back into the superannuation fund, given their total superannuation balances.

While they do not think John needs to understand the intricacies, the advisor and accountant discuss the exempt current pension income situation, and the requirement to get an actuarial certificate. The adviser explains that based on the previous pension strategies that he has implemented for John and Mary, 96% of the fund is in pension mode. As there is an accumulation balance, the fund is unsegregated and would therefore require an actuarial certificate.

On 31 March, when $717,000 is commuted from the pensions, and added to the existing accumulation accounts, the percentage of the fund now in pension mode has decreased to 83%. Again, because there are accumulation accounts, the fund is unsegregated and so an actuarial certificate is required.

On 1 April when the property is transferred out in-specie (therefore being treated as a lump sum benefit), the fund is then 100% in pension mode. At this point in time, the fund is considered to be segregated and does not require an actuarial certificate.

	01-Jul			31-Mar	30-Jun
Pension mode	*96%*				*100%*

83% for 1 day

In calculating the exempt income (which will be applied to the income earned by the fund, including the capital gain on the transfer of the property), the adviser explains the actuary will take the weighted average of the tax free components, during the period when the fund is unsegregated.

For example:
- For the first 274 days of the year, the fund was 96% tax free.
- For day 275, the fund was 83% tax free.
- For the last 90 days of the year, the fund was 100% tax free.

To calculate the tax-free proportion, the actuary would take the weighted average of the first 275 days (the unsegregated portion).

As there is only one day where the tax-free proportion is lower, the weighted average remains at 96%. If there had of been a longer period where there was a higher balance in accumulation, then this would have reduced the tax-free proportion.

Accordingly, this is applied to the capital gain to calculate the capital gains tax, as follows:

= (950,000 – 932,000) x (100% - 96%) x 10%

= 18,000 x 4% x 10%

= $72

Have you thought about? What if on the same day you started pensions with the accumulation balances, and then commuted the $950,000 using the pensions with the lowest tax-free proportions, and then transferred the property in-specie?

Option 2: purchase the property from the fund and invest in super

Another option available is to purchase the property from the fund.

The advisor calculates that the following costs will result from the transaction:

- Capital gains tax $72
- Stamp duty $52,070

John and Mary would pay the stamp duty in their own names, and the fund would pay the capital gains tax.

The advisor explains to the accountant that the exempt current pension income calculation would be the same as in option 1.

John starts doubting his advisors as to them having his best interests at heart when they tell him this, but realises that since he is planning to spend every second weekend down playing golf the cost of accommodation for the year will be $47,250 and the payback period for this would be just over 1 year.

This option appeals to John as he and Mary have cash outside of the fund that they could use to purchase the property. It also means that the overall balance in the fund would remain the same, and there would be cash in the fund to invest.