

## Tech Time



### Perpetual's monthly technical guide

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#### New life expectancy tables

The Australian Government Actuary has released new life expectancy tables effective 1 January 2010. The new tables should be used to calculate the Centrelink deductible amount for all superannuation income streams that commence from this date.

As life expectancies are continuing to increase, the net effect is that the deductible amount will decrease and effectively increase the assessable amount of income for the purpose of the income test. This is illustrated in the following example:

Jose is 65 and applies for the age pension. He commences a super income stream with \$250,000 and draws an income of \$20,000. What is the assessable income if he commenced an income stream on 31 December 2009 compared to 1 January 2010?

| Date commenced   | Deductible amount             | Assessable income |
|------------------|-------------------------------|-------------------|
| 31 December 2009 | \$14,124<br>(\$250,000/17.7)  | \$5,876           |
| 1 January 2010   | \$13,484<br>(\$250,000/18.54) | \$6,516           |
| Difference       | \$640                         | \$640             |

The new life expectancy tables are on the back page.

#### Calculating the deduction for death benefit payments - ATO ID 2010/5

The Australian Taxation Office (ATO) has recently released ATO ID 2010/5. It clarifies the formula that should be used to calculate the deduction that may be claimed when paying a death benefit to a dependant. A dependant is as defined for the purposes of the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act). Applying this deduction effectively increases the payment to the eligible dependent of the member by the amount of the deduction.

The formula is:

$$(0.15 \cdot P) / (R - 0.15 \cdot P) \cdot C$$

Where:

- P** = the number of days that occur after 30 June 1988.
- R** = the total number of days in the service period that occur after 30 June 1983.
- C** = the taxable component of the lump sum.



**Tech tip:** The taxable component excludes any insured amounts where the superannuation fund has claimed a tax deduction for insurance premiums or a future liability to pay benefits.

Interestingly the formula is consistent with previous ATO interpretative decisions, for example ATO ID 2007/219, and just maintains currency of the formula.

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## Confirmation of the definition of child - ATO ID 2010/1

The ATO have recently released ATO ID 2010/1 which confirms that the definition of a child for the purpose of calculating a deduction for death benefit payments can also include a child over the age of 18.

In coming to their decision, the ATO referenced the definition of 'child' to the definition contained in section 995-1 of the Income Tax Assessment Act 1997 (Cth) and noted that a child of an individual includes an adopted, step, ex-nuptial, or a child of the individual's spouse and that there was no age limit on a child.

In addition they referred back to the definition provided under the former legislation for the 'anti-detriment amount' which made reference to 'any child' of the deceased.

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## Acquiring property through self managed super funds

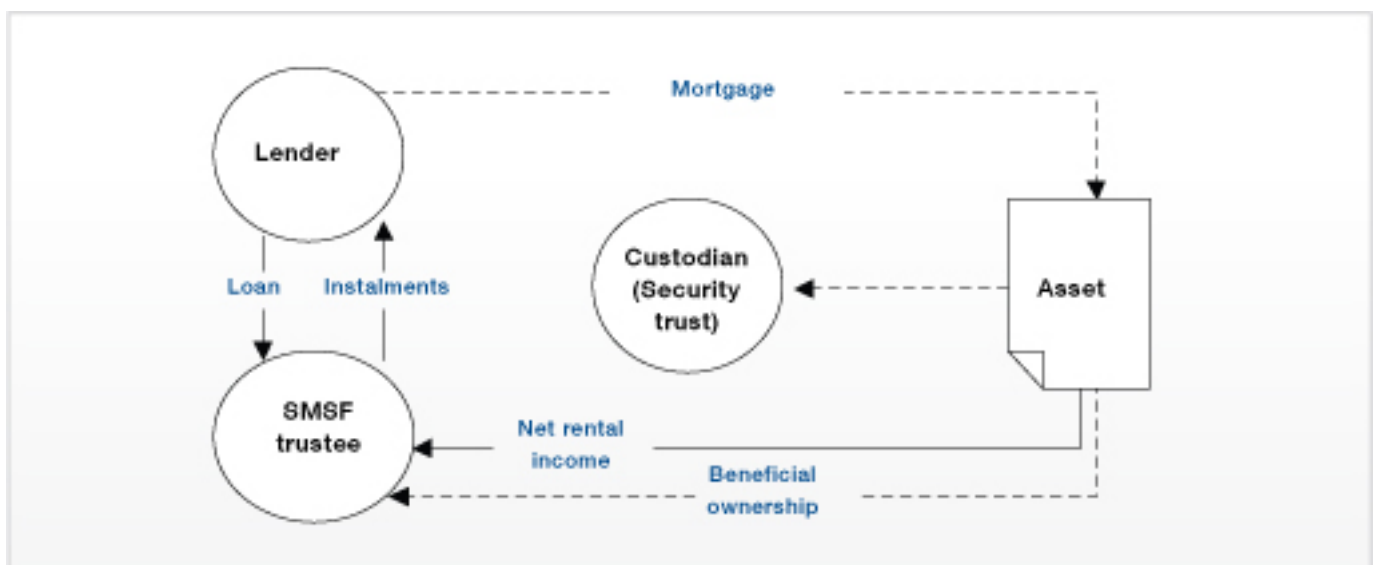
A question often raised is how best to get an existing investment property into a self managed super fund (SMSF). Unfortunately, the first obstacle to overcome lies in the acquisition rules outlined in section 66 of the SIS Act, which generally prohibits the acquisition of assets from related parties unless they are specifically covered by the exemptions. Fortunately for commercial property owners, an exemption applies, but unfortunately for residential property owners, the same flexibility generally does not apply.

The second obstacle to overcome is having sufficient funds within the SMSF to make the purchase. The good news is that even where there is not enough money, there are a couple of strategies that may be applied to give the SMSF at least partial ownership of the property. These include using the borrowing provisions, and owning the property as tenants in common.

### 1. Purchasing a property using the borrowing provisions

Section 67(4A) of the SIS Act allows superannuation funds to borrow to invest in a range of assets, including property. To be compliant with these rules, the super trustee must have a beneficial interest in the asset with the right to acquire legal ownership of it after paying at least one instalment. These types of arrangement allow super trustees to replicate direct and geared investments in assets that occur outside the superannuation environment.

The process can be best illustrated by the diagram below:



### What are the key advantages?

- The opportunity to gear gives the fund exposure to the underlying asset for a smaller monetary outlay than if it bought the asset outright. This potentially increases the gains
- Borrowing is one way of effectively increasing contributions, as it is possible to invest more than the contribution caps allow. For example, if your client (aged 55) contributed the maximum amount of \$500,000 to their super fund, executing a borrowing arrangement could provide the fund with the opportunity to invest significantly more than this amount (depending on the relevant loan-to-value ratios). This allows the fund to purchase assets it may not otherwise be able to afford, such as commercial property
- The nature of compliant borrowing arrangements means that they provide the investor (ie the super fund) with 100% of any income earned. This income could effectively be used to fund the interest and fees related to the borrowing
- Provided the fund is assessed on any income distributed, the fund would ordinarily be entitled to a tax deduction for the interest costs. In addition, where the arrangement is properly executed, there would not be any tax payable upon final payment by the super trustee and transfer of the legal title in the asset to it
- Because the SMSF has beneficial ownership of the asset from the outset of its acquisition, all of the capital gains realised are assessable within the fund from the date the arrangement is structured.

### What are the key disadvantages?

- In the same way that gearing provides the potential to make high percentage gains, it also carries the risk of making large percentage losses. There is also the risk that the value of the asset will fall to such an extent that if the SMSF were to default, all the payments invested could be lost
- There is increased compliance risk as there are strict requirements that must be met to ensure the investment is not considered a borrowing
- There is increased funding risk as the income generated from the asset may not be sufficient to fund the ongoing interest and administration costs. The fund would need to have cash reserves available to meet any shortfall.



**Tech tip:** Borrowing should only be undertaken where the strategy is consistent with the investment strategy of the fund, its governing documents, the sole purpose test and any other investment restrictions.

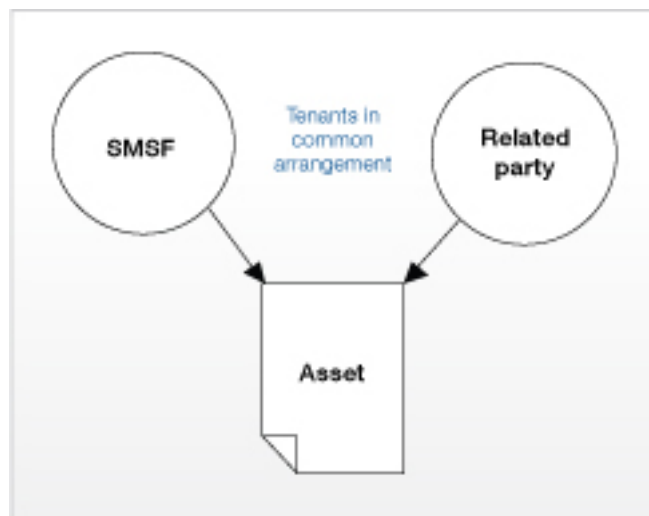
## 2. Owning the property as tenants in common

An SMSF can purchase either a residential or commercial property with a related party and not contravene any SIS Act requirements. For example, this may allow them to purchase a \$1 million property where the fund only has \$500,000 and the member provides the other \$500,000.

However, there are two key issues that may arise with this strategy:

1. If the aim is for the SMSF to acquire the entire asset over time then this strategy will only work with the purchase of commercial property as the acquisition rules would prevent the strategy working with residential property.
2. The member actually has to have the funds available as it is in the ATO's view 'not acceptable for a co-owner to use their share of a property or any fund asset to obtain a borrowing to finance their part of a purchase.' This view is taken because the ATO believes that in the event of default, the asset would need to be realised and would thereby expose the SMSF to the same risk as if they had undertaken the borrowing directly.

Unlike a borrowing arrangement, the mechanics of purchasing a property as tenants in common are very simple as illustrated in the diagram below:



### What are the key advantages?

- Very straightforward, with no complex documentation or trust arrangements required
- Commercial property can be acquired from a member progressively over time
- Low risk compared to a borrowing arrangement.

### What are the key disadvantages?

- Co-owner must have the funds available or be able to source borrowing funds without using the 'asset' as security
- Residential property cannot be progressively acquired over time
- The SMSF is only assessed on its portion of the assessable income and growth and as a result the remaining portion would be taxed at the co-borrowers tax rate.

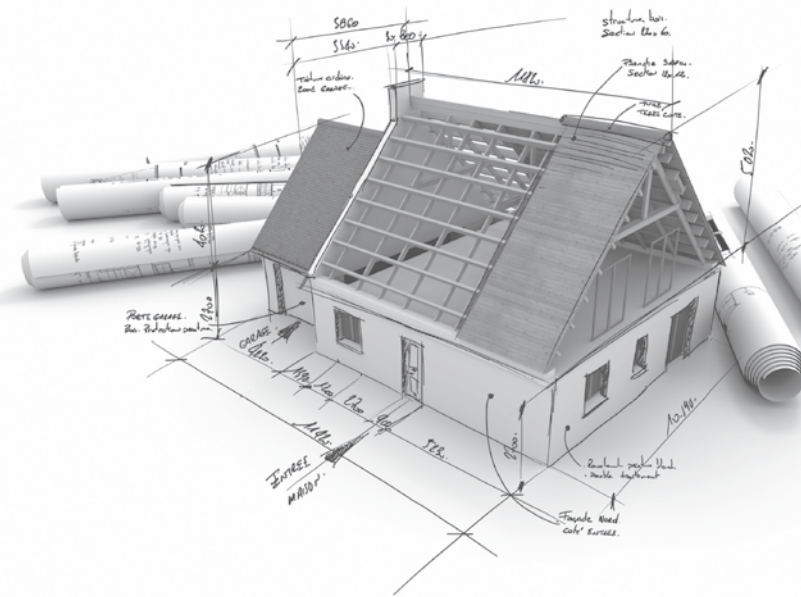
### What are the key disadvantages?

- Need to invest with non-related parties which may not be practical or possible
- Need to set up a trust structure
- Do not have 100% ownership of asset
- Usual risks of gearing.

### 3. Purchasing property using a non-related geared unit trust

Investing in a non-related geared unit trust is another effective method of financing the purchase of an asset where the SMSF does not have all of the funds required to make the investment. To ensure this strategy does not breach any SIS Act requirements it is essential that any related parties have a minority interest.

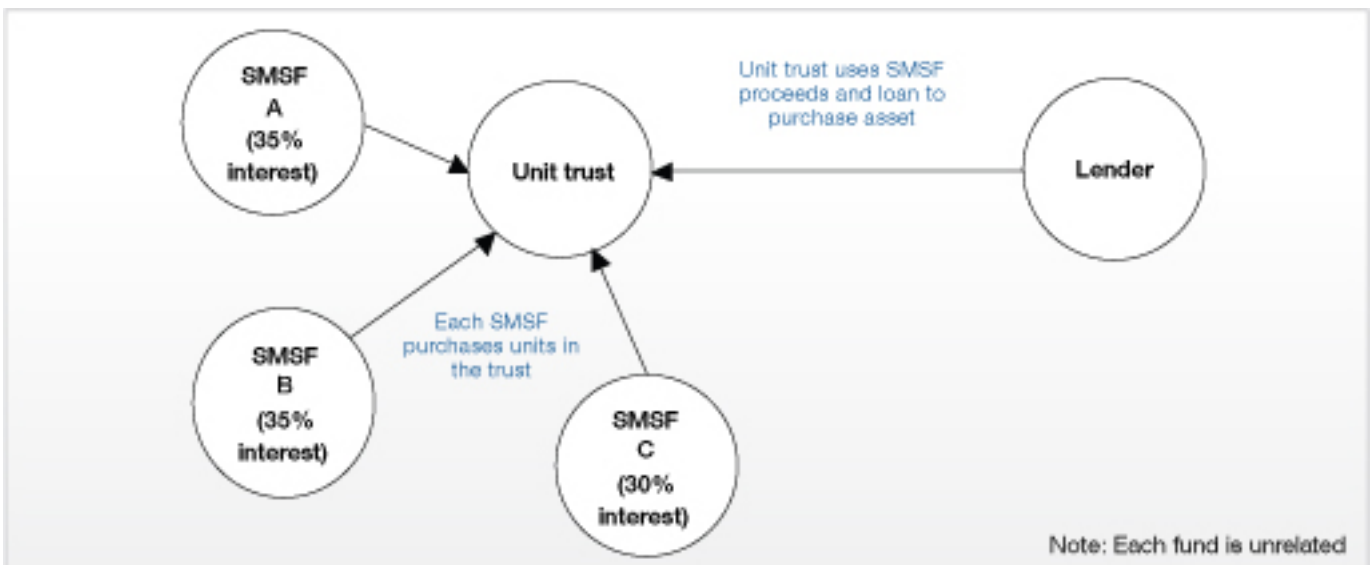
**Tech tip:** A related party includes members and their 'Part 8 associates' as well as standard employer sponsors and their 'Part 8 associates.' This includes relatives, partners and any companies or trusts that they control.



The diagram below illustrates how this strategy works in practice:

### What are the key advantages?

- Ideal for close friends with common goals or interests
- Member does not need to have funds or provide security for a loan
- Usual benefits of gearing.



## Australian life expectancy tables 2005 – 2007

| Age | Male life expectancy | Female life expectancy | Age | Male life expectancy | Female life expectancy |
|-----|----------------------|------------------------|-----|----------------------|------------------------|
| 50  | 31.43                | 35.17                  | 76  | 10.68                | 12.78                  |
| 51  | 30.53                | 34.24                  | 77  | 10.07                | 12.05                  |
| 52  | 29.63                | 33.31                  | 78  | 9.48                 | 11.35                  |
| 53  | 28.73                | 32.38                  | 79  | 8.92                 | 10.67                  |
| 54  | 27.84                | 31.45                  | 80  | 8.38                 | 10.01                  |
| 55  | 26.95                | 30.53                  | 81  | 7.86                 | 9.37                   |
| 56  | 26.08                | 29.61                  | 82  | 7.36                 | 8.75                   |
| 57  | 25.20                | 28.70                  | 83  | 6.89                 | 8.17                   |
| 58  | 24.34                | 27.79                  | 84  | 6.45                 | 7.61                   |
| 59  | 23.48                | 26.89                  | 85  | 6.03                 | 7.08                   |
| 60  | 22.63                | 26.00                  | 86  | 5.64                 | 6.58                   |
| 61  | 21.79                | 25.11                  | 87  | 5.27                 | 6.11                   |
| 62  | 20.96                | 24.23                  | 88  | 4.94                 | 5.68                   |
| 63  | 20.14                | 23.35                  | 89  | 4.63                 | 5.28                   |
| 64  | 19.34                | 22.48                  | 90  | 4.36                 | 4.91                   |
| 65  | 18.54                | 21.62                  | 91  | 4.11                 | 4.57                   |
| 66  | 17.76                | 20.76                  | 92  | 3.89                 | 4.27                   |
| 67  | 16.99                | 19.92                  | 93  | 3.69                 | 3.99                   |
| 68  | 16.24                | 19.08                  | 94  | 3.51                 | 3.75                   |
| 69  | 15.49                | 18.24                  | 95  | 3.36                 | 3.53                   |
| 70  | 14.76                | 17.42                  | 96  | 3.22                 | 3.33                   |
| 71  | 14.04                | 16.61                  | 97  | 3.10                 | 3.16                   |
| 72  | 13.33                | 15.82                  | 98  | 2.99                 | 3.00                   |
| 73  | 12.64                | 15.03                  | 99  | 2.90                 | 2.86                   |
| 74  | 11.96                | 14.27                  | 100 | 2.81                 | 2.74                   |
| 75  | 11.31                | 13.51                  | 101 | 2.73                 | 2.63                   |

This analysis has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL 234426 Perpetual Superannuation Limited (PSL) ABN 84 008 416 831 AFSL 225246 RSE L0003315 for the use of financial advisers only, it is general information and is not intended to provide you with financial advice. The technical interpretations expressed in the article are the opinions of the author at the time of writing and do not constitute a recommendation to act. Any information referenced in the article is believed to be accurate at the time of compilation and is provided by Perpetual in good faith. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.



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