DBA Butler Pty Ltd Lawyers

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Insurance and death

Many people have been concerned about the tax treatment of superannuation benefits paid on death that include insurance proceeds. In particular, in certain circumstances proceeds may be taxed at up to 46.5%.

Superannuation death benefits

Where a lump sum is paid on the death of a member that contains insurance proceeds in respect of which deductions have previously been claimed (or the trustee is entitled to claim), that part of the benefit (as determined using a special formula) representing the deceased's future service period forms part of the element untaxed in the fund.

If the recipient of the lump sum is a tax dependant, the element untaxed is not subject to tax.

Conversely, if the recipient is not a tax dependant, the element untaxed will be subject to tax at 31.5%.

If a pension is paid to a tax dependant on death, the pension (including any insurance proceeds) will be tax-free if either the deceased or the tax dependant is at least 60 years of age.

However, if the deceased and the tax dependant are under 60 years of age, the pension will be subject to tax at marginal tax rates less a 15% tax-offset.

Commutation of a pension

If a pension is commuted within the later of 6 months of the deceased's death or 3 months of probate (the Post-Death Period or 'PDP') it is treated as a lump sum death benefit as discussed above. Thus, the element untaxed will be taxed at 31.5% for non-tax dependants.

If, however, a pension paid on death to a tax dependant is commuted after the PDP, the resulting lump sum does not receive the concessional tax treatment that applies to a lump sum death benefit.

Thus, if deductions have been claimed (or the trustee is entitled to claim deductions) in respect of insurance, that part of the benefit (as determined using a special formula) that represents the deceased's future service period forms part of the element untaxed in the fund. See Table 1.

Table 1: element untaxed

Age	Not exceeding low rate cap[1]	Not exceeding untaxed plan cap[2]	Exceeding untaxed plan cap
< 55	31.5%	31.5%	46.5%
55-<60	16.5%	31.5%	46.5%
60 & over	16.5%	16.5%	46.5%

[1] $140,000 (financial year 2007-08)

[2] $1 million (financial year 2007-08)

Note that the element taxed has priority (to the element untaxed) in offsetting the low rate cap. If there is no remaining low rate cap, the entire element untaxed will then be taxed at 31.5% up to the untaxed plan cap and 46.5% thereafter.

Summary

Broadly, the above means that:

- Insurance paid to non-tax dependants will generally give rise to a 31.5% tax rate on the element untaxed.
- A 46.5% rate can apply where a pension (containing insurance proceeds) is commuted after the PDP and the $1 million untaxed plan cap (as indexed) is exceeded.

Unit trusts: key issues

Have the budget changes affected unit trusts?

The short answer is no. However, the budget changes have made superannuation (especially SMSFs) the preferred vehicle for many investors. In turn, unit trusts are popular vehicles for SMSFs. The surge of moneys into SMSFs has in turn led to a surge of moneys into unit trusts.

Has *CPT Holdings* affected unit trusts?

CPT Holdings was a 2005 High Court case examining who owned land: the unit trust trustee or the unit holders? The court held that even if a unit holder owns all of the units in the trust, that entity is not the owner of land held by the trust. This case was decided in the context of Victorian land tax.

CPT Holdings emphasised that there is no constant fixed meaning of 'unit trust'. Instead, one must look at the trust deed. *CPT Holdings* has made it more important than ever to actually read the entire contents of the trust deed in making a determination. No-one should assume that a trust is a fixed trust merely because the deed's front cover or ancillary material says it is a unit trust or indeed fixed trust.

Is your unit trust actually a fixed trust?

'Fixed trust' is a tax law concept. A trust is a fixed trust if the beneficiaries have fixed entitlements to all of trust income and capital (s 272-65 ITAA 1936).

Aren't all unit trusts fixed trusts?

No. Many incorrectly assume that all unit trusts are fixed trusts. We have reviewed many unit trust deeds that purported to be fixed trusts. However, these deeds contain provisions such as:

> Trustees may distribute net income or capital to any one or more unitholders to the exclusion of the other unitholders regardless of the proportion of the units held.

A trust purporting to be a unit trust with the above provision is a non-fixed trust. Especially after *CPT Holdings*, ATO auditors are more likely than ever to want to review purported fixed trust deeds.

Why does it matter?

A distribution made to a superannuation fund from a non-fixed trust is special income and taxed at the top marginal tax rate (ie, 45%, not 15%): see s 273(6) ITAA 1936 or the proposed s 295-550(4) ITAA 1997. This applies regardless of whether the fund is in pension mode.

In addition, extra tests need to be satisfied under the trust loss and franking credit rules.

DBA's unit trust is a fixed trust.

Excess Undeducted Contributions

Those who made contributions in excess of the $1 million post-tax limit between 10 May 2006 and 6 December 2006 will be able to have these contributions returned without penalty by applying to the ATO before 30 June 2007. The ATO will issue a release authority once the proposed new super legislation has been passed. Note, however, that the SMSF's deed must also authorise such a release.

Those who do not apply for an authority will be liable to pay 46.5% tax on excess contributions.

Those who made excess contributions *after* 6 December 2006 may not have these contributions released but may apply for the ATO to exercise its discretion to disregard them or reallocate them to another income year.

However, this will only be allowed in special circumstances (eg, if, due to a timing issue, two employer contributions of $50,000 each are received in the same income year), otherwise tax of 46.5% applies.

Pension Documentation

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I want to order documentation to commence ($440): ☐ Allocated Pension ☐ Market Linked Pension

Signature_____ Name of person ordering _____

Name of Firm _____

Postal address of firm _____ State _____Postcode _____

Tel_____ Fax _____ Email _____

Send or fax to DBA Butler Pty Ltd. Don't send any money. You will be invoiced upon receipt of documentation.
Prices include GST, exclude postage disbursement. Documentation is sold subject to the condition that one pension is rolled back per kit purchased.

For further Information please contact:

DBA BUTLER PTY LTD, Lawyers, 23 Union Street, South Melbourne Vic 3205 (ABN 74 120 513 037)

Ph 03 9682 0903 Fax 03 9682 0907 dba@dbabutler.com.au www.dbabutler.com.au

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