Technical News

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Super transfers from overseas – Government amendments

The Federal Government has introduced legislation into Parliament (Taxation Laws Amendment (2004 Measures No. 2) Bill 2004) to implement its proposals to improve the tax treatment relating to benefits transferred from overseas superannuation arrangements into Australian complying superannuation funds.

Broadly, under current law if an overseas fund (specifically, an "eligible non-resident non-complying superannuation fund") pays a benefit in relation to an Australian resident client then, unless the payment occurs within 6 months of the client becoming an Australian resident (and satisfies certain other conditions), the growth of the benefit since the client became an Australian resident will be included in the client's assessable income. This is so whether the payment is made directly to the client or to an Australian complying superannuation fund or even to another overseas fund. If paid to an Australian complying superannuation fund the transferred amount will be subject to preservation and therefore may not be accessible for the purposes of meeting the tax liability.

If the Government's proposals are enacted some key points to note are as follows.

1. If the client arranges for the overseas benefit to be transferred directly into an Australian complying fund then the client can elect for part or all of the benefit to be taxed in the hands of the fund as contributions rather than treated as the client's own assessable income. An election will only be effective if after the transfer the client no longer has an interest in the transferring fund. It must be in writing and comply with any relevant (but yet to be issued) regulations.

This means that, where an effective election is made, the tax on the benefit would be at 15% rate rather than the taxpayer's marginal rate, and the fund would pay the tax, not the client. No surcharge would apply.

2. However, the client needs to consider the tax ultimately payable on the Australian benefit. This is because the part of the transferred benefit which will be as a taxable contribution in the fund's hands will not qualify as undeducted contributions, and so it will typically be classified as pre- or post-83 component. On the other hand, the balance of the transferred benefit will typically qualify as undeducted contributions.

For example, if the benefit is ultimately taxed as post 83 component at the rate of 16.5% (i.e assuming the post 83 tax free threshold is already used up), then the overall effective tax rate could be said to be 29.025% (i.e. 15% up front plus 16.5% of the remaining 85%). This of

course ignores the advantage of the low tax on earnings in the meantime and the possibility of the super benefit being paid in pension form.

Example to illustrate:

Emily aged 56, who on 1 July 2004 will have a UK fund benefit of $170,000 which she will transfer to her Australian super fund (in which she will have a benefit of $150,000 already accumulated). Assume she will have been an Australian resident for 4 years and the earnings growth of the UK benefit will have been $52,000 and that the amendments are enacted. This amount will be included in her assessable income unless she elects for some or all of that amount to be treated as a taxable contribution in the hands of her Australian fund.

Assume also that she is retiring soon and for various reasons will want to withdraw all her super as a lump sum benefit in the relatively near future. Let's say she can make a firm estimate that her other Australian taxable income for the 2004/5 income year will be $52,000. In these circumstances the idea of making the election to have the $50,000 treated as taxable to the fund may appeal, bearing in mind the effective tax rate of 29.025% referred to above compares favourably with having it taxed at her personal marginal tax rates of 42% or more.

If her estimate of 2004/5 taxable income were to be less (and particularly if it were estimated to be less than $21,700) then she might consider not making an election or making only a partial election.

Note that the other $100,000 of the transferred amount would be treated as undeducted contributions (assuming the transferred benefit was wholly vested and properly payable to her under the UK fund's rules at the time of transfer).

The formula for calculating the amount which is potentially included in Emily's assessable income is broadly described at the end of this article.

3. If enacted, the amendments will apply to payments made on or after 1 July 2004. This means that clients who are expecting transfer of an overseas benefit and seek to take advantage of the make an election for an Australian fund to pay the tax should delay payment where possible. Note, however, that clients who are not yet Australian residents or who have been Australian residents for less than 6 months should be contemplating the prospect of arranging a benefit transfer as soon as possible, bearing in mind that amounts transferred within the first 6 months of residency may not be included in the client's assessable income. Incidentally, unfortunately the 6 month window is not proposed to be lengthened.

4. If the client receives the overseas benefit directly then, as with the current law, the growth will be included in the client's assessable income (even if the client subsequently contributes an equivalent amount to an Australian fund).

5. Payment of a benefit from one overseas fund to another (also being an eligible non-resident non-complying superannuation fund") will not be included as assessable income as a result of the transfer (but any relevant growth on the benefit may ultimately be assessable income when a benefit is paid from the receiving fund to the client or an Australian fund). This improves the current law in circumstances such as where an Australian resident client has a benefit transferred from a UK employer fund to another UK pension arrangement.

6. However, where a benefit is transferred from one overseas fund (‘Fund A’) to another (‘Fund B’) while the client is an Australian resident (and the benefit would have potentially been assessable income if paid to the client because the client had been a resident for at least 6 months) and Fund B subsequently pays a benefit either to the client or to an Australian fund (‘Fund C’), then, broadly, the growth which occurred in Fund A while the client was an Australian resident will be assessable income of the client or of Fund C (if the client makes an election for Fund C to pay the tax). There are some quirky aspects to the rules in relation to these sorts of arrangements involving multiple transfers which will not be explored here.

Example continued:

If Emily had instead transferred the $150,000 (including the $50,000 residency growth) to another overseas fund (Fund B) on 1 July 2004 and a year later it has grown to $165,000 and she then transfers it to an Australian fund (Fund C) then the potentially assessable amount is the Fund B growth of $50,000 plus the Fund C growth of $15,000; i.e $65,000.

7. Where during their Australian residency the client has been assessed for FIF tax on the overseas fund’s earnings, current law enables the client to reduce their assessable income arising from the transfer having regard to the amount of FIF income assessed.

Under the proposed changes, if the client makes an election for the relevant growth to be assessed in the fund’s hands as a taxable contribution, this will mean the growth is not included in the client’s assessable income . However, the client will have been assessed as having had FIF income. To avoid double taxation (i.e. treating the same amount as both taxable contributions and FIF income) the client will be entitled to a deduction of the lesser of the taxable contribution (i.e. the amount covered in the election) and the client’s FIF attribution surplus immediately prior to the transfer.

8. There are also amendments proposed to improve the drafting of the current provision. For example, in circumstances where a person has become an Australian resident then ceased to be an Australian resident then has become an Australian resident again, the proposed amendments would ensure that only the benefit growth that occurred during the periods of Australian residency is assessable income (of the client or the fund, as the case may be). Under the current law, arguably the benefit growth during the intervening period of non-residency would be assessable.

Parliament is now in recess until 11 May 2004, however we will keep you informed of further progress on this issue as developments arise. If you would like more background information on the current treatment of overseas transfers, refer to our tmb publications dated September and October 2002. For registered advisers, these can be obtained from our Technical Library at https://advisers.macquarie.com.au/advisers/secure/technical/analysis_strategy/analysis_strategy_detail.htm.

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The formula to calculate the amount that will be included in a taxpayer's assessable income (unless the taxpayer has made the appropriate election to have part or all of the transfer amount treated as a taxable contribution) under proposed s27CAA can be broadly described as follows:

Step 1. Determine the amount of the relevant transfer payment that is properly payable* on the day it is paid from the paying fund.

Step 2. Determine the total of:

- the amount of the taxpayer's entitlement in the paying fund, as relates to this payment, that is properly payable* immediately before the relevant day**, plus
- any amounts included in the transfer payment that represent contributions made by either the taxpayer or an employer, on or after the relevant day**, plus
- any amounts transferred into the paying fund from another overseas fund, as relates to this payment, on or after the relevant day**.

Step 3. Subtract the total amounts at step 2 from the amount at step 1. The result broadly represents the earnings accrued on the overseas superannuation entitlement prior to the payment date while the individual was an Australian resident.

Step 4. To ensure any earnings representative of non-residency periods are excluded, the amount at step 3 is:

- multiplied by the total number of days the taxpayer was an Australian resident from the relevant day** to the day the payment is made, and then
- divided by the total number of days from the relevant day** to the day the payment is made.

Step 5. The result at step 4 is then further adjusted by adding any previous transfer amounts that would have been assessable under these provisions, but for the fact the payment was made from one overseas fund to another overseas fund (i.e. not to an Australian fund). Broadly this ensures that any earnings accrued in an overseas fund while the taxpayer was a resident of Australia are only captured when the superannuation entitlement is transferred to an Australian super fund.

The precise details of the formula are laid out in schedule 9 of the amending bill, Tax Laws Amendment (2004 Measures No.2) Bill 2004.

**properly payable* is the amount of the taxpayer's vested benefit on the day it is paid out or transferred (refer to Taxation Ruling 2003/12 for further detail).

***relevant day* means, for a relevant payment, the later of:

- the day on which the taxpayer became a member of the paying fund, and
- the first day during the period to which the relevant payment relates on which the taxpayer became a resident of Australia.

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