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Personal deductible superannuation contributions

People who are entirely self employed, such as those operating their business as a sole trader or through a partnership, are eligible to claim superannuation contributions as a tax deduction. The ability to claim a deduction for a personal contribution also extends to people who are not working at all, and those who were engaged in employment activity in the financial year but have employment income below a certain level. In order to be allowed to claim a deduction, clients must also meet strict notice requirements. These eligibility and notice requirements have been causing much confusion in the industry for a number of years now. Failure to meet these rules can be costly for the client.

In this TapIn Guide, we consider the various issues surrounding personal deductible superannuation contributions.

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Eligibility

To be eligible to claim a tax deduction for a superannuation contribution, a person must:

- Be broadly less than age 75 at the time of making the contribution, and
- If engaged in employment activity (as defined for Superannuation Guarantee purposes) in the financial year, receive less than 10% of total assessable income, reportable employer superannuation contributions and reportable fringe benefits from that employment, and
- Give written notice to the superannuation fund (referred to as a notice of intent) that they wish to claim a tax deduction for all or part of the contribution within specified timeframes.

Concessional contributions cap

Personal deductible contributions count towards a person's concessional contribution cap. The cap is \$25,000 per financial year for individuals under age 50. This cap is indexed but only in \$5,000 increments. A transitional cap of \$50,000 per financial year (unindexed) applies to individuals who are age 50 or over at any time in a financial year during the transitional period (up until 30 June 2012).

From 1 July 2012 onwards, it is proposed that the transitional cap of \$50,000 per annum be permanently extended to individuals who are:

- Aged 50 or over at any time in the financial year; and
- Have total superannuation account balances of less than \$500,000.

At the time of writing, the legislation to enact this proposal had not been introduced and the Government has not provided any further details.

Deductible contributions in excess of the cap attract the normal contributions tax of up to 15% plus an additional tax of 31.5%. The excess concessional contributions also count towards the individual's non-concessional contributions cap of \$150,000/\$450,000.

Contributions in excess of taxable income

An eligible individual cannot claim a tax deduction for a personal contribution that is in excess of their taxable income for the financial year. Any deductible contribution amount in excess of the contribution cap will also be classified as a non-concessional contribution and will be included under the non-concessional contribution cap. If this cap has already been used, penalty tax will apply to the excessive contribution.

Available deduction amount not limited by concessional cap

The concessional contributions cap does not limit the tax deduction an eligible person can claim for personal contributions. However, as discussed above, the amount of deduction claimed is limited by the person's taxable income.

Example 1 – Available deduction not limited by concessional cap

Josh (age 51) operates his graphic design business as a sole trader. In the 2010/2011 financial year, he makes a personal deductible contribution into superannuation of \$65,000. His taxable income for the year is \$100,000. Josh can claim a tax deduction for the entire contribution of \$65,000, as this amount does not exceed his taxable income. However, the \$15,000 in excess of his concessional cap will effectively be taxed at 46.5% and will also be counted towards his non-concessional contributions cap.

Age requirements

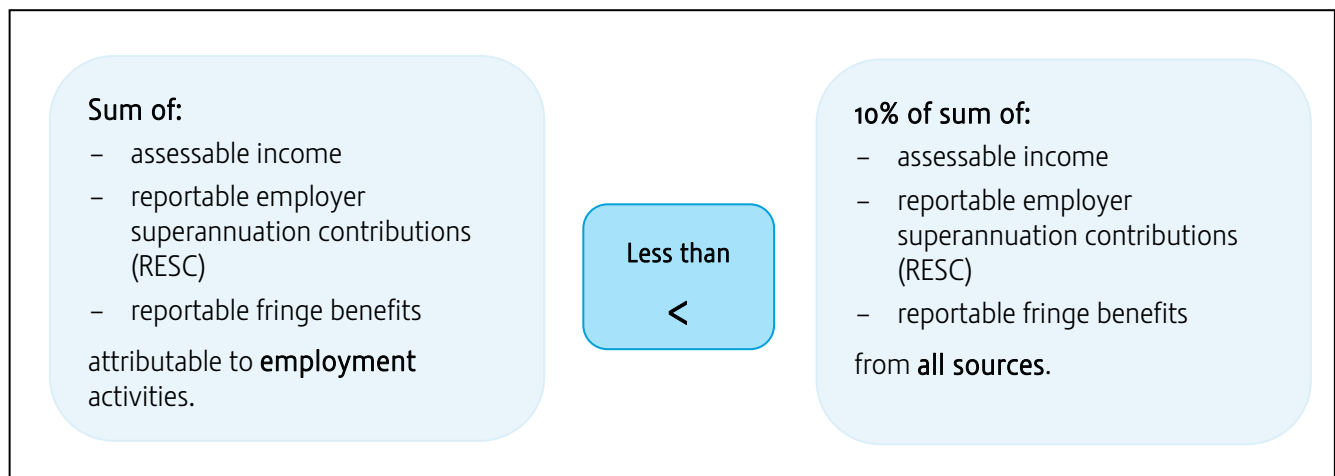
To claim a superannuation contribution as a tax deduction, the person must be able to contribute to superannuation. Therefore, people aged 65 – 74 (inclusive) must meet the work test.

Contributions generally cannot be accepted by a superannuation fund after 28 days from the end of the month in which the person turns 75. This is the case even if the person remains gainfully employed.

Furthermore, an individual under age 18 at the end of the relevant financial year will only be able to claim a deduction if they have also derived income from carrying on a business or employment and satisfy all the other rules.

Less than 10% rule

Where a person has engaged in employment activities in the tax year, a deduction for personal contributions can only be claimed where the less than 10% rule is satisfied as follows:



This means that 3 categories of people may be eligible to claim a deduction for a personal superannuation contribution:

- Entirely self employed people.
- People who are not engaged in an employment activity at all during the financial year. For example, people who are not working and only derive income from passive investments, social security and income streams.
- People who are engaged in employment activity in the financial year but derive less than 10% of their income from employment.

Strategies to meet the less than 10% rule

Given the significance of the less than 10% rule, strategies to help a person qualify should be considered. These strategies will broadly involve reducing employment-sourced assessable income and/or increasing non-employment sourced assessable income.

1. **Bringing forward intended termination of employment:** When high levels of investment income and/or taxable capital gains are anticipated in the next financial year, consider bringing forward any intended termination of employment into the current financial year. This will ensure that employment income (in the following year) is minimal.
2. **Making a lump sum superannuation fund withdrawal:** If a client is aged 55 to 59 with unrestricted non-preserved superannuation benefits, making a lump sum withdrawal (using up to \$160,000 of taxable component and the proportional tax-free component) will increase non-employment sourced assessable income for the year.
3. **Start a transition to retirement income stream:** If a client is aged 55 to 59 with preserved superannuation benefits, starting a transition to retirement income stream, which includes a taxable portion, will increase non-employment sourced assessable income for the year.

- 4. Borrowing money to invest:** If the client is considering borrowing to invest, then in the year the borrowing is undertaken, income producing geared investments will increase the person's non-employment sourced assessable income. However, the interest expense will likely reduce the individual's taxable income.
- 5. Triggering a capital gain:** The assessable portion of the capital gain will increase a person's non-employment sourced assessable income. However, the capital gain will also increase the person's taxable income, thus a larger personal deductible contribution would need to be made to offset the impact of the additional tax.

Employment activity

A person engaged in an 'employment' activity in the financial year will need to meet the less than 10 per cent rule in order to claim a deduction for their personal contribution. For this purpose, the person is engaged in employment activity if the activity results in them being treated as an employee for Superannuation Guarantee (SG) purposes (either a common law employee, or under the expanded definition for SG).

Under the expanded definition for SG, company directors and certain contractors are considered employees. Broadly, for a contractor to be considered an employee for SG purposes, the contract must be "wholly and principally" for that person's labour. This is quite a complex area. The ATO's Superannuation Guarantee eligibility decision tool can assist employers in determining whether an individual they employ under a contract is an employee for SG purposes.

This tool can be located on the ATO website at:

<http://calculators.ato.gov.au/scripts/axos/axos.asp?CONTEXT=&KBS=SGEligibility.xr4&go=ok>

Further, the less than 10% test extends to employees who are exempt from receiving SG. For example, employees earning less than \$450 per month and employees aged 70 and over. Even though such people are exempt from SG, they are still engaged in employment activity and thus the less than 10% test still applies.

Person not engaging in employment activity

As discussed above, the less than 10% rule does not apply where a person has not engaged in any employment activity in that financial year. For example, a person who is no longer employed at any time in the tax year but is still in receipt of workers' compensation payments is not engaged in employment activity in the tax year.

Example 2 – Less than 10% rule (lump sum annual & long service leave)

Amanda terminated her employment on 28 June 2010.

She received a lump sum payment representing accrued annual and long service leave of \$15,000 on 4 July 2010. She did not return to any employment for the remainder of the 2010/2011 financial year.

Even though Amanda's annual and long service leave is income from employment activity, she does not need to meet the less than 10% test for the 2010/2011 financial year as she has not been engaged in any employment activity in that year.

Had Amanda terminated employment on 2 July 2010, she would have been engaged in employment activities in the 2010/2011 financial year and the less than 10% test would need to have been satisfied.

No physical employment duties required

Importantly, the person does not have to physically be at work carrying out the obligations and duties of the job in order to be engaged in employment activity. For example, the ATO regards a common law employee to still be engaged in the employment activity while they remain on the books of the employer and in receipt of workers compensation even though they are not physically at work. In this case, the workers compensation payments will be included in the less than 10% rule calculations.

Example 3 – Less than 10% rule – worker’s compensation

Brian was employed by Blackwood Pty Ltd and was injured at work in November 2008. From November 2008 to 30 June 2011 Brian was not physically at work but received worker’s compensation payments. Brian resigned from Blackwood Pty Ltd on 10 July 2010. On 17 July 2010, Brian received \$21,000 from Blackwood Pty Ltd for unused long service leave and annual leave.

Brian made a personal superannuation contribution of \$21,000 to a complying superannuation fund in the 2010-11 tax year.

As Brian was still employed by Blackwood Pty Ltd in the 2010-11 income year, he is considered to be engaged in an employment activity in that tax year. Brian is required to meet the less than 10% rule to claim a deduction for personal superannuation contributions made in the 2010-11 tax year.

The income attributable to Brian’s employment activities in the 2010-11 tax year accordingly includes the worker’s compensation payments and the unused long service leave and annual leave payments from Blackwood Pty Ltd to the extent that they are assessable in the 2010-11 tax year.

While further clarification will be required, the ATO is suggesting that similar treatment may also apply where the person is in receipt of salary continuance/income protection benefits, especially where the illness/injury is employment related. A case by case analysis will be required.

Non residents making personal deductible superannuation contributions

In determining the less than 10% rule, the relevant employment activity need not be an activity in Australia.

A non-resident of Australia for tax purposes only has to lodge a tax return if they have income that is taxable in Australia. This excludes any income from which non-resident withholding tax has been deducted (eg bank interest and unfranked dividends).

For a non-resident for tax purposes, income attributable to employment outside Australia is non-assessable and not counted in the less than 10% rule. A non-resident with Australian sourced income that is not attributable to ‘employment’ activities (eg rental income from an investment property) may therefore be eligible to deduct personal superannuation contributions made to an Australian superannuation provider against their Australian sourced income.

An Australian tax resident must declare their worldwide income in their Australian tax return. Therefore, for an Australian tax resident, overseas employment income will be counted in the less than 10% rule.

Income from employment activity

Assessable income from the employment activity includes:

- Salary and wages;
- Other payments, such as commission, director’s remuneration etc which are treated as salary or wages by section 11 of the SGAA for persons other than common law employees;
- An employment termination payment received by a person in consequence of the termination of their employment; and
- Workers’ compensation payments made because of an injury suffered while engaging in an ‘employment’ activity, where the payments are received by a person while holding the employment, office or appointment the performance of which gave rise to that entitlement.

For the above inclusions in assessable income, it is generally the gross amount which is counted, ignoring any expenses incurred in gaining the income. However, in the case of partnerships or trust income, only the person’s share of ‘net income’ from the partnership or trust is included in assessable income for the purpose of this calculation.

Reportable employer superannuation contributions (RESCs)

RESCs are counted in the less than 10% rule. These are employer superannuation contributions which may be influenced by an individual (for example, salary sacrifice contributions made by an employee).

When determining the eligibility of an individual to make personal deductible contributions, it is important to ensure that any RESCs are included in the calculation for the purposes of the 10% test. Failure to do so may result not only in the loss of a tax deduction, but also inclusion of the denied amount against the non-concessional contribution cap (and potential excess arising where already used).

Notice of intent (NOI)

Once we've determined that the individual is eligible to claim a tax deduction for personal contributions, there are additional requirements to meet. The eligible individual must provide the fund with a valid notice of their intention to claim the deduction within specific time frames (discussed below). This notice must be in an approved form.

Once the fund acknowledges receipt of this notice, the member will be allowed the tax deduction when they lodge the tax return for the income year in which the contribution was made.

Notice of intent requirements have been a common area for mistakes. Close attention to these rules is required, particularly in the situation where a member makes an intended tax-deductible personal contribution and subsequently either fully or partially exits the fund or commences a pension from the fund prior to providing the NOI to the fund.

Time Frames

A person intending to deduct their personal superannuation contributions made in a tax year must give the superannuation trustee a valid NOI in the approved form.

The notice must be given to the fund by the **earlier** of:

- The day the member lodges their income tax return for the financial year in which the contribution was made, or
- The end of the following income year.

The NOI can be lodged personally or via an agent (including a legal personal representative in the case of a deceased person who made a contribution prior to death).

The trustee must also acknowledge receipt of the notice.

The legislation does not provide funds with any discretion to acknowledge or vary notices that do not comply with these new rules

Example 4 – Time frame for lodging notice of intent

Brian is self-employed. He makes a \$10,000 personal superannuation contribution in March 2011. If he remains in the fund and does not undertake any movement of amounts out of his account which may render any NOI lodged invalid (see later), then Brian must lodge his NOI before the **earlier** of:

- The date he lodges his 2010/11 income tax return, or
- 30 June 2012 (being 12 months after the end of the tax year in which the contribution was made).

Approved form

Superannuation funds may supply their own form which can be completed by a member to notify that a contribution is to be claimed as a tax deduction. Furthermore, some funds may automatically send out these forms to certain members for completion. The ATO also has a form "Deduction for personal super contributions" that client's can use to notify their superannuation fund that they wish to claim a deduction.

This form is available on the ATO website at: <http://www.ato.gov.au/corporate/content.asp?doc=/content/86434.htm>

Importantly, regardless of whether or not the fund sends out forms, it is the responsibility of the individual to notify the fund of their intention to claim a deduction for a contribution they have made.

Invalid NOIs

Even if notices are lodged within the correct time frame, they can sometimes be considered invalid.

Once the contribution is made, any subsequent movement of money out of the superannuation account may affect the validity of a NOI if the NOI is lodged after that movement out has occurred.

An NOI lodged in respect of a personal superannuation contribution made in a tax year will accordingly be **invalid** in the following circumstances:

- The person is no longer a member of the fund at that time (e.g. benefits have been entirely paid out to them or rolled over to another fund).
- The trustee no longer holds the entire contribution (e.g. the person has been paid a lump sum superannuation benefit or had part of their benefit rolled over to another superannuation fund). Previously, this also included transfers to a successor fund. However, legislation allowing a deduction for eligible contributions to be claimed from successor superannuation funds after 1 July 2011 has now been passed.
- The trustee has commenced an income stream. It is the Commissioner's view that **any** income stream commenced from a superannuation fund account will be based in whole or in part on a contribution made to the account. This is the case even if after commencing the income stream there is an amount remaining in the account that received the contribution that exceeds the amount sought to be claimed as a deduction (see example over page).

Example 5 – Valid notice of intention to deduct (partial withdrawal)

Rachel, who is 54, has \$100,000 in superannuation. This amount includes a tax free segment of \$10,000.

She makes a \$50,000 personal contribution in March 2011. The fund records this contribution against the tax-free segment for Rachel's superannuation account. This means that amount would be counted against the tax free component of any superannuation benefit paid to Rachel. The value of her superannuation account is now \$150,000.

In June 2011, Rachel rolls over \$30,000 into another fund, leaving her with an account balance of \$120,000. The \$30,000 roll-over is comprised of a \$12,000 tax free component and a \$18,000 taxable component. The tax free component of the roll-over is worked out as shown below.

$$\begin{array}{rcl} \text{Roll-over amount} & \times & \frac{\text{Tax free component of interest before roll-over}}{\text{Value of the superannuation interest before roll-over}} \end{array}$$

$$= \$30,000 \times (\$60,000/\$150,000)$$

$$= \mathbf{\$12,000}$$

The tax free component of the remaining superannuation interest is \$48,000. Rachel then lodges a notice in September 2011 advising the trustee that she intends to claim a deduction for the \$50,000 contribution made in the 2010-11 income year. That notice is not valid. Rachel's superannuation account no longer holds the entire \$50,000 contribution.

However, Rachel could give a valid deduction notice for an amount up to \$40,000. That amount is worked out as follows:

$$\begin{array}{rcl} \text{Tax free component} & \times & \frac{\text{Contribution}}{\text{Tax free component of interest before roll-over}} \\ \text{of remaining interest} & & \end{array}$$

$$= \$48,000 \times (\$50,000/\$60,000)$$

$$= \mathbf{\$40,000}$$

Example 6 – Invalid notice of intention to deduct (starting a super pension)

Libby has \$150,000 (all taxable component) in superannuation. Libby makes a \$50,000 personal contribution in March 2011 so that her account is now \$200,000.

If, before lodging a notice, she were to commence a pension using \$180,000 of her \$200,000, her fund will have commenced to pay a superannuation income stream based in whole or part on the contribution. A notice Libby purports to give her fund to deduct the contribution will be invalid.

The outcome will be same even if, after making her personal contribution, Libby were to commence a pension of only \$140,000 leaving the value of her account at \$60,000 which is in excess of the \$50,000 amount she intended to deduct.

Varying a Valid Notice

While it is not possible to revoke or withdraw a valid notice in relation to previously made contributions, you can vary a previously provided notice. However, only variation downwards is permitted. The reduction can be down to nil.

There is no time limit for requesting a variation if the reason for doing so is because the ATO has subsequently disallowed the deduction that the member claimed in their tax return. For example, the ATO might disallow the deduction if the person was in receipt of employment income and failed the less than 10% employment income rule.

For any other reason, a request for variation must be made by the **earlier** of:

1. The day the member lodges their income tax return for the financial year in which the contribution was made, or
2. The end of the following income year.

It is also important to realise that even if the variation request had been made within the above time frame, or is made following the disallowance of the tax deduction by the ATO, the request will not be effective if at that time either the:

1. Person was not a member of the fund, or
2. Fund no longer holds the contribution, or
3. Fund had begun to pay a pension based in whole or in part on the contribution.

Example 7 – Variation request out of time

Joan met all the eligibility conditions for claiming a deduction for her personal contributions made during the 2010/11 income year.

Joan lodged a valid notice to claim a tax deduction for a personal contribution of \$5,000 made during the 2010/11 income year. She claimed the tax deduction in order to help offset some CGT she had calculated following the sale of an investment property during that income year.

Her fund acknowledged this notice and in her 2010/11 income tax return, Joan claimed a tax deduction for the \$5,000 contribution.

Upon receipt of her notice of assessment for 2010/11 she discovers that she would have been better placed if she had only claimed a tax deduction of \$3,000. This is because of some imputation credits and other offsets she was allowed but had not fully factored into her tax calculations when completing her tax return. She accordingly seeks to request an amendment to her assessment and approaches the fund to make a variation to the previous notice, down from \$5,000 to \$3,000.

As Joan satisfied all the conditions for claiming the \$5,000 tax deduction, she will not be able to vary the amount to \$3,000. This is because the variation request is made after the date she lodged her tax return for the income year in which she made the deductible contribution.

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