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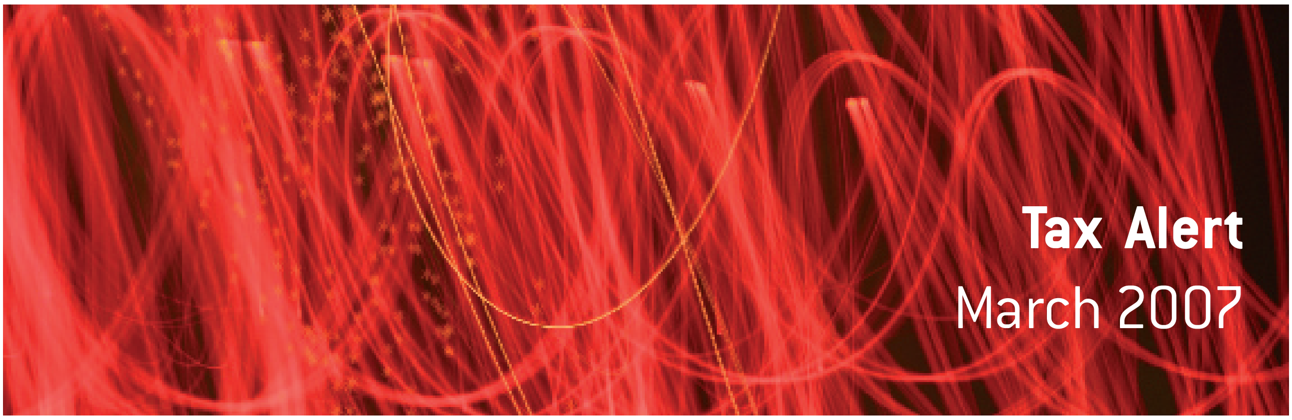


Simplified Superannuation Measures Become Law

> "On Thursday, 15 March 2007, the main body of the legislation comprising the Simplified Superannuation measures received royal assent. The Tax Laws Amendment (Simplified Superannuation) Bill 2006 has now become an Act of Parliament."

This and related legislation will have the effect of implementing a whole new regime for the taxation treatment of superannuation. This alert comments on two aspects of the new legislation, namely:

> the relevance and effect of the $1M Capital Gains Tax (CGT) cap amount; and

> the potential tax ramifications of employer Eligible Termination Payments (ETPs) made before 1 July 2007.

We have considered these two areas as we are seeing multiple applications of the issues in practice and we expect both areas will be of importance in the lead up to 1 July 2007.

$1M CGT Cap Amount

From 10 May 2006, each individual taxpayer now has a $1M CGT cap amount ("**CGT cap**"). The CGT cap will apply for the individual's lifetime. In order to understand the relevance and effect of the CGT cap it is necessary to come to terms with the concept of a "non-concessional" superannuation contribution.

Non-Concessional Contributions

Non-concessional contributions include what have traditionally been described as undeducted contributions. Non-concessional contributions differ from concessional contributions, where the employer or a self employed person will be entitled to a tax deduction for the amount contributed to superannuation.

From 1 July 2007 non-concessional contributions will be subject to an annual limit of $150,000. This amount will be indexed each year and will be three times the amount allowed for concessional contributions. As you may be aware, a number of transitional measures exist in relation to the limits imposed on non-concessional contributions, namely:

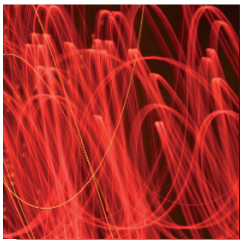
> an ability for a taxpayer to make a non-concessional contribution of up to $1M in the period between 10 May 2006 and 30 June 2007; and

> an ability for persons under 65 years of age to bring forward the limit so as to allow them to make a $450,000 non-concessional contribution in one year (referrable to that year and the following 2 years) ("**the bring forward**").

Any contributions in excess of the above limits will give rise to excess contributions tax at the top personal marginal rate of tax.

Carve-Out of CGT Cap

The CGT cap represents a "carve-out" from the non-concessional contribution limits. In other words, amounts falling within the CGT cap (up to an individual's $1M lifetime threshold) will not count towards contributions made under the above non-concessional contribution limits. Provided an individual has not exceeded their CGT cap then such contributions are outside the limits imposed on non-concessional contributions (including the above mentioned transitional limits).



What Amounts Comprise the CGT Cap?

Amounts comprising the CGT cap are relatively limited. They only relate to taxpayers who can qualify for the Small Business CGT Concessions and even then only in certain circumstances.

The specific amounts that comprise the CGT cap are as follows:

> up to $500,000 of capital gains that are disregarded as CGT exempt amounts under the Retirement Exemption (subdivision 152-D);

> the capital proceeds from a disposal of assets that qualify for the 15 Year Exemption (subdivision 152-B); and

> the capital proceeds from a disposal of assets that would have qualified for the 15 year Exemption (subdivision 152-B) but for:

- the disposal of the asset resulting in no capital gain or capital loss;
- the asset being a pre-CGT asset; or
- the asset being disposed of before the required 15 year holding period has elapsed because of the permanent incapacity of the person.

Two matters should be noted. First, in relation to the 15 Year Exemption, the amount includes the capital proceeds (as distinct from an otherwise taxable capital gain) whereas when applied to the Retirement Exemption, only the CGT exempt amount is included. The CGT exempt amount is a defined term under the legislation and, in essence, means an amount between zero and $500,000 chosen by an individual taxpayer to disregard when applying the Retirement Exemption.

The second matter to note is that the provisions only allow for the proceeds of pre CGT assets where the taxpayer would have qualified for the 15 Year Exemption. The proceeds of the disposal of pre CGT assets are otherwise not included in the CGT cap

Case Study

The following example (taken from the explanatory memorandum to the legislation) illustrates the operation of the CGT cap:

Ruth, aged 59, sells an active asset used in her small business which she has owned continuously for 15 years. The proceeds from the sale are $1.1M. She qualifies for the CGT exemption in relation to subdivision 152-B and disregards the capital gain of $390,000 on this basis. Ruth would like to contribute the entire proceeds to her superannuation fund.

Assuming Ruth has not previously made contributions or used her CGT cap, she may elect to contribute $1M under the cap exemption and have the remaining $100,000 count towards her non-concessional contributions cap. This would allow her to make an additional $50,000 worth of non-concessional contributions in the year without exceeding her annual cap.

Alternatively, as she is under 65, she may use the "bring forward" to contribute $450,000 and only use her CGT cap for the remaining $650,000. This will leave Ruth with a CGT cap of $350,000 for use in the future. However, any further non-concessional contributions made in that year, and the following two years, will exceed her non-concessional contributions cap and result in an excess contributions tax liability.

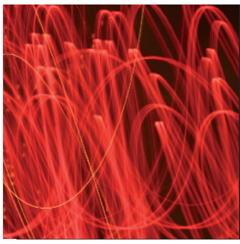
Note that if Ruth had her capital gain disregarded under the subdivision 152-D exemption instead she would have only been able to contribute the capital gain (ie, up to $390,000) and not the capital proceeds under the cap exemption.

It is possible for clients to avail themselves of the CGT cap where the capital gain is made by a trust or company. This would require careful consideration of the circumstances and in particular the manner in which the proceeds are dispersed from the company or trust.

Common Misunderstandings

There are a number of common misunderstandings relating to the CGT cap. One of these is to confuse the CGT cap with the 10 May 2006 to 30 June 2007 $1M non-concessional contribution limit.

Another misunderstanding is that legislation has been effected to increase the Retirement Exemption



lifetime limit for each individual from $500,000 to $1M. Again, this is not the effect of the CGT cap and the Retirement Exemption continues to maintain a $500,000 lifetime for each CGT concession stakeholder.

Employer ETPs

Transitional Opportunity

Employers looking to pay eligible termination payments to employees in the near future should compare the tax position before and after the new financial year. From 1 July 2007, employer ETPs will only receive tax concessional rates up to $140,000 (indexed annually) with the balance being taxed at top marginal rates. Moreover, on or after 1 July 2007, employer ETPs will not be able to be rolled over to superannuation. It should be noted that there is grandfathering in some circumstances where employers were subject to contractual obligations to pay termination/ severance payments as at 10 May 2006.

By contrast, the pre 1 July 2007 position may yield significant opportunities particularly where an employer ETP is rolled over. Although such a roll over will be taxed at up to 15% in the superannuation fund, there will be no tax liability to the employee. Moreover, subject to the employee first having attained age 60, cashing after 30 June 2007 will be tax free.

Provided there are genuine commercial reasons for effecting an employer ETP, it is considered that these types of arrangements could potentially apply to related party transactions.

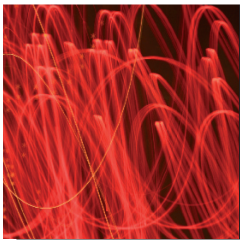
Case Study

Mr & Mrs Z are currently over 60 years and wish to retire.

Mr & Mrs Z are employees of XYZ Co Pty Ltd ("XYZ") that has recently sold its business and terminated their employment.

In consequence of the termination of Mr & Mrs Z's employment and after careful consideration by XYZs board as to what is appropriate as an arm's length payment to Mr & Mrs Z, XYZ pays an employer ETP of $200,000 to each of Mr & Mrs Z prior to 1 July 2007. Mr & Mrs Z each rollover the $200,000 they have received to the XYZ Superannuation Fund ("Fund"). XYZ should qualify for a deduction subject to satisfaction of the section 25-50 ITAA 1997 conditions.

Although the Fund is liable to 15% tax on the $400,000 it receives, there should be no taxation consequences to Mr & Mrs Z. Analysis will need to be undertaken as to the character of the payments and the potential application of section 109 of ITAA 1936. Once in the Fund, Mr & Mrs Z may then take a tax free pension funded by the employer ETP and/or cash lump sums on a tax free basis.



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