

Complying Pensions New Transitional Relief

New transitional relief ('New TR') became law on 25 June 2004. This is supplementary to the transitional relief that became law on 12 May 2004 ('Existing TR') for SMSFs providing defined benefit pensions ('DBP').

A DBP is any pension other than an allocated or market linked (aka 'growth') pension.

Broadly, the New TR applies if a person was a SMSF member on 11 May 2004 who, before 1 July 2005, retires after attaining 55 years (or their preservation age if relevant) or attains 65 years and who commences a DBP prior to 1 July 2005. The first pension payment must be within 12 months of the pension's commencement date.

The Existing TR requires the terms and conditions of the DBP to be in place as of Budget night. Interestingly, the Existing TR has been retained; particularly given the debate that has surrounded what is sufficient power in a trust deed to provide for the payment of a DBP.

While the New TR is welcome, it does give rise to a number of interesting questions.

What Pensions & Funds are covered?

Like the Existing TR, the New TR also applies to DBPs including:

- Complying lifetime pensions ('CLP');
- Complying life expectancy pensions ('CLEP'); and
- Flexi-pensions.

Further, the New TR only covers funds with fewer than 50 members (eg, SMSFs and Small APRA Funds).

Retirement

The New TR applies if the member 'retires'. This term relies on the existing definition of

(Continued)

'retirement' in the *Superannuation Industry Supervision Regulations 1994* (Cth) ('SIS Regs').

Typically, retirement is satisfied if a person has reached 55 years (or their preservation age) and ceases all gainful employment.

However, on attaining 60 years of age, a person generally only needs to cease a position of gainful employment.

The SIS Regs appear to require the retirement to occur after 11 May 2004 but before 1 July 2005. If a person wishes to rely on retirement prior to 11 May 2004, expert advice should therefore be obtained.

Assets Test Exemption

The New TR opens up the prospect for some people now being in a position to obtain a DBP from their SMSF which qualifies for the 100% asset test exemption.

As you are aware this exemption phases down to 50% on 20 September 2004. This is a significant opportunity that should not be overlooked.

Pension RBL Strategies

The New TR also opens up the prospect for some people to obtain a pension in a SMSF that qualifies for the pension RBL.

In particular, some members may be able to obtain a DBP, such as a CLP, with a lower RBL value compared to the value of the assets used to pay that pension.

This valuation formula applies to both the CLP and the commutable lifetime (aka 'flexi') pension.

The CLP is measured against the person's pension RBL. However, the commutable lifetime pension is measured against the person's lump sum RBL.

The difficulty under the Existing TR remains the very strict Treasury/ATO view requiring quite explicit detail in a SMSF's trust deed as of 11 May 2004. Under this view very few, if any, would have qualified for transitional relief.

Trust Deed Impact

Each member wishing to commence a DBP from a SMSF should ensure their trust deed is adequate. If the trust deed is not adequate, then members will be unable to commence a DBP.

If a SMSF cannot rely on the Existing TR, then it may have no other option but to amend its trust deed to provide for DBPs and seek to rely on the New TR.

Note, however, that any amendment to a SMSF's trust deed to provide for the payment of a DBP may compromise the Existing TR that may be available.

It is important to note that the Existing TR may be available for all fund members. However, the New TR may only be available for a select few who meet the new criteria.

Naturally, the general anti-avoidance rules should also be considered if the New TR is sought to be relied upon.

DBA understands that the ATO is working on a draft publication on what is required to satisfy the Existing TR. In light of the recent view expressed by Treasury/ATO that the trust deed should express in quite explicit detail the terms and conditions of the particular pension, the trust deed is a very important part of any DBP strategy.

DBA has amended its SMSF package in view of these recent changes. Furthermore, it is now dangerous to have deeds amended by suppliers who are not superannuation experts as any amendment can compromise the fund's transitional relief.

Other Pension Changes

There have been numerous other changes to the SIS Regs on 25 June 2004. These changes, which do not commence until from 20 September 2004, are summarised as follows:

- The 10 year period in respect of which a lump sum can be paid on the death of a primary beneficiary of a CLP, has been extended to

Timely Seminar:

The *DBA Network* will be holding a ½ day workshop at the Savoy Hotel, Melbourne on the morning of **16 July 2004** covering SMSFs & DBP changes, SMSFs & joint ownership of property, Family Trust Elections & SMSFs and the link between Binding Nominations and Wills.

the lesser of 20 years or the primary beneficiary's life expectancy. This allows a lump sum of the balance of that period to be paid on the death of a primary beneficiary to a reversionary beneficiary or the estate (if the pension is non-reversionary).

- There will no longer be a requirement that the member must first obtain pension age before commencing a CLEP. This means that only a condition of release, eg, retirement, will be required to commence a CLEP.
- The term options for CLEPs will be aligned to those applicable to the new market linked pensions. Broadly, this will provide the option to use the primary beneficiary's or the surviving spouse's life expectancy assuming that they were up to 5 years younger.
- If the CLEP is made reversionary, then a commutation to a lump sum can only be paid on the death of both the primary beneficiary and the surviving spouse. Accordingly, the decision to make a pension reversionary should be carefully considered.
- The detail to the new market linked pension is included in new SIS Reg 1.06(8), 1.07C and Schedule 6. New regulation 1.06(8) details the characteristics of the pension. Regulation 1.07C deals with pro-rating the pension in a financial year in which all or part of the pension is commuted. Schedule 6 provides the detailed formula and factors for calculating the amount of the pension.

The Government is undertaking a review of the role that DBPs play in small funds and is due to issue a report in April 2005. It therefore appears that the DBP environment for the foreseeable future is now a lot clearer.

For further Information please contact:

DBA BUTLER PTY LTD, Lawyers, 23 Union Street, South Melbourne Vic 3205
Ph 03 9682 0903 Fax 03 9682 0907 dba@dbabutler.com www.dbabutler.com

DBA News contains general information only and is no substitute for expert advice. We disclaim all liability howsoever arising from reliance on any information herein unless you are a client of DBA that has specifically requested our advice.

✓ Superannuation ✓ Tax ✓ Succession Planning