

## Anti-detriment deductions

Anti-detriment deductions are an often overlooked but powerful strategy. Despite having been in existence for over 20 years, they are not fully understood ... even by many super professionals! This article seeks to provide a basic overview of these useful deductions.

### Historical context

Anti-detriment deductions were introduced from 1988 when certain super contributions first became taxed. The deductions seek to ensure that children and spouses of deceased super fund members do not suffer any detriment as a result of contributions tax. They are best explained with a simple example.

Consider Dad, who makes a concessional contribution to a brand new super fund of \$100,000. Naturally, the super fund must pay \$15,000 tax on the contribution, leaving \$85,000.

If Dad then died, there would only be \$85,000 left in his member account to pay to his spouse or children.

Naturally, if the contributions had not been subject to income tax, Dad's member account would have \$100,000 in it instead of \$85,000. In other words, there is a detriment of \$15,000 (ie, \$100,000 – \$85,000).

Tax law says that if the super fund pays out to the spouse or children not just the \$85,000 but also the tax detriment amount (ie, \$15,000), the super fund gets a deduction. The deduction is calculated as the tax detriment amount divided by 15% (ie, a deduction of  $\$15,000 \div 15\% = \$100,000$ ). This way:

- the spouse or children have received the same amount that they would have received if the contribution had not been taxed; and
- the super fund gets a deduction to compensate it for paying the 'top up' amount to the spouse or children.

### Benefits of the anti-detriment deduction

Anti-detriment deductions are typically very large (deductions ranging from \$100,000 to several million dollars are not uncommon). These deductions can be used to:

- offset any CGT that arises upon death; and/or
- create a carried forward tax loss. Carrying forward losses in a super fund is relatively straight forward, so the benefits of the deduction can also be utilised by other SMSF members, such as the deceased's children who might later join the fund.

With the right knowledge, an anti-detriment deduction can be claimed almost every time someone dies.

### Common issues for obtaining an anti-detriment deduction

In real life several practical issues often arise which the simple example did not flesh out, such as:

**Calculating the tax detriment amount** — in the simple example, the tax detriment was clearly \$15,000, but often the amount will not be so easily ascertainable. Multiple methods (including several formulas) can be available to calculate this amount. Each method can lead to a different amount.

**Where to source the anti-detriment payment from** — in the simple example, the super fund only had \$85,000, so where can it find the extra \$15,000?

One answer is from reserves. Note that fund trustees that maintain reserves must have a reserving strategy in place and must also ensure that, eg, they maintain a reasonable level of reserves and understand the implications for members' contributions caps, should any amounts be allocated from the reserves.

What about SMSFs without reserves? If the deceased had life insurance in the fund, this might be able to be used (subject to the fund's trust deed and other considerations such as implications regarding contributions cap).

What if there are no reserves and there is no insurance? There are other strategies but discussing them is beyond the scope of this newsletter.

**ATO scrutiny** — anti-detriment deductions attract close ATO scrutiny. When the tax return is lodged, an ATO 'please explain' letter often follows. Accordingly, it is strongly advisable to have tied down every aspect of the deduction before claiming it.

DBA Butler's new Anti-Detriment Memo fully explains all of the points touched upon in the article and much more. For more information, see the end of this newsletter

## Div 7A and gearing strategies

SMSF trustees borrowing from related parties must consider the potential div 7A consequences if the lender is a related company.

Most trustees will already understand the importance of benchmarking the terms of the loan from the related entity to what is offered commercially. However, in attempting to benchmark a loan, parties sometimes forget the possible div 7A consequences.

Broadly, div 7A treats some loans from companies to shareholders or their associates (which can include an SMSF) as a 'deemed dividend', which is assessable to the recipient as an unfrankable dividend. One exception to div 7A is a loan with, broadly, a maximum term of 25 years (if, broadly, 110% of the loan is secured by mortgage over real estate) or 7 years (in any other case) and an interest rate equal to or above the 'benchmark' rate (currently 9.45%). (Other requirements must also be met — seek advice if in doubt.)

Therefore, parties must be mindful of both the benchmarking requirement and of div 7A.

### *Tax planning versus SIS compliance — watch out!*

If the parties have simply set the interest rate so as to ensure div 7A does not apply, this might not demonstrate that the parties have based the terms of the loan on what is offered commercially. In this case, if the borrowing is queried, the SMSF trustee might have difficulty justifying the rate because it does not appear to be based on any commercial evidence. Trustees and their advisers should be aware of this subtlety, especially as commercial interest rates continue to fall but the div 7A benchmark rate remains fixed. Naturally, evidence backing up the terms of the loan should be retained.

## **\*NEW\* Anti-Detriment Memo**

This is a must read for all SMSF advisers, especially those with an interest in SMSF estate planning. It contains the information to become an expert in anti-detriment deductions and is the most detailed explanation ever written on the topic. It includes detailed commentary on the law, practical guidance when actually claiming such a deduction, 15+ detailed examples and explanations, the latest from the regulators, template minutes to implement and invaluable tips that come from our years of hands-on experience. Contents include:

The basic rules	— <i>How are reserves taxed upon receipt?</i>	<i>Clients with children</i>
How to calculate the anti-detriment amount?	<i>Insurance — Tax implications of insurance</i>	ATO scrutiny
<i>Audit method</i>	<i>Other method 1</i>	Frequently asked questions
<i>ATO ID method</i>	<i>Other method 2</i>	<i>How long does a trustee have to pay a anti-detriment amount?</i>
<i>EM method</i>	Other Issues	<i>What if benefits are paid by way of pensions?</i>
<i>Other method 1</i>	<i>Trust deed/governing rules</i>	<i>Where is the term 'anti-detriment' actually used in the income tax law?</i>
<i>Other method 2</i>	<i>Payments to deceased estates</i>	<i>How do SMSFs interact with other types of superannuation funds?</i>
<i>Further methods</i>	<i>Is anti-detriment superior to withdrawal and recontribution?</i>	Checklist
<i>Which method to use?— Effect of withdrawal and recontribution</i>	<i>Timing</i>	Template trustee resolutions
How to fund the anti-detriment amount?	<i>Lump sums</i>	Conclusion
<i>Reserves — Will using reserves have any excess contributions tax implications?</i>	Which clients do anti-detriment deductions benefit most?	Legislative extract
	<i>Clients with unrealised capital gains and no spouse</i>	

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