DBA Butler Pty Ltd Lawyers

NEWS

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New Pension Regulations

The government has recently released regulations that affect the payment of allocated pensions ('AP') and market linked pensions ('MLP'). In particular, the regulations provide greater planning opportunities for pensioners from 1 January 2006*.

Allocated Pension Changes

New factors will be introduced that reflect current life expectancy tables. The factors will apply to APs starting on or after 1 January 2006. However, the old pension factors will continue to apply to:

- APs commenced prior to 1 January 2006; and
- certain APs commenced after 31 December 2005 but before 1 July 2006. In this six month transition period, a member can choose to use either the old factors or the new factors, but once chosen, those factors will apply for the remaining term of the AP.

Where an AP reverts to a child beneficiary, annual pension payments to the child will need to be determined using a different set of factors specific to child beneficiaries. A 'child beneficiary' is a reversionary beneficiary who is either under 16 years of age or is in full-time studies and under 25 years of age. The new factors effectively require the pension to be paid out by the time the child beneficiary reaches 25 years of age. The new factors will apply to APs that revert to child beneficiaries, and not just those APs that commence on or after 1 January 2006.

Market Linked Pension Changes

Broadly, an MLP that commences on or after 1 January 2006 may be paid over one of the following terms:

- the life expectancy of the pensioner (or their life expectancy assuming they were up to five years younger);
- if the MLP reverts to the pensioner's spouse, their spouse's life expectancy (if greater than the pensioner's) or their spouse's life expectancy assuming they were up to five years younger; or
- a term that is greater than the above terms, up to the pensioner's (or the pensioner's spouse's) 100th birthday (if the spouse is a reversionary pensioner and younger than the pensioner).

For example, if Dad's MLP is payable up until his 90th birthday (based on his life expectancy), then under the new rules, he may choose a term that is between this and his 100th birthday.

Market Linked Pension Income Payments

For all MLPs (not just those commencing on or after 1 January 2006), there will be greater flexibility for determining annual pension payments. From 1 January 2006, the pension payable for a particular year may be calculated as: [account balance at 1 July] ÷ [relevant pension factor] **± ≤10%**.

Example: On 1 July 2006 Dad is 65 and commences an MLP payable over a term based on his life expectancy (a term of 18 years after rounding). The account balance of his MLP as at 1 July 2006 is $500,000. The base income in the first year will therefore be $500,000/13.19 = $37,907. Under the new rules, Dad can instead choose to take a pension payment of between $37,907±10% (ie, between $34,120 and $41,700(after rounding)) in that first year.

*Subject to the fund's trust deed providing this flexibility.

Reserves supporting Pensions

The account balance used for determining the annual pension payment of an AP or MLP includes 'fund reserves attributable to the pension benefit'. Therefore, where a fund has reserves attributable to a pension benefit, the pension payment will need to have regard to the reserves. This will require funds paying APs or MLPs to determine whether reserves are attributable to the pension or not. Documentation supporting reserves should therefore be carefully reviewed.

Is a spouse an eligible employee?

We are sometimes asked whether a director of a trustee company is an eligible employee for superannuation purposes. Often the trust is simply a family trust involved in passive investments, eg, a trust that invests money for the family.

While a director is a deemed employee (for tax purposes), the director must actually be engaged in activities sufficient to constitute him or her as an employee. Therefore, it is prudent to ensure that the director's employment duties are documented in a written agreement, that any salary paid is at arms length and all the usual PAYG and employment declarations are made.

ATO ID 2002/288 provides interesting reading on this topic. In particular, it includes the following extract from Egan's case: 'The contribution of Mrs Egan was minimal. She signed a few cheques over the years and took messages for and from Mr Egan when he was overseas or interstate. Her contribution to the business appeared to be little more, if any, than a spouse of a busy consultant might provide'. In Egan's case, Mrs Egan was held to not be a company employee.

If, based on the totality of facts, the director is not attending to any duties normally expected of a director of a trustee company or does not meet the criteria of an employee, it may be advisable to consider whether personal superannuation contributions as an eligible person under section 82AAT of the *Income Tax Assessment Act 1936* (Cth) is a more attractive alternative.

Broadly, an 'eligible person' is one who earns less than 10% of their assessable income and reportable fringe benefits from eligible employment. An eligible person is entitled to a tax deduction up to the age based limit, but loses deductibility on 25% of any contributions greater than $5,000 (in which case these contributions would be regarded as undeducted contributions).

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