

SMSFs with individual trustees cannot pay ETPs

The decision to have individual trustees or a company act as trustee of a self managed superannuation fund ('SMSF') has now become clear cut, thanks to a recent clarification by the ATO.

Since mid 1993, many advisers have relied upon a loose interpretation of section 19 of the *Superannuation Industry (Supervision) Act 1993* (Cth) ('SISA'). Section 19 requires that an SMSF with individual trustees must have as its sole or primary purpose the provision of old-age pensions or have a corporate trustee.

However, up to now, members of SMSFs with individual trustees have generally ignored this requirement by commencing a pension and then requesting the immediate commutation of that pension to a lump sum eligible termination payment ('ETP'). This practice was promoted by the former regulator of SMSFs, the Insurance and Superannuation Commission, when the SISA was introduced and has been relied on by many ever since. Invariably, no pension amount would actually be paid, no pension documents ever prepared and no reasonable benefits limit ('RBL') reporting made. Typically, the member request for the pension and the request, typically the next day, to immediately commute that pension, were the only two pieces of paper relied upon to document this process.

The ATO, however, has recently clarified that if a pension is payable, it must actually be paid in accordance with the law. This means that even if an allocated pension is paid for only 1-2 days, the minimum amount of the pension for that financial year must still be paid.

Note, where an allocated pension is fully commuted, then the minimum amount as pro-rated (for the number of days the pension was paid as a proportion of the entire year) must be paid. If the pension is partly commuted, then the minimum for the entire financial year must still generally be paid. Note that no specific pro-rating rule applies if the allocated pension commenced prior to 1 October 2003.

More importantly, the normal documentation required to establish a pension must be completed, including the member's request for a pension to be paid, RBL notification, PAYG requirements, TFN declaration, trustee resolutions and a product disclosure statement ('PDS') specific to that type of pension given to the member on or before commencing the pension. (We recommend that a PDS be provided in relation to each type of pension – see our website for further details on our pension kits and PDS products).

The ATO also considers that the trust deed should show that the fund has been created primarily for the purpose of providing pensions to members of the fund if the fund has individual trustees. We have come across a number of deed suppliers whose deeds do not satisfy this basic test.

The ATO has also given their interpretation on what 'primarily' means in respect of an SMSF with individual trustees. Some have taken the view that it is sufficient to pay 50% of a member's account balance as a pension and the balance can then be paid out as a lump sum. However, the ATO has taken a strict view of what 'primarily' means. The ATO believe that the ability to pay lump sum ETPs is generally only allowed when a right to commute a pension to a lump sum is available.

The ATO's views clearly confirm that a corporate trustee is now the preferred form of trustee. Having a corporate trustee typically saves money at the end of the day as it provides considerable administrative savings, provides greater asset protection, is more flexible and provides greater control from an estate planning point of view. A corporate trustee is now also required to allow members to take a lump sum benefit and side step all the paperwork associated with starting and then commuting a pension to obtain a lump sum ETP. Finally, the cost of a corporate trustee can easily be recouped once the costs of commencing and commuting a pension is considered.

Defined benefit pension deadline reminder!

The deadline for commencing a defined benefit pension ('DBP') is fast approaching! Care must be taken in utilising the 31 December 2005 transitional relief, as its availability is quite restricted. This relief applies to enable an SMSF to pay a DBP to a person:

- who was a member of the fund on 11 May 2004 and who, before 1 January 2006, retires (as defined in the *Superannuation Industry (Supervision) Regulations 1994* (Cth)) on or after attaining age 55 or attains age 65; and
- who, after 11 May 2004, becomes entitled to be paid a DBP and the first pension payment is made within 12 months of the person becoming entitled to the pension.

If you have clients who are considering taking a DBP prior to 31 December, timely action must be taken to ensure that all appropriate documentation and actuarial calculations are in place prior to 1 January 2006.

Salary Sacrificing & Non-commutable Pensions

It is now possible for those that attain their preservation age to commence a non-commutable pension ('NCP') without having to retire. Some people accessing an NCP are also being paid a salary. These people may seek to salary sacrifice some of their salary to save tax. If say, they are on a \$63,000 annual salary, then their marginal tax rate above \$63,000 is 42% (ignoring the Medicare levy). If they salary sacrifice some of their salary, they will only incur an initial 15% on receipt by the fund. Their tax on exit from the fund may fall between nothing to 15% for a lump sum ETP or typically a maximum rate of 32% if the full 15% pension rebate applies. If they are on a 30% tax rate, then the rebate will reduce this to 15%.

The ATO have, however, raised the risk that the general anti-avoidance provision, Part IVA of the *Income Tax Assessment Act 1936* (Cth), may be applied to wind back any tax benefit from such strategies. While the ATO has previously been reticent to raise Part IVA concerns in relation to superannuation strategies, advisers should not become complacent.

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