DBA Butler Pty Ltd Lawyers

NEWS

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This edition of DBA News includes:

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SMSFs paying Defined Benefit Pensions ('DBP')

The 2004 Budget has introduced a number of unexpected changes to the ability of self managed superannuation funds ('SMSFs') to pay Defined Benefit Pensions ('DBPs'); ie, broadly, any pension other than an allocated pension ('AP').

Up until 11 May 2004, SMSFs were free to provide (assuming their trust deeds permitted) a range of DBPs including lifetime complying pensions ('LCP'), life expectancy complying pensions ('LECP') and flexi-pensions ('FPs') (aka commutable lifetime pensions or non-complying lifetime pensions). However, new SMSFs established after 11 May 2004 are generally restricted to only offering APs and the growth pension ('GP'; proposed to commence in September 2004).

What do the new DBP rules provide?

New SMSFs established after 11 May 2004 cannot generally provide a DBP. Therefore, SMSFs established in the future will generally only be permitted to provide an AP as well as, from 20 September 2004, GPs that will enable members to access the pension RBL. The rules for the GP are yet to be passed as law.

The Transitional Relief

However, transitional relief is available for funds established on or before 11 May 2004 ('Existing Funds') where the deed already has sufficient power to pay a DBP.

The particular type of pension that may be paid depends on a careful interpretation of the deed (eg, some deeds may only authorise the payment of a LECP but not a LCP). Unless there is sufficient power for one or more of the particular types of DBPs in the deed, there will be no transitional relief for that type of pension. The transitional relief only allows deeds of Existing Funds, with sufficient power, to continue to pay any DBP that was authorised by the deed as at 11 May 2004 (see below).

The determination of what constitutes sufficient power in the deed to pay a particular DBP will therefore depend on the specific pension powers in the particular trust deed under examination. This will need to be assessed on a case by case basis.

DBA's deeds supplied from mid 1999 have extensive power to pay LCPs, LECPs and FPs, and therefore, these funds should readily qualify for transitional relief. For those with DBA deeds pre-dating mid 1999, we would be pleased to undertake a review of any deed and confirm its status, if instructed.

DBA offers a service of reviewing trust deeds to determine whether or not they qualify for transitional relief. We can issue a letter confirming the powers and provide appropriate advice on what types of DBPs can be paid under deeds of Existing Funds.

Should SMSFs set up before 12 May 2004 amend their deeds?

Every deed that requires a super deed of variation ('SDV') or deed upgrade first needs to be analysed to determine whether or not the deed has sufficient power to pay a DBP. If so, DBA needs to tailor the deed so as to retain that power.

Note, any change to a DBP power after 11 May 2004 will jeopardise any transitional relief. Therefore, care is needed before any Existing Fund's deed is varied. In view of the 12 May changes, any amendments should only be made by superannuation lawyers. Unless amendments are carefully drafted, the ability to pay DBPs in the future could be forever jeopardised.

While the members of a SMSF may not currently intend to take a DBP, they should nevertheless seek to retain any DBP power wherever possible as it may provide an attractive option in the future; especially for future generations.

DBA has already updated its SMSF documentation

We have already updated our SMSF documentation in view of the 12 May 2004 changes and will be monitoring developments to ensure appropriate changes are made as required. We recommend that in view of the changes, SMSF deeds from now on only be sourced from law firms with experienced superannuation lawyers.

Furthermore, SMSF deeds should not be amended unless those amending the deed have developed strategies for not jeopardising the fund's transitional relief.

Further Changes:

Minimum Benefits

All of a member's benefits in a SMSF are minimum benefits after 11 May 2004. The only exceptions to this rule are:

- Where an employer vesting schedule was agreed to in writing on or before 11 May 2004. Such a vesting schedule can continue to allow for non-mandated employer contributions (eg, contributions above the 9% SGC rate) to vest over a period of time. The non-vested portion only becomes a minimum benefit when the amount vests; typically upon service after a certain period, eg, at 10% p.a.

- To allow payment of a temporary incapacity benefit that is not attributable to either a member-financed benefit or a mandated employer-financed benefit. This typically allows non-mandated employer contributions and insurance moneys to pay an income stream during any period of temporary incapacity.

This means that as each member's benefits in a SMSF after 11 May are generally minimum benefits, they can no longer be forfeited to reserves or another member.

Forthcoming Seminar

The *DBA Network* will be holding a ½ day workshop at the Savoy Hotel, Melbourne on the morning of **21 May 2004** covering the impact of the 2004 Budget on SMSFs and estate planning.

Contributions to be allocated

All contributions to SMSFs are required to be allocated within 28 days of the end of the relevant month to a member's account in the fund. Where it is not reasonably practicable to allocate within the 28 day period, the trustee must allocate as soon as reasonably practicable thereafter.

This rule has primarily been designed to ensure the timely allocation of contributions to members' accounts. Apparently, there were some taxpayers seeking to allocate contributions directly to a reserve account in order to defer the superannuation surcharge tax. This strategy is no longer available after 11 May 2004.

Will the new rules be amended?

DBA is aware of a number of professional organisations who oppose the DBP changes and will be seeking to have the new regulations disallowed. It is therefore quite possible that these laws may change. DBA will be reviewing the progress of these changes and will keep its clients informed of any relevant changes.

Surcharge Reduction

The maximum surcharge rate will be reduced to 7.5% in the 2006/2007 and subsequent financial years on an incremental basis from 1 July 2004.

Co-Contributions

The maximum Government co-contribution will increase to $1,500 from 1 July 2004. Co-contributions will phase out completely at an income of $58,000.

For further Information please contact:

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