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FY2012 SMSF Checklist

As we are now over the half way mark for this financial year, this SMSF update focuses on a number of important planning issues leading up to 30 June 2012.

Contributions

Concessional contributions ('CC')/Non-concessional contributions ('NCC')

CCs are generally contributions which are included in the assessable income of the SMSF. An example of a CC is a contribution made by an employer on behalf of an employee. An NCC is a contribution by a member that is not claimed as a deduction.

Most members are subject to a maximum $25,000 CC cap unless they wish to pay excess contributions tax. However, a member who is 50 or over on the last day of the financial year has a $50,000 CC cap. Note that this higher CC cap may cease on 30 June 2012.

From 1 July 2012 it is proposed that the $50,000 CC cap will only apply to those 50 or over who have less than $500,000 in superannuation. The details of how this $5000,000 will be assessed and the legislation covering this proposal have not yet been released.

Both CCs and NCCs are subject to contribution caps. If these caps are exceeded, excess contributions tax of up to 93% may be payable. Planning a strategy now to optimise contributions subject to the caps means making sure there will be no excess contributions tax.

One common trap giving rise to excess contributions tax assessments is where a member makes a $150,000 NCC in one income year and then make the $450,000 in the next or following two income years. We have seen many hefty excess assessments issued where the contribution in the initial year slightly exceeded $150,000 (invariably by oversight, eg, a calculation error) thereby triggering the bring forward rule in that year.

An excess contributions tax assessment of $69,285 applies to a $1,000 excess in the initial year as the initial year of $151,000 kicked off the three year bring forward rule. Fortunately, the ATO have been exercising their discretion in certain small excess cases such as these but proper planning in the first place before making any sizeable contribution should overcome any excess.

Gainful employment

'Gainful employment' is a condition that must be met by members aged between 65 and 75 wishing to contribute to a fund. Such members must satisfy this test before making a contribution. A person is gainfully employed on a part-time basis if they are employed for at least 40 hours in a period of not more than 30 consecutive days.

Government co-contribution

Members who make a NCC to a fund may be eligible to receive a co-contribution from the Government. The Government will make a co-contribution where the member's taxable income (ie, broadly assessable income less deductions) is less than $61,920. The co-contribution amounts are going to be reduced and advisers should ensure their clients maximise this benefit for FY2012.

Self-employed

Where a member is self-employed and makes personal contributions, less than 10% of their assessable income (and certain other amounts) must be attributable to their employee activities for them to claim a deduction. A valid notice must also be given to the trustee in an approved form (ie, NAT 71121) before their tax return is lodged. If a pension is being commenced which uses any of the contribution, then the notice has to be given to the trustee before the pension commences.

Pension planning

The minimum payments, calculated in accordance with Schedule 7 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) ('SISR'), for account-based pensions ('ABP') and transition to retirement income streams ('TRIS') must be paid before the end of each financial year. Note that for FY2012, the minimum payment for these pensions is 75% of the usual minimum amount. A TRIS has a maximum annual payment of 10% of the opening account balance funding the TRIS. Appropriate minimum and maximum payments should be made before 30 June 2012.

SMSF borrowing

SMSF trustees should ensure that any related party loan supporting a borrowing is properly maintained.

For example, regular payments should be made in accordance with the loan agreement.

If the lender to the SMSF is a related company or discretionary trust, care should be taken so the loan agreement continues to meet the requirements of Division 7A of the *Income Tax Assessment Act 1936* (Cth). The div 7A interest rate is currently 7.8% and the interest rate under the loan agreement may differ.

Succession planning

Binding death benefit nominations ('BDBN')

BDBNs should be reviewed at least annually to ensure they still accurately reflect each member's wishes. The SMSF deed should also be reviewed to ensure a BDBN can continue indefinitely as many older SMSF deeds require BDBNs to be updated every 3 years.

Auto-reversionary pensions

A pension (other than a defined benefit pension such as a lifetime pension) that has already commenced can be made 'auto-reversionary' (ie, it automatically reverts to another eligible dependant upon a member's death). Members should review their existing pensions and decide whether they should make them auto-reversionary especially following the ATO's draft ruling TR 2011/D3. Broadly, this draft ruling provides that unless a pension is auto-reversionary (typically to a spouse), then it is taken to cease upon the member's death (thereby giving rise to adverse tax consequences).

The SMSF deed and pension documents should therefore be reviewed to determine whether an amendment is required to make the auto-reversion binding as the ATO do not accept a reversion that is discretionary, eg, if the pension resolution provides for a reversion but the deed provides the trustee with the power to not revert, then the ATO may not accept the reversionary nomination. Note that generally a trustee's discretion cannot be fettered (or limited) and hence the deed generally requires amendment to allow for a binding reversionary nomination that will satisfy TR 2011/D3.

In-house assets ('IHA')

IHAs are a major focus of the ATO's SMSF audit campaign for FY2012 and loans to related parties and related trusts (see commentary on also unpaid distributions below) are common contraventions especially given the difficult economic conditions that we've experienced in the past few years. Recent cases have highlighted that an SMSF is not to be used as a ready source of finance and the ATO's discretion is unlikely to be exercised where a contravention has happened even if the loan was only temporary and the family was suffering financial difficulties: see Olesen v Parker [2011] FCA 1096.

Broadly, the market value of an SMSF's IHAs must not exceed 5% of the total market value of the fund's assets. Firstly, trustees and advisers should ensure this 5% threshold is not exceeded as 30 June approaches. This is especially relevant as investment markets have been proving difficult and many funds have suffered considerable loses in recent years.

If the IHA limit exceeds 5% at 30 June, the SMSF trustee must reduce the level of IHAs to below 5% before the next 30 June.

Where an SMSF is presently entitled to an unpaid distribution (aka UPE) from a related unit trust, the ATO generally considers this amount to be a loan and therefore constitute an IHA if it is not received by the SMSF within 12 months of the relevant end of financial year, see: SMSFR 2009/3. Thus, advisers should carefully inspect each SMSF with a related trust and make sure that timely recovery of all unpaid distributions occur.

Conclusions

The ideal time is now to plan what needs to be done before 30 June. The above is a brief snapshot of many other items in our SMSF FY2012 Compliance Kit (refer to http://www.dbalawyers.com.au/strategy-compliance-kits).

SMSF Online Updates – 10 February 2012 – its now easy to keep up to date!

Our live webcasts have proved a great success based on client feedback. The first of four SMSF Online Updates for 2012 is on Friday 10 February 2012 from 12 noon to 1.30pm. The session will cover some hot topics including the latest cases, legislation, regulatory developments and other SMSF tips and traps.
To register please visit http://websem.dbanetwork.com.au. Alternatively, direct all enquiries to Marie Zarifis on (03) 9092 9400 or mzarifis@dbanetwork.com.au.

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