DBA Lawyers

NEWS August 2012

Latest on TR 2011/D3

Draft taxation ruling TR 2011/D3 has proved very controversial. It was slated to be issued in final form on 25 July 2012. However, the ATO now lists the planned issue date as 'TBA'.

Given the uncertainty as to when it will be finalised, we now take stock of two of its most controversial aspects and their practical implications.

Cessation of pensions upon death

The controversy

TR 2011/D3 states that a pension:

> ceases as soon as the member in receipt of the [pension] dies, unless a dependent beneficiary of the deceased is automatically entitled under the superannuation fund's deed, or the rules of the [pension], to receive [a pension] on the death of the member.

The associated practical implications are significant. Remember that each pension is a separate superannuation interest. For example, consider Cedric. He might have two pensions in his SMSF: one comprised entirely of the taxable component and one comprised entirely of the tax free component.

Under the approach in TR 2011/D3, the default position upon Cedric's death is that the pensions cease. Presumably, the two interests would merge and there would then be one interest comprised half of the taxable component and half of the tax free component.

The implications — making pensions reversionary

Many have sought to ensure that, upon the death of a member, a 'dependent beneficiary of the deceased is automatically entitled' to continue to receive the pension. Such a pension is referred to as a reversionary pension.

This raises the question of whether a pension that was commenced as non-reversionary can be altered to become reversionary. Some take the negative view believing that the entire pension must be commuted and the resulting lump sum must be used to start a new 'reversionary' pension.

DBA Lawyers believe the exact answer depends on the governing rules of the SMSF. However, generally, we suspect that it is possible to alter the terms of an existing pension so that it becomes reversionary. We believe the case of *Gra-Ham Pty Ltd v Perpetual Trustees WA Limited* [1989] 1 WAR 65 is illustrative.

In *Gra-Ham* the governing rules of a trust provided the trustee and the manager the power to 'alter modify alter add to or cancel the provisions of this Deed'. This power was exercised to retrospectively defeat vested or accrued rights of a particular beneficiary. The beneficiary challenged this but the Supreme Court of Western Australia (Full Court) held that retrospective variation was valid. This principle has been affirmed many times and in many courts since.

We believe this principle also applies to pensions. Namely, assuming there is a broad variation power, it is possible to alter the terms governing the pension — retrospectively if need be — so that it is reversionary.

SMSF SUCCESSION PLANNING DAY

Lawyers from DBA Lawyers will be presenting a special one day intensive SMSF succession planning seminar on 8 October 2012 in Coffs Harbour.

It will cover all the steps — and all the top tax strategies — you need to take to ensure that you have fully planned for all aspects of succession, including ensuring the right people will be running the fund when members lose capacity. It will consider the strategies arising from TR 2011/D3 and much more (eg, anti-detriment deductions).

For more information or to register please visit www.dbalawyers.com.au/smsf-succession-planning-day

Ability to pay a pension *in specie*

The *Superannuation Industry (Supervision) Regulations 1994* (Cth) expressly provide that a lump sum includes an asset. However, it is silent as to whether a pension payment can include an asset. APRA have taken the view that a pension payment can not include an asset, stating that '[p]ayments cannot be paid in specie where ... the payment is in respect of a pension ...'.

Naturally, APRA does not regulate SMSFs, rather, the ATO regulates SMSF. The ATO's TR 2011/D3 states that:

> All payments made from a [pension] count towards the minimum payment requirements … including a payment

> made as a result of a partial commutation, unless it is rolled over within the superannuation system. This would be the case regardless of whether the partial commutation payment is made in cash or *in specie*.

The implications

The comments in TR 2011/D3 lend support to the view that pension payments can be *in specie*.

However, practically, there is still uncertainty and so it's best to avoid *in specie* pension payments. Rather, it is less controversial to structure any *in specie* payments as lump sums resulting from partial commutations. As the extract shows, the ATO's position in TR 2011/D3 is that lump sum payments still count towards minimum pension payments. Further, if the actuarial method is being used to calculate the pension exemption, the partial commutation is unlikely to have a material effect on the amount of tax payable. (However, for transition to retirement income streams this is typically not possible.)

Payment constituting pension payment at fund level and lump at recipient level

TR 2011/D3 states:

> The amount payable to the person upon a partial commutation of a [pension] is a superannuation lump sum for income tax purposes as the member is taken to have made an election under paragraph 995-1.03(b) of the ITAR 1997 for that payment not to be treated as a superannuation income stream benefit.

Also, as stated in the earlier quote, the ATO's position in TR 2011/D3 is that such a lump sum upon partial commutation will count towards the minimum pension requirements.

Accordingly, consider Arlen. He is 58 years old, and receives an account-based pension from an SMSF. The pension is comprised entirely of the taxable component. He wishes to receive a $100,000 payment of listed securities from his SMSF and for this to constitute his minimum pension payments for the year.

Under the extracted comments in TR 2011/D3, assuming the paperwork was in order, it appears that the $100,000 transfer of listed securities to Arlen:

- would constitute pension payments (even though paid *in specie*) at the SMSF level; and
- a lump sum in Arlen's hands thus may well be tax free due to the low rate cap.

The Complete Guide to SMSFs and Planning for Loss of Capacity and Death

✂ -

I want to order *The Complete Guide to SMSFs and Planning for Loss of Capacity and Death* ($550) — this 140+ page book is fully up to date as at 1 August 2012 and details everything you need to know about SMSF succession planning. For full terms and conditions, see www.dbalawyers.com.au/complete-guide

Signature ____________________ Name of person ordering __________________________

Name of Firm ____

Postal address of firm____

____

State _________________________ Postcode____________________________________

Tel____________________ Fax ________________ Email________________________

Don't send any money. You will be invoiced upon receipt of the book.

SPECIAL DISCOUNT — if you register for the SMSF Succession Planning Day (see page 1) and purchase *The Complete Guide* book at the same time, you receive a 50% discount off the price of *The Complete Guide*. For more information, or to register/purchase, visit http://www.dbalawyers.com.au/smsf-succession-planning-day.

For further Information please contact:

DBA LAWYERS PTY LTD (ACN 120 513 037) Level 1, 290 Coventry Street, South Melbourne Vic 3205

Ph 03 9092 9400 Fax 03 9092 9440 dba@dbalawyers.com.au www.dbalawyers.com.au

DBA News contains general information only and is no substitute for expert advice. Further, DBA is not licensed under the *Corporations Act 2001* (Cth) to give financial product advice. We therefore disclaim all liability howsoever arising from reliance on any information herein unless you are a client of DBA that has specifically requested our advice.