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TR 2011/D3 finalised as TR 2013/5 and SMSFD 2013/2

— *the 'must know' points*

After over two years of debate, draft taxation ruling TR 2011/D3 was finalised yesterday as both:

- taxation ruling TR 2013/5 and
- self managed superannuation fund determination SMSFD 2013/2.

The finalised materials reveal some very positive surprises.

No compliance activity before 1 July 2012

TR 2011/D3 (released in July 2011) stated that it applied with effect from July 2007. Some had felt this was unfair as it would be retrospectively holding taxpayers to a standard that they had no idea existed at the time.

The finalised materials provide some leniency, stating:

> … it is not appropriate for the ATO to take compliance action to apply the views of the law expressed in this Ruling with regards to when a [pension] ceases on the death of a member before the 2012-13 income year.

Tax free payments before age 60

Naturally, those under 60 typically pay tax on the taxable component of super pensions received. However, consider the following:

- Jack — aged 57 — receives a payment from his SMSF as part of his pension.
- At the SMSF level, the payment counts towards satisfying the minimum pension requirements.
- At the recipient level, Jack elects, pursuant to reg 995-1.03 of the ITAR 1997, that in his hands the payment is taxed as a lump sum not as a pension payment.

Naturally, if the above works, it means the following:

- **No tax at the SMSF level** — allow the SMSF to be eligible for pension exemption in subdiv 295-F of the ITAA 1997.
- **No tax at the recipient level** — allow the first $180,000 of taxable component to be received tax free pursuant to low rate cap amount in s 301-20 of the ITAA 1997.

Is this too good to be true? Yesterday's materials seem to suggest that this can work but only in certain circumstances, typically where:

- Jack's pension is an ABP and not a TRIS and
- Jack makes the election that the payment be treated as a partial commutation and this election is made *before* the payment is made.

Naturally, not all pensioners aged 55–59 will be able to engage in the above as the majority of pensions to those under age 60 are TRISs not ABPs.

Year of death and failure to meet pension minimums

TR 2013/5 provides some welcome relief for pensioners dying before pension minimums are met.

Under a strict reading of TR 2011/D3, a pension automatically ceased for the entire year if there was a failure to meet minimum annual payment requirements. Worse still, any payments received would be taxed as lump sums. Accordingly, under TR 2011/D3 the following could have occurred:

What could have happened under TR 2011/D3

Bill — aged 58 — is receiving a TRIS comprised entirely of the tax free component. The required minimum payments for a financial year are $40,000.

Bill receives $15,000 in July of the financial year. He would have received $25,000 in June, however, before this can occur, he dies in May.

Under a strict reading of TR 2011/D3, there was a concern that the ATO might form the view that no pension existed and thus the SMSF was not eligible for the pension exemption.

Further, the $15,000 might have been treated as a lump sum.

Because Bill was probably not eligible to receive a lump sum, there was the concern it might have been treated as an unauthorised payment under s 304-10 of the ITAA 1997 and therefore taxed at Bill's marginal tax rates, even though it was comprised of the tax free component.

However, TR 2013/5 seems to provide a carve out in this situation. It states:

> Once a [pension] commences it is payable (that is, there is an obligation to pay [pension] benefits from that [pension]) until such time as that [pension] ceases. This remains true even if the member dies

> before any payment is due to be made under the terms of that arrangement.

The ruling later goes on to further elaborate:

> … a [pension] may be payable for a period of time even if the member dies before any payment is due to be made under the terms of that arrangement. That is, based on the member's entitlement to a series of related payments over an identifiable period of time there is a [pension] in existence up to the time of the member's death.

What probably will happen under TR 2013/5

Accordingly, under the finalised ruling, Bill's SMSF should get the pension exemption and the $15,000 payment should be tax free to Bill.

Taxation upon death — the sting is largely gone

When TR 2011/D3 was released in July 2011 it was very controversial. One key controversy was its statement that a pension generally 'ceases as soon as the member in receipt of the [pension] dies'.

This meant that the pension exemption would typically cease immediately upon death. Accordingly, SMSFs might have hefty tax bills due to the transferring out of *in specie* death benefits with large unrealised capital gains.

TR 2013/5 still adopts this view that a pension ceases immediately upon death. However, remember recent legislation has softened the impact of this. The recent legislation is *Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013* (Cth). It inserted, among other things, reg 995-1.01(3) into the ITAR 1997. This broadly provides that the pension exemption will continue past death until:

- if the pension is not automatically reversionary — as soon as it is practicable to pay the death benefits or
- if the pension is automatically reversionary — until the trustee or reversionary beneficiary ceases the pension.

Accordingly, the sting that TR 2011/D3 introduced is largely gone.

However, recall Wayne Swan and Bill Shorten's joint media release on 5 April regarding tax treatment of earnings on superannuation assets supporting income streams. There, they stated that from 1 July 2014 the pension exemption will be capped at $100,000 pa.

This could reintroduce certain stings for those who die with large unrealised capital gains in their SMSF.

That being said, the grandfathering rules should protect many, namely, in respect of assets purchased before 5 April 2013, the reform will only apply to capital gains that accrue after 1 July 2024.

Get your paperwork right!

TR 2013/5 states that a pension's:

> commencement day can not precede the member's request or application

As a strict matter of law, DBA Lawyers does not believe that a member's request or application is necessarily required to commence a pension. (Rather, we believe it depends on the fund's specific governing rules.)

However, it is now best practice to have a member's request or application when starting a pension.

DBA Lawyers offer SMSF pensions kits that have always included member applications (along with PDSs, and much more). See www.dbalawyers.com.au/products-order-forms/pensions

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