

SMSFs: The Big Questions



CRAIG DAY

Executive Manager, FirstTech

Colonial First State

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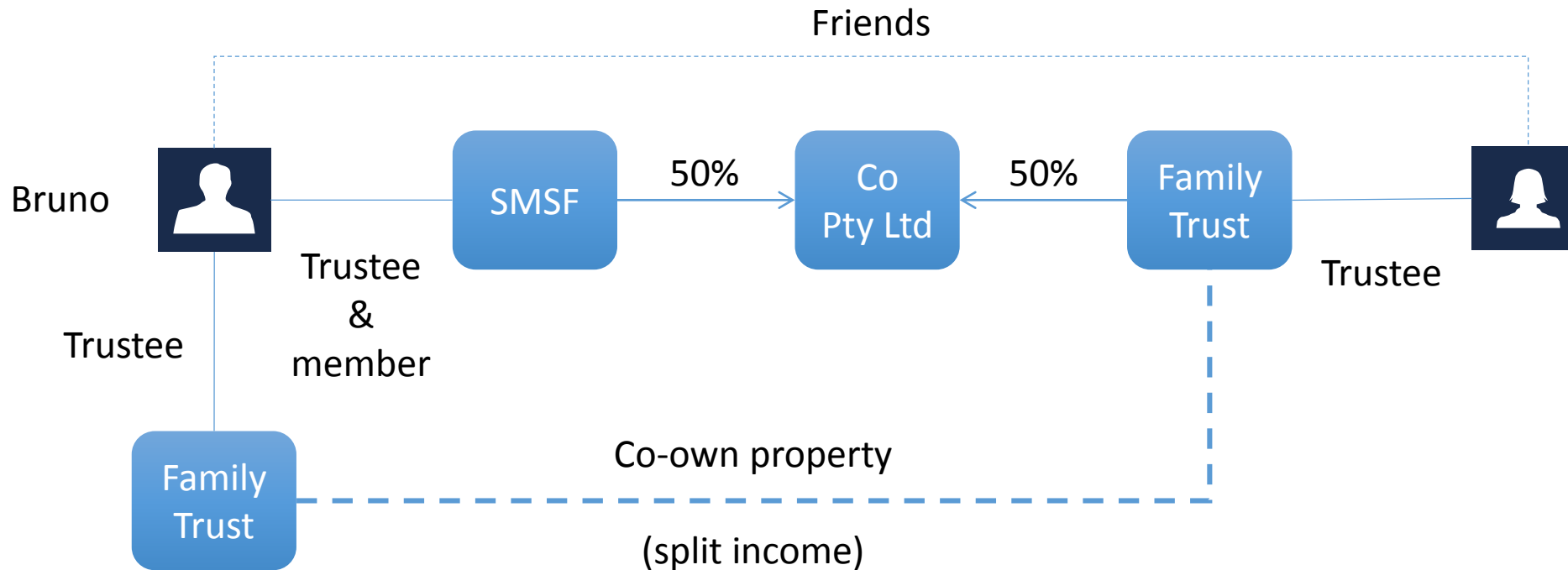
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CASE STUDY – Bruno

Does Bruno have a problem?





Part 8 associates

If a member is a partner in a partnership

- their partners (including spouse and kids)
- the partnership

Includes where member acting as trustee



Meaning of partnership

Includes both common law and tax law definitions

- operate a business together
- earn income jointly

Earn income jointly where co-own assets

- joint tenants or tenants in common



CASE STUDY – BERT

Bert (66) has an ABP in his SMSF with a balance of \$800,000 (100% taxable). Bert takes his minimum (\$40,000) as a single annual payment each June.



Bert now wants to withdraw \$40,000 from his pension to gift to his grandkids. However, he doesn't want to have to receive any more payments.

How should Bert take the payment – commutation, pension payment or a bit of both?



ABP definition

Definition of ABP in SIS Regs includes requirement for:

- annual payment
- total amount of payments (other than by rollover) must meet a prescribed minimum



SMSFD 2013/2

Regs do not exclude payments made by way of partial commutation from counting towards minimum

TR 2013/5 – Partial commutation

Where a member consciously exchanges something less than their full entitlement to receive future, periodic (including annual) income stream benefits for a lump sum



What about commutation rules

ABP cannot be commuted unless:

- for partial commutations – remaining balance higher than minimum reduced by value of payments¹, or
- pro-rata min payment already paid

Balance of \$760,000 > \$0



What if payment made via in specie transfer of shares?

Pension payment can only be paid in cash

But partial commutation – counts towards minimum



Would in specie partial commutation trigger a CGT?

Asset used to discharge fund's income stream liabilities

ATO confirmed cap gain on segregated assets exempt²



What if receiving age pension?

Assuming grandfathered ABP

Additional pension payments:

- count as income
- reduce pension entitlement for rest of year

Commutation:

- not counted as income
- DA recalculated
- DHS deem min paid as income

Gifting rules apply



From left field...

In specie partial commutation of account balance considered full commutation as was for full amount of annual payment

- failed pension definition
- pension stopped at start of year
- CGT applies to in specie xfers

ATO happy with partial commutation where pension payments also received in year



CASE STUDY – BERT (Part II)



Assume Bert was age 58 and retired (instead of 66) when he withdrew the \$40,000 from his \$800,000 (100% taxable component) ABP.

What would be the best way for Bert to withdraw the amount from his ABP for tax purposes – super lump sum or income stream benefit?



Taxation of income stream benefit paid from ABP

Payments taxed as income stream benefits unless member makes election under Tax Reg 995-1.03 that payment not to be taxed income stream benefit



Tax Reg 995-1.03 requirements

Can only make election where:

- pension rules allow for the amount of payments in a year to be varied¹
- made election before the particular payment is made

Provide to trustee?

Apply to multiple payments?

¹ Other than just due to: the indexation of the benefit under the rules of the product, the splitting of the benefit under family law, the commutation of the benefit (including commutation to pay a surcharge liability), or the payment of an assessment of excess contributions tax.



Taxation of income stream payments 56 to 60

Taxable component included in assessable income

- taxed at MTR less 15% offset



Taxation of lump sums payments 56 to 60

Taxable component included in assessable income. Tax offset applied to reduce tax rate:

- to nil where within low rate threshold
- to 15% where amount above member's low rate threshold



**Tax liability – where payment
taxed as super income
stream benefit**

Assuming Bert on 37% tax
rate:

- $\$40,000 \times 37\% = \$14,800$
- $\$40,000 \times 15\% = \$6,000$

Tax payable = \$8,800

**Tax liability – where payment
taxed as super lump sum benefit**

Assuming taxable component of
lump sum payments within low
rate threshold

- $\$45,000 \times 0\% = \text{Nil}$



CASE STUDY – Eliza



Eliza is 56 and works full time earning \$100,000p.a. She also has \$300,000 preserved benefit in an SMSF.

Eliza would like to commence a TTR pension and to elect for the payments to be taxed as lump sums.

Can she do this?



TTR Pension rules

- Satisfy ABP rules
- total payments in a year
 - at least ABP minimum
 - max 10% of balance
- non-commutable other than where cashing UNP



Meaning commutation?

Commutation occurs where:

“a member consciously and validly exercises their right to exchange some or all of their entitlement to receive future income stream benefits for an entitlement to be paid a lump sum.” TR 2013/5



Can a 995-1.03 election be made in relation to a TTR?

Yes – TTR pension payments able to be varied between min and 10%

Does making election result in a commutation of the pension?



TR 2013/5

Commutation request and making election don't appear linked

Example: making request to commute does not result in election being made

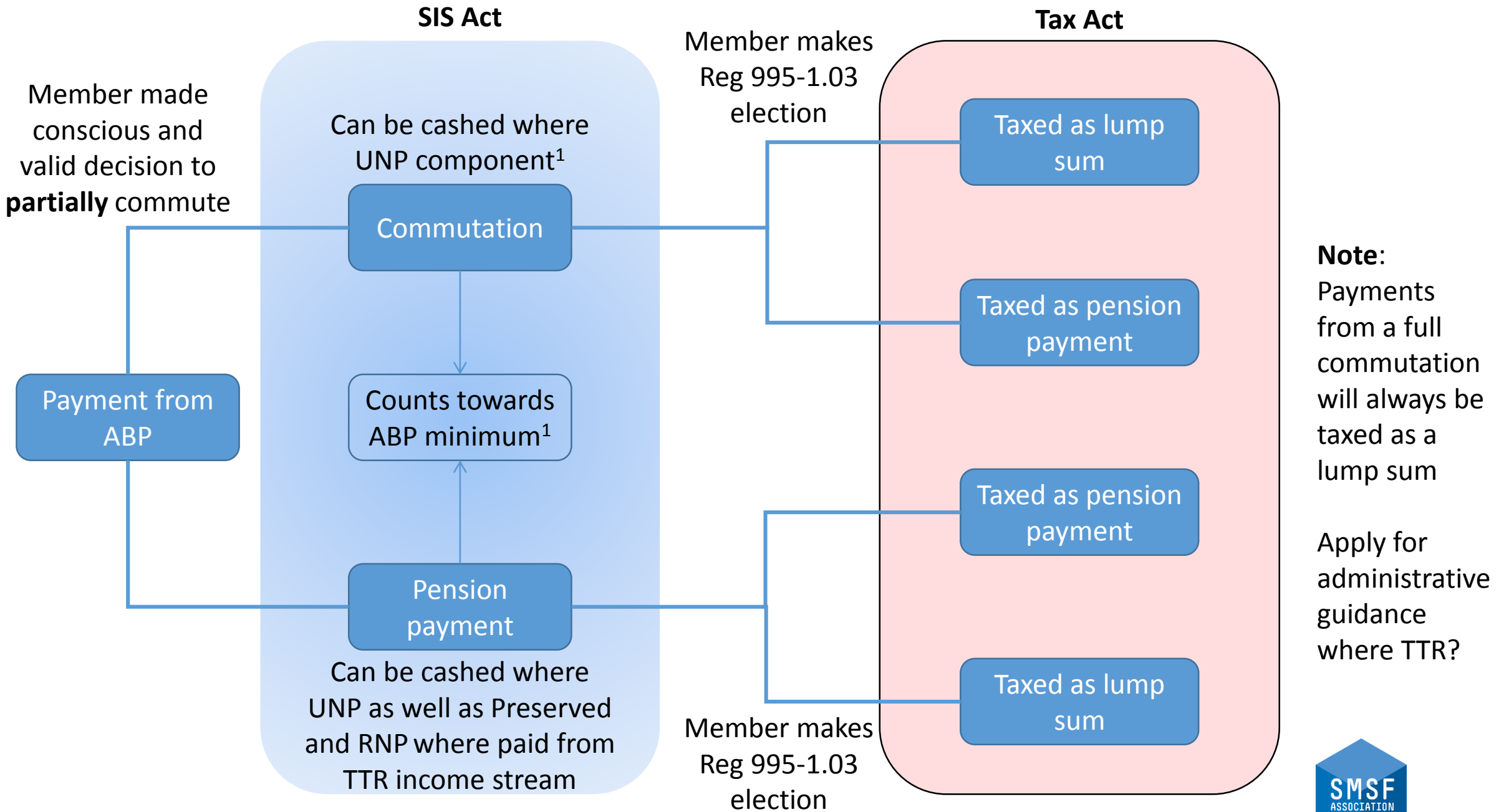
Further guidance?



ATO website¹

*“The election is an income tax law provision, whereas the minimum pension payment requirement is a super law requirement. **This means that an amount paid from a pension is still treated as a pension payment for super purposes, even though, for tax purposes, a member can make an election and take advantage of the low rate cap threshold to receive the amount tax free for members under age 60**”.*

¹ <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-webinars/?page=12>





CASE STUDY – Lena

Lena owns a commercial property which is valued at \$750,000.



Lena now wants to transfer the property to her SMSF as an in specie contribution and to claim the small business CGT retirement concessions.

Assuming Lena satisfies the basic eligibility requirements, will she be able to qualify for the \$500,000 retirement exemption?



Eligibility requirements

- 1 – Satisfy basic Small Biz CGT rules
- 2 – Dispose of asset
- 3 – If under 55 – contribute an amount equal to the asset's CGT exempt amount to super by the later of when:
 - you made the choice and
 - you received the proceeds



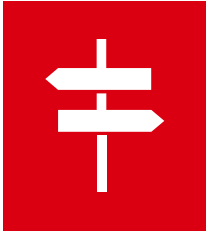
Problem with in specie

Disposal of assets and contribution of proceeds occur at same time

NTLG Losses & CGT Sub-Committee

- rules do not contemplate the CGT event, choice and payment can all take place simultaneously
- cannot claim on in specie transfer

Not eligible for CGT exempt cap



Recent ATO PBRs¹

Confirm:

- eligible to claim retirement exemption
- contribution of assessable gains excluded from NCC cap

Apply for private ruling



CASE STUDY – Paul and Linda

Paul and Linda were a couple and were members and individual trustees of their SMSF. Linda died on 1 January this year.

The fund's trust deed specifies a person ceases to be a member of the fund on death.



By when will the fund need to be restructured?

A – 1 July of that year

B – Within six months of the date Paul commences to pay Linda's death benefits



Is Paul Linda's LPR in her will?

If yes – fund continues to satisfy definition until death benefit commenced to be paid

- 6 months from that time

If no – fund fails definition on death unless LPR is appointed

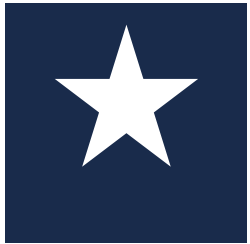
- 6 months from date of death



Can anyone else become a member on death?

Any person who has some beneficial interest in a fund may be entitled to be recognised as a member

Includes contingent beneficiaries – persons who may become entitled to benefits on the death of the member¹



CASE STUDY – The Jedro SMSF

The members of the Jedro SMSF would like to acquire an asset from the fund. However, they can't afford to buy the asset outright and don't want to borrow.



Could the trustees sell the asset to themselves via an arm's length vendor terms arrangement?

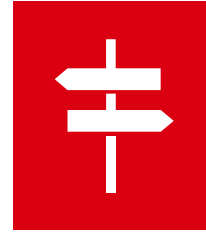


Section 65

Trustee must not lend or provide any form of financial assistance to a member or relative of a member

Loan – includes the provision of credit or any other form of financial accommodation

Credit – an arrangement for deferred payment of a loan or purchase



Alternative

Acquire in instalments and hold as tenants in common with trustee

- cannot lease back to member unless BRP

If member needs to borrow – security must not be provided over whole asset



CASE STUDY – Bill

Bill and his sister run a business together. They recently entered into a buy/sell arrangement using insurances.



Bill decided to take out his insurance through his SMSF. In the event his spouse would receive a lump sum death benefit and his sister would take his share of the business.

If the SMSF was not included as a party to the arrangement, and was in no way bound by the arrangement, would this be ok?



ATO ID 2015/10

Required an SMSF to acquire life insurance as part of buy/sell

Breach of sole purpose test

- contributions not to provide retirement benefits
- insurance policy not used to pay death benefits

Also breach of financial assistance rules



Does it matter that SMSF not bound by agreement

No – fund still used for purpose that contravenes sole purpose test

- If advice provided – SOA would include evidence

Part IVA – why structured that way?

Can it be done through a large fund?

- is trustee aware of purpose?
- beware section 194 of SIS!



Thank you Questions?