The SMSF Academy Podcast - Transcript

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Topic	Satisfying the Retirement Condition of Release
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Aaron Dunn: You're listening to episode 21 of the SMSF Academy Podcast.

Announcer: Welcome to the SMSF Academy Podcast, the show designed to help professionals stay ahead of the curve. Now here's your host, the man that's in the know and shows you how SMSF is done right, Aaron Dunn.

Aaron Dunn: Hi there, Aaron Dunn here from the SMSF Academy and welcome to our SMSF podcast for this week. We continue to get some fantastic feedback from this weekly podcast where we look at the most current topics impacting SMSFs, designed to help you stay ahead of the curve. Now this week we're going to be talking about the issue of conditions of release, an area that is growing in importance around understanding the implications of a member satisfying a condition of release, and in particular, the focus around nil cashing conditions.

So why is this important you may ask? Well it is really important because of the key change that we have seen around the payment of transition to retirement income streams. So, where we have an individual that is currently in receipt of a TRIS we know that from the first of July 2017 that individual has lost the income tax exemption, the earnings that were attributable to that pension are no longer eligible for tax exemption inside the fund. That is, it's gone back to a 15% tax rate. And the only way that that TRIS will be able to move into retirement phase and therefore be eligible for the earnings tax exemption on its fund income is that we need to satisfy a condition of release.

As I've already touched on, this will be an area that I think the ATO will pay far greater attention to, to ensure that the individual has satisfied the relevant condition of release with a nil cashing condition that will enable that individual to move those benefits into retirement phase. Because failure to do so will of course mean that we don't have that income eligible for retirement phase and we clearly have a distinction now in taxation rates of the TRIS that is not in retirement phase versus when we have an income stream that is now reportable against that individual's transfer balance cap.

So first and foremost, when we look at the requirements around conditions of release, we haven't seen any specific changes to Schedule 1 within the SIS Regulations when we look at how an individual must satisfy a specific condition of release. What we have seen is APRA recently update their practice guidance, SPG 280 in June of 2017 that reflected some changes that needed to occur with the super reforms for the RSE licensees. Whilst it doesn't have direct application to SMSFs, it's around the application of the law in respect to the SIS Act and SIS Regulations that is relevant. This updated guidance provides us with some valuable information to revisit what we need to do in respect to retirement for a member whether they are under 60 years of age or a member having attained age 60.

Because of course once we've reached 65 the condition of release of attaining age 65 is ordinarily satisfied. So, our focus here is how or what is the condition, that nil cashing condition, that enables an individual's preserved and restricted non-preserved benefits to be able to move to unrestricted non-preserved benefits. Where we have a member that is under age 60, a member's retirement here occurs when an arrangement under which the

member was gainfully employed has come to an end. And the trustee here needs to be reasonably satisfied that the member intends never again to become gainfully employed on either a full-time or part-time basis.

So, when we look at the definition of gainful employment and we look at what part-time employment is defined as, it is for ten or more hours per week. If we have an individual that has been working and effectively does not intend on working for more than ten hours per week, then they would be eligible once they have reached preservation age to say that they have retired, because they are not seeking or never intending on becoming gainfully employed on at least a full-time or part-time basis.

So, it does come down to this concept of intent and it is very subjective here around whether an individual's intent at one point in time can change in the future that will enable them, whilst currently able to access benefits, if that intent changes, well then does that preclude them from actually saying that they have satisfied that condition of release. It is very easy to say that there was no real intention where that person ceased work on the Friday and said they have effectively retired but then picked up work again on the Monday. So quite clearly there you would say that the individual under the age of 60 actually never had an intention at that point in time that they were never going to seek gainful employment again on either a full-time or part-time basis.

As we move further away from that (retirement date) that intention could change. And I regularly say to people when I do training, that if we get three, five, six months or more down the track, it is not unreasonable that the intent of what that individual did initially may have changed. And that may be because there's only so much golf that an individual can play. It may be that their spouse may not want them around the house and the fact that they don't have other hobbies to keep them going and keep them mentally stimulated that they thought they may have been able to do. Or they may also have some specialist skills that now are in demand that means that they could go back in some way, shape, or form, and do some consulting and specialist work because of that unique skillset that they have. But they may never have seen that coming and never intended to go back and seek that level of work.

So, under the age of 60, it is a decision that because they're the trustee and member themselves, it is something that they're going to need to contemplate and make that decision at <u>that</u> particular point in time. And that's really to the only extent in which you would need to satisfy yourself as the trustee and the other trustees of the fund that <u>the intent</u> was there that you were never going to seek further work. But it is something that you're going to need to very clearly document going forward because if we are moving a Transition to Retirement Income Stream into retirement phase now, we would need to not only show that we're satisfying that condition of release but we would need to put in place the written notice as well to say that we are moving it into retirement phase.

When we look at an individual that has attained age 60 here, the retirement condition somewhat extends (and becomes simpler to satisfy). In addition to this intention to never

again become gainfully employed on a part-time or full-time basis, so if they have genuinely retired there we could move through on that retirement definition. But furthermore, we could also look at this in a far simpler way. And that is that a member's retirement here is considered to have occurred if an arrangement under which that member was gainfully employed has come to an end on or after the member attained the age of 60.

So, this is an important difference here because when we look at this second definition here of having attained age 60 in the APRA guidance, SPG 280, what APRA does confirm in here is that the trustee is only required to be satisfied of the member's cessation of gainful employment. Therefore, the member's future intentions of work here are actually irrelevant once that individual has attained age 60 to satisfy the retirement condition. We're looking here at Item 101 of Schedule 1 in the SIS Regulations.

We can have circumstances here wherein two or more arrangements that an individual has going concurrently, and one of those arrangements actually ceases, what APRA says in this guidance is that they consider this to actually be a valid condition of release of retirement at that point in time. So if we have individuals that may be working two jobs, they may have had a role, a job maybe at the electoral commission (AEC) in addition to their primary role, if they then cease that employment with the electoral commission for example, then that in itself, if they are over the age of 60, would mean that the benefits that they had as preserved and restricted non-preserved would be satisfying that condition of release of retirement and would become unrestricted non-preserved benefits at that time.

Most importantly though, that in itself will not change the character of any preserved benefits that would accrue after the condition of release has occurred. So, the fact that they're continuing on with one or more other employments means that the contributions being made both by the employer and by the member, on the basis that they are eligible to make further contributions, will mean that they will be preserved and won't be accessible until there is a further cashing condition that is met, whether they then genuinely cease work and are retired, or they have ceased a further employment, or ultimately they may attain age 65.

But most importantly there you will end up with a line in the sand so when that initial cessation of employment has occurred, that benefit can move to unrestricted, but any future contributions and benefits that will accrue will continue to accrue to the preserved benefits of that member until such a time that we actually satisfy a further cashing condition.

So this decision of retirement is a real critical one going forward when we think about the SIS Regulation 6.01(7) because, as I've stated throughout the podcast today, we do need to distinguish between the requirements of an individual that has attained age 60 where we only need to look at the cessation of that employment versus the intent of that individual that hasn't yet reached age 60 and what we need to satisfy there around whether gainful employment has ceased and we actually have that genuine retirement having occurred.

The ATO have a really good example on their website in the SMSF resources (section). And we might just go through this to help give you some understanding around the analysis of what the ATO concludes as to whether gainful employment has ceased or not.

So, we have Charlie here who's 57 years of age and the beneficiary of the Crackle Discretionary Trust, and Crackle here carries on a smash repair business. Now Charlie's been an employee of Crackle for 20 odd years and for the 2016/17 year he then ceases his employment within that business and he's paid out any accumulated leave entitlements that are owed to him at that particular point in time. Now what we have is a situation where Charlie is no longer under any employment contract with either Crackle or any other entity, a related party or at arm's length.

So, the directors of the trustee of his SMSF, of which he's a member, are satisfied therefore that he never intends again to be gainfully employed on at least a full-time or part-time basis. So Charlie's fund then starts to pay him an account-based pension. However, after Charlie's employment has ceased he then continues to perform substantive duties for Crackle, much the same as was the case when he was actually an employee. And instead of receiving remuneration by way of salary and wages, he is now receiving distributions of trust income from Crackle.

So, when we look at the analysis here of what's actually gone on, as I've touched on earlier the superannuation definition of retirement for a person under age 60 is to determine whether we have a cessation of employment and never intending, so this intention to again be gainfully employed. Now, if we have passive income such as the receipt of rent, trust distributions, dividends and so forth, this is not ordinarily going to effect the retirement definition, as the income here that is received is not a direct result of specific actions or exertion by that member in respect to a particular task.

However, where we've got the situation where the business is operated through a family trust or private company, like is the case here in Charlie's example, the ATO makes very clear that they would look a lot closer at the arrangement before they can determine that Charlie has actually satisfied the retirement condition of release. And this is now critically important because this is where we're moving, even if it was a TRIS being paid to him, that he's now subject to 15% to a TRIS in retirement phrase that would be a zero percent tax rate. But he's got an account based pension here so we're moving from accumulation to retirement phase in this case.

So, like I said, where the business is operating through the family trust or private company, the ATO will take a closer look at it and work out here whether there's any evidence that he was actually still performing these substantive duties for the business. And that in itself could indicate that there is an ongoing relationship between the two, so the business and him. Even though he's in essence been paid out for his role as part of his termination there.

So, it's usual, it's unusual I should say, for a business like Crackle to allow someone who is not contracted to assist in the ongoing running of the business without some form of

agreement or understanding that would be in place. So, if Charlie's work here leads to an increased level of turnover for the business that results in larger distributions or disproportionate increases in dividends, the Commissioner here could actually take the view that the arrangement under which Charlie was gainfully employed has not actually come to an end as he's still receiving ‘gain or reward’ from the distributions from the Crackle Discretionary Trust.

So as each business and arrangement here is going to be different, it would always have to be decided on a case-by-case basis here around what substantive duties would ultimately entail. However, what the ATO makes clear in this example is that the follow factors may be taken into consideration. So, the time that Charlie may spend assisting the business, so we would need to satisfy the trustees here that Charlie does not intend to work more than ten hours a week in the future, because if it's less than ten hours then he's not gainfully employed on at least a part-time basis. Also, that the effect, the expectation, or understanding, or agreement that Charlie will receive reward for his efforts even if it's not in the traditional form of salary and wages. They'll also contemplate whether the amount received is linked to Charlie's direct or indirect performance. They'll also look at whether the payments received are referred to in Crackle's trust deed and then whether the business will be able to operate or earn as much income if Charlie was not performing these duties.

So, the result here is although Charlie's employment contract was terminated and he's been paid his leave entitlements, the fact that he's continuing to assist Crackle, performing essentially the same duties as he did as an employee, but just, I guess, disguise this up in some other way, shape, or form, in their view would warrant further consideration as to whether a condition of release with a nil cashing restriction, i.e., retirement has been satisfied. And based upon the facts available, the Commissioner here could not be certain that Charlie has satisfied that retirement condition of release.

So the ATO makes very clear here that for individuals who are under the age of 60 and thinking of either starting an income stream or whether they're moving their Transition to Retirement Income Stream into a TRIS in retirement phase or commuting and repurchasing it as an account-based pension, it is critical that extra care be taken to ensure that the individual has satisfied the trustee and, if required, the ATO that they have ceased to be gainfully employed and that they do not intend to be gainfully employed into the future.

So, like I said this is something that is going to have far greater scrutiny put on this topic going forward because of the clear distinction, not only from accumulation to retirement phase, but also through this TRIS function as well. So, if you do have any other questions that you'd like to ask around the conditions of release, if you've got any examples that you'd like to run past me, I'd be more than happy to contemplate that for you. I encourage you to look at the ATO's site and find out a little bit more around the ATO's views on this. Also look at APRA's guidance, SPG 280, that provides us with a little bit of further information around the payment standards and what an individual under 60 versus a member having attained age 60 is required to do as well.

Thank you for joining me in today's SMSF Academy podcast. I hope you got plenty out of it. If you've got any other questions you can reach out to me at info@thesmsfacademy.com.au or through our various social media channels.

I look forward to you joining me for our next podcast where I'll be joined by the CEO of Class, Kevin Bungard, and we'll be talking all things around Class's benchmark report, some of the challenges, issues, and opportunities confronting professionals because of these changes. Other than that, have a great rest of the day and I look forward to you joining me soon. Take care. Bye now.

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