Podcast Show - Transcript

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Aaron Dunn: Hi there. You're listening to the SMSF Academy Podcast, and this is Episode 18.

Speaker 2: 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 everyone. Aaron Dunn here from the SMSF Academy, and thanks for joining me again for the SMSF Academy Podcast. Great to be back in getting this podcast up and running on a regular basis. We had some fantastic feedback from our last episode where we looked at the ATOs position paper around events based reporting. I want to stay on the same theme today when we talk about the topic of paying pensions, because it is an area, in my view, that we're going to see an increasing level of importance in making sure that we get this area of, not only advice, but also in the operation of those income streams correct as well.

What we're going to go through today is talk a little bit about these new risks and also opportunities of retirement phase income streams under the superannuation reforms. We'll also look at how we're taking benefits, both in terms of some of the strategic considerations, but in particular, some of the lessons we've now learned from the ATO as a result of the introduction of these measures, in particular, when we consider the guidance within PCG 2017/5 and what we need to contemplate in respect to how we may be taking income stream benefits into the future.

Now, over the past month or so of being around the country presenting, emceeing, and so forth, attending both the Class Connect Conference and also BGLs RegTech events. One of the things that really stood out in the conversations that I was having with professionals is this, I guess, lack of understanding in how these income stream rules are really going to impact on the ability for tax exemption being claimed in the future. We know with a key difference now between a transition to retirement income stream not being eligible to being retirement phase until that condition of release has been met against an account based income stream that does have that retirement phase income tax exemption. It means that some of the requirements, in particular, conditions of release, are going to have far greater scrutiny, not only at an audit level, but also right through to the ATO ensuring that the tax exemption is ordinarily applied and, therefore, allowed. One of the things, like I said, that I found in conversations that I had right across these conferences is the amount of usage of individuals with the software generated pension documents.

Now before I go into that topic, I just want to preface this with some background information to help give this some context. We have seen, over the past 6, 7, 10 years, a greater focus on, when we look at case law, a greater focus on death benefit nominations. If we go back some time, it was an area that didn't have a great level of attention addressed when we looked at death benefit nominations. What we have seen, over time, is the courts take a very dim view where the trustees haven't put in place death benefit nominations that aligned themselves with the trust deed of the fund. In many instances where we looked at blended families, what that meant was we had an invalid death benefit nomination. That ultimately meant that there was a level of discretion allowed for that remaining trustee, and whilst the wishes of the deceased member may not have been carried out, there was really no legal standing for the beneficiaries that were challenging that decision to be successful because there was an invalid nomination. Only since this is really starting to be addressed at a greater level inside the industry are we seeing the real importance of individuals putting in place that death benefit nomination that lines up with the trustee.

Now let me go back to the conversation that I was starting earlier around pension documents, because not only in the conversations that I was, like I said, having at these events, but also as a follow up, we ran a bit of a straw poll across our members at a recent

webinar that we held. What we found that is around two thirds of practises are still using SMSF software generated documents. Now, you might be saying, "Well, what's the problem with that?" In theory, there may be no problem, but are you absolutely sure that the documents are lined up with the funds governing rules? Because when we think about the potential risks of not aligning your pension documents to the governing rules of the fund, if it's not being paid in accordance with those rules, then there is genuinely now a potential loss of tax exemption of that retirement phase income stream. When we think about tax ruling 2013/5, the Commissioner makes very clear inside that tax ruling where we fail to comply with the terms and conditions of the income stream, let alone the SIS Regulations, then that pension would ordinarily fail.

There is a potential loss of tax exemption there in addition to some of the more strategic opportunities that would now be allowed, subject to how the pension documents are drafted. A couple of really good examples that have come to the fore over the past few years have been the ability to alter those terms and conditions of that income stream without having any detrimental impact on entitlements that an individual may be able to receive. Something like an age pension, if we think about income streams that are prior to the first of January 2015, we have had confirmed that if we add a reversionary beneficiary to a pre-January 2015 income stream, the grandfathering that is attached to that income stream from a selling point of view would actually carry on.

The only way that we can really make any alteration if we're not following the terms and conditions that have been imposed by the deed, would therefore be with the pension to commute and repurchase that. If we, for example, wanted to add a reversionary beneficiary, and that in itself when we think about some of the risks is going to increase the level of reporting to the ATO, because we're going to see commutations and repurchases. Then if we don't complete that within the prescribed time frames once we get past our transitional period, well, there would, of course be, some administrative penalties around that as well.

The other area of risk that I see may be around transition to retirement income streams. We have seen some changes to these rules prior to the first of July 2017 that will allow for a TRIS where a condition of release has been met, so retirement, attaining age 65, and so forth, where the provisions of the 10% maximum would ordinarily fall away for income tax purposes and allow for that benefit to move to retirement phase. Now, again, subject to the way in which the terms and conditions of that income stream have been drafted and the way in which it correlates back to the trust deed itself, some of those conditions may be hardwired into that income stream. Again, if we have a situation whereby the requirements for retirement phase income stream allow for that 10% to be removed, if the deed itself or the pension terms and conditions haven't, without some formal ability to do so to remove that, then again, we're going to fall back to that breach in respect to the not meeting the pension or payment standards around the operation of that pension. Going back to TR 2013/5 around where a pension commences and ceases, in that regard, we'd have a pension that would cease and, therefore, again, it puts into the loss of tax exemption because the pension will be deemed to have ceased at the start of the year.

It is an area that, like I said, I'm seeing a far greater level of attention needing to be looked at with the new superannuation reforms. I'd encourage you to be going back and looking at what the governing rules of the funds say and how the documentation that you may be generating from your SMSF software correlates back to the deed. If there's any doubts in that, you may want to contemplate how you need to tie that information back up together. The way we do it in our deed is we effectively allow for the pension to occur. That pension documentation can become what's called a special rollover fund. The importance of that process means that we can then, into the future, if we wish to alter those terms and conditions in respect to the specific income stream. A good example there, again, is the

ability to add a reversion or remove a reversionary beneficiary. By virtue of altering those terms and conditions, we can very quickly do so, and there may be an opportunity there as well to do that around the transition to retirement income streams and altering the terms and conditions to allow for that to convert to an account based pension. There are, certainly, some benefits there as well by having properly constructed pension documents.

The other thing that I wanted to look at here today is around the taking of benefits. This is something, again, when we look at the new environment and what we've learned from the practical compliance guidelines that the Commissioner has set out, is that we need to contemplate, going forward, how these benefits are going to be constructed. If we have, say, a member who's 67 years of age and they got $1.6 million of benefits in retirement phase so their minimum pension at 5% is going to be $80,000 a year. The question, though is, is if they're going to have to take $150,000 out during this income year or in a future income year, what is the best way in which to take that income and take that benefit payment over that particular financial year?

When we look at what the Commissioner spoke about with the PCG 2017/5, if we are going to look at commuting, maybe, amounts above that minimum, then the timing of those commutations is going to be critically important. We aren't going to have the benefit of hindsight as we've had for some time now when it comes to these benefits. If someone takes $150,000 out, we just tell them to take that money out, and when we get to the end of the year, we would look, ordinarily, at the allocation and work out the best way in which we would, arguably, treat that benefit payment. That may have included just taking this pension. There may have been some level of commutation where we've looked at a partial commutation and maybe elected to use the Reg 995 election where we could've taken some of that amount out and traded it against the member's low rate cap where they're under the age of 60.

There are plenty of ways in which we could cut that cloth. Even where we had that partial commutation, we could include that towards the minimum pension for the year where we had our SMSF determination 2013/2. Some of those things have changed because we, of course, have seen the repeal of regulation 995103 in the income tax regulations. We've also seen, within section 107D, that the amount that is taken as a result of a partial commutation will not count towards the minimum pension obligation. There are two key changes that have gone from the '16/'17 financial year into the '17/'18 year.

Again, going back to this requirement of the $150,000, what we're going to have to contemplate up front now is how we're going to deal with those above minimum amounts. Now, ordinarily, we might just take that out as the minimum pension, but it's not going to count towards the member's transfer balance at all. Those pension payments don't create a debit in respect to that benefit that is being paid. Now, that might not pose a problem but, in a lot of instances where we've got a husband and wife who the combination of those two is going to be greater than the transfer balance cap of the survivor, we do want to start to think about how we might be triggering those debits back off with the above minimum amount. As a general rule, what we're going to be doing is first taking the minimum pension then, second, we're going to contemplate whether the member has any accumulation benefits, which we would look to be taking those next. The reason for that is we want to increase the level of tax exemption that we would have in the fund.

Third, we'd be contemplating undertaking a commutation and then treating that amount as a lump sum. The rationale for that is, is that it would trigger a debit against that member's account so in the event of the death of that member, we then have the ability to use that debit against their account when we need to contemplate maybe the reversionary income stream that's continuing to be paid or a pension that is going to be paid because of those changes we have seen to SIS Regulation 6.21 that will only allow for the income stream to

be commenced or continue within the confines of the transfer balance cap. Otherwise, the benefit must come out as a lump sum.

There are a few decisions that need to be made in there but we're not going to have the ability to do that at the end of the year. What I'm seeing and what I've had to discussion with a range of practitioners including some of our members is putting in place documentation as part of the ongoing pension requirements to consider how the benefits are going to be taken for the year and where an individual might not necessarily know what they're going to take at the start of this financial year. They would want to be clear in respect to how those benefits are going to be paid over that financial year. So, thinking about where we had this $80,000 minimum with our member here and they're going to take $150,000 for the year, I think we would want to be very specific in respect to that they intend on taking the minimum pension for the year and that any amount above that minimum, they may look to commute that income stream for those above amounts.

They may also, if there's an accumulation account, where they complied with the transfer balance cap, you may look to take those additional amounts out as accumulative benefits but what PCG 2017/5 has taught us is that this conscious decision to exchange the right to income steam for a lump sum needs to be made before the fact. This is where, in the PCG you may recall, we needed to undertake that commutation prior to the 30th of June. We didn't need to quantify what that amount was but we needed to have ensured that the request had occurred that had been subsequently accepted by the trustee and then as part of the completion of the financial statements at the end of the year. We would then ensure that that commutation amount has been confirmed and reflected in the financial statements as such. This same sort of principle here, I think, should be applied in respect to how we're going to be taking benefits.

We may not know at this time what the level of income is going to be taken by that particular member. We may know that it is going to be a $150,000 and we may be looking at setting aside how that benefit is going to be taken and I would be making that clear up front prior to the benefit being taken. So rather than having the benefit of hindsight and looking at this after the fact, we need to be far clearer in respect to how we're doing this.

If we didn't know that it's going to be a $150,000 or maybe but we're not sure, this is where I think we need to be far smarter in the documentation that we're preparing in so far that we will be taking that minimum pension and then we would be specifying that we intend on taking any amount above the minimum would be requested by the member to be treated as a commutation and we would have that subsequent acceptance come back from the trustee confirming that that's the case and where such an amount happens to be withdrawn in the future above that minimum, that would be confirmed. That then looks like a view that is consistent with what the regulator stated in 2017/5. The same principles again, like I said, would apply around accumulation. In both instances, I think we need to make sure we've stated that fact first and then we would enable ourselves to treat the amount when that event has occurred as the lump sum withdrawal from the accumulation account or whether it's done as part of a commutation because what is going to be critically important going forward is that we're able to ensure that we get that reporting done within the prescribed time frames for the current year but right up until the 30th of June, we will have the ability to report those up to the 1st of July 2018.

As our transitional period for SMSF and then we may be required to be reporting that debit either 10 days after the end of the month in which that event occurred, which is going to be in line with the August legislative instrument in which the TBAR reporting would ordinarily occur, or the Commissioner is going give us missives an additional two year window beyond the 1st of July '18, transitional period to effectively have that reported 28 days after the end of the quarter. As we stand here in early September 2017, we don't know as yet

what that time frame is going to be so you'll just need to follow, ultimately, what those reporting obligations would be. Importantly from that, there is going to be a reporting time frame that we're going to need to adhere to as well in respect that commutation.

The argument then, and the reason why I say this and why I think it is so important, is that if we look to take the benefit and later on we look to undertake that commutation, what the Commissioner talks about in TR 2013/5, is that there's a valid and conscious decision to exchange what was an accumulation at what was a pension benefit into a lump sum benefit and that decision needs to be made prior to the benefit being paid and is also confirmed within the SMSFD 2013/2. If we don't put that in place up front, what we're going to see or what the potential is that may occur, is that the ATR may say, "Well, no you don't have a valid commutation because the request has happened after the event has occurred." Rather than happening prior to is what should've happened initially. So if we look at the commutation requirements in TR 2013/5, the request to commute takes effect as soon as the trustee's liability to pay the periodic superannuation income stream benefits is substituted with a liability to pay that member or dependent beneficiary a superannuation lump sum. There is, in essence, a requirement to ensure that that's done prior to the actual event occurring and that was also the case when we looked at our regulation 9951 requirement where the election needed to be done up front.

If we don't put that in play, it could be argued that the commutation didn't exist and therefore it would need be treated as a pension. We don't get the debit in respect to that member's transfer balance account, which could have longer term implications for them. It's just an area that I think it is going to be growing in importance when we think of the way in which we structure our income streams, both initially so the documentation that we put in play to enable that pension to be paid. We need to, I think, in my view, spend very close attention to how we're drafting our pension documents. The analogy I used earlier around death benefit nominations has certainly highlighted some gaps around the way in which that information was previously prepared and it has really, through an educative process, in many instances, the hard way, unfortunately for some clients, has meant that there has been a far greater level of attention to that. Now the concept of a standard template for a DBN really no longer exists and we are seeing that those DBNs done strictly in accordance with the way in which the trust deed requires it to be done.

I think this next evolution we're going to see is going to be around the payment of income streams because, again, there will be certain risks involved where they haven't aligned to the governing rules of the fund and if they're not aligned with the governing rules, it will come with some inherent risks in respect to that. Not only in respect to the tax exemption but also in respect to the advisor or professional who is preparing that paperwork as well. Something we should clearly take a close look at in terms of how you are currently going about that. We have included below, with this blog post, as part of our podcast a question, so poll, where we're asking these question of you in terms of how you're currently preparing your pension documents.

I'll be really interested in some feedback from you in terms of how you are doing it and what you see as maybe the benefits and risks. Clearly the benefits of using the software, is it saving you time? Are you doing a lot of work in there? What, I guess, the industry is now trying to focus on is this, "Well how can you get to a point where you can't replicate that efficiency as such?" But you can use the API to be able to pull that data out and populate documents that would correlate back to the trustee and send that information straight back into your Class Super or BGL Simple Fund 360 software and do that as efficiently as you possibly can.

If you could maybe please provide some feedback in our poll in respect to how you are currently doing that work, that would be much appreciated. Other than that, that was really

just about it. Making sure you're understanding not only the preparation but the ongoing payments, in particular, with the greater than minimum amounts. There's not only a priority of how you might be taking those benefits out but thinking about, again, how you'll be documenting that on an ongoing basis over and above what the TBAR reporting will be as well, taking into account the guidance that the ATO has provided us around the practical compliance guidance as well.

So that's it for me. Thank you once again for joining us for our SMSF Academy Podcast. I hope you found today's podcast of great value. If you do have any questions, please feel free to reach out to us at info@thesmsfacadmey.com.au or through our social media channels. Other than that, I wish you a pleasant rest of the day and I look forward to catching up with you in our next podcast.

Speaker 2: Thanks for listening to the SMSF Academy Podcast. Please note that the podcast provides general advice only and is based upon our understanding of the law at the time of the recording. If you have any comments or questions from this podcast or wish to subscribe to the series, you can find us at thesmsfacademy.com.au, tweet us @thesmsfacademy, like us on Facebook, or connect with us on LinkedIn.