

ANTI-DETRIMENT DEDUCTIONS FOR SMSFs

Anti-detriment deductions, more formally known as 'tax saving amounts', have been available to super funds for many years.

After tracking the history of anti-detriment deductions, this paper details how they can be of benefit for SMSFs.

History

The 15% tax on contributions and super fund income was introduced by the then Treasurer, Hon. Paul Keating, from 1 July 1988.

Criticism of the introduction of the tax included, among other comments, that it was an effective 'death tax'.

The reason for claiming the introduction was a death tax revolved around the fact that the eventual payment of benefits, following the death of a member, would be lowered as a result of the tax being introduced at that time. The flow-on effect, it was claimed, would be to the detriment of the dependants of the deceased.

To overcome that criticism, legislation was introduced which would allow a 'claw back' of taxes paid by the superannuation fund in respect of the deceased person's:

- taxable super contributions; and
- income credited to their member's account.

Calculation of Taxes Paid

The amount of tax paid for anti-detriment purposes can be calculated in a number of different ways, although the two most common options are either:

- calculating the amount of **tax actually paid**; or
- applying a **formula**.

Although trustees may select either method for calculating the amount of tax paid for anti-detriment purposes, applying the 'tax actually paid' method would generally only be used when the member was in the fund for a short period of time.

The formula method is more commonly used, particularly for longer term members, as it is a simpler method than wading through records for many years of transactions.

Additionally, records may not be available to the fund trustee, as some benefits may have been transferred from another fund.

In an interpretative decision, ID 2010/5, the ATO confirmed a formula which may be used when calculating the amount of tax paid for anti-detriment purposes.

Anti-Detriment Calculation

Calculation of the anti-detriment amount using the formula is included later in this paper. An example of the 'tax actually paid' method is provided below.

In this example, a member has contributed \$25,000 per annum for four years, and the fund has received income of \$1,250 per annum. Tax of \$15,000 has been deducted from the contributions, and \$750 from the income.

As this example covers a relatively short period of time, the actual tax paid method can be easily used.

The amount of tax paid equals \$15,750, being \$15,000 and \$750, as mentioned above.

The member balance is \$89,250, which would ordinarily be the amount paid to the beneficiaries, before considering the application of the anti-detriment deduction.

Assuming the trust deed of the SMSF permits the trustee to pay the increased amount, and the trustee decides to do so, the death benefit is then increased by the sum of \$15,750.

Details	Contributions		Income		Total
	Amount	Tax	Amount	Tax	Net
Year 1	\$ 25,000	-\$ 3,750	\$ 1,250	-\$ 188	\$ 22,313
Year 2	\$ 25,000	-\$ 3,750	\$ 1,250	-\$ 188	\$ 22,313
Year 3	\$ 25,000	-\$ 3,750	\$ 1,250	-\$ 188	\$ 22,313
Year 4	\$ 25,000	-\$ 3,750	\$ 1,250	-\$ 188	\$ 22,313
Total	\$ 100,000	-\$ 15,000	\$ 5,000	-\$ 750	\$ 89,250

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That results in a total amount to be paid to the beneficiaries of \$105,000 (i.e. the before tax amount of contributions and income).

When the trustee of the SMSF is preparing the annual (income tax) return for the year in which the increased benefit was paid, it will claim the allowed deduction. That deduction is calculated by taking the increased amount, \$15,750, and **dividing** that amount by 15%. The resulting deduction is calculated as:

$$\$15,750 \div 15\% = \$105,000$$

In many SMSFs, a deduction of \$105,000 is likely to create a tax loss for that year. It may take some years of taxable income before the loss has been cleared.

That will be covered in more detail later in this paper.

Process to Claim Anti-Detriment Deductions

The claim for anti-detriment deductions can only be made if the death benefits are paid from the superannuation fund in the form of a lump sum, and also provided that the benefits are paid to:

- a spouse;
- a former spouse;
- a child (of any age) or
- Legal Personal Representative.

In the year of the payment of benefits, the amount paid from the deceased member's account or accounts in the fund can include the increased amount, calculated in accordance with the formula or the actual tax paid method.

The taxes that are calculated to have been paid in respect of the deceased member are clawed back by way of a tax deduction claimed

by the superannuation fund, as previously mentioned.

The amount of the deduction is then included in the annual return of the fund in the year of payment.

Any surplus deductions over and above the income of the fund for the year can be carried forward to future years and offset against future income.

That carried forward loss will often be reflected in the books of the superannuation fund as a 'Future Income Tax Benefit', and will be gradually reduced over future years through income received each year by the fund. Effectively, future income will have a 'tax holiday' until the carried forward income losses have been exhausted.

Funding the Increased Payment

Payment of the increased benefits can give rise to complications within an SMSF, because the funds needed to pay the increased benefit must be sourced from limited options. Generally, the increased amount will be sourced either from:

- a reserve, created for that purpose; or
- pooled funds held, effectively, for other members.

Reserve

One option for funding the payment of the increased amount is to use a reserve. At the time of making an anti-detriment payment to dependants, following the death of a member, the funds would be drawn from that reserve.

However, a complication in respect of the use of reserves is that the ATO has deemed that any payment

from a reserve in respect of the death benefits of a member will be assessed under the Concessional Contributions cap, which may result in an assessment for Excess Concessional Contributions tax.

Therefore, the additional tax payable may not warrant the exercise of paying the increased amount and claiming an anti-detriment deduction.

Pooled funds

The other common option is to use money held within the fund to pay the increased amount.

That money, whilst being part of the overall assets of the SMSF, effectively represents the benefits held for other members in the SMSF. Therefore, cash would be paid out of the fund and, in the accounts of the fund, would be replaced by the 'Future Income Tax Benefit' asset.

The remaining members of the SMSF may agree to such action, given that they will be effectively receiving a 'tax holiday' in respect of future contributions and income for a period of time, until the carried forward loss has been recouped.

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The trust deed of the SMSF should permit the trustee to apply pooled funds and create an asset titled 'Future Income Tax Benefit', or similar.

Case Study - Anti-Detriment Deductions

Having considered the calculation of the tax saving amount using the 'actual amount of tax paid' method, let us apply the ATO formula provided in ID 2010/5.

That formula is:

$$\frac{(0.15 \times P)}{(R - 0.15 \times P)} \times C$$

Where:

P = Days in R after 30 June 1988

R = Days in service period after 30 June 1983

C = Taxable component of Lump Sum after excluding insurance proceeds (if deduction claimed)

If we apply the formula in the situation of Stuart, born 1 January 1957, who commenced his service period on 1 January 1974 and passed away on 1 January 2012, using a superannuation benefit of \$600,000 (\$250,000 of which represents tax free component), with no insurance

proceeds, we see the formula will pan out as follows:

1974 Service Period

P = 8,585 days in R after 30 June 1988

R = 10,412 days in service period after 30 June 1983

C = \$350,000

$$\frac{(0.15 \times 8,585)}{(10,412 - 0.15 \times 8,585)} \times (\$600,000 - \$250,000)$$

$$\frac{1,287.75}{9,124.25} \times \$350,000$$

Tax saving amount = \$49,397.

The amount of the death benefit, initially \$600,000, is increased by \$49,397, meaning the total lump sum benefit payment will be \$649,397.

To recoup the amount of tax paid, the trustee of the SMSF includes a deduction in the annual return in the year of payment of the benefit, of \$329,315, calculated as:
Tax deduction = \$49,397 ÷ 15%.

2004 Service Period

If all of the details regarding Stuart remained the same, except for the commencement date of his service

period, which is changed to 1 January 2004, the result will vary considerably.

P = 2,922 days in R after 30 June 1988

R = 2,922 days in service period after 30 June 1983

C = \$350,000

$$\frac{(0.15 \times 2,922)}{(2,922 - 0.15 \times 2,922)} \times (\$600,000 - \$250,000)$$

$$\frac{438.30}{2,483.70} \times \$350,000$$

Tax saving amount = \$61,765.

Death benefit =

\$600,000 + \$61,765 = \$661,765.

Tax deduction = \$61,765 ÷ 15% = \$411,765

The table below summarises the situation in regards to Stuart's death benefits and anti-detriment deductions, both in respect of the 1974 service period and the 2004 service period, as well as between benefits paid to a spouse and to non-dependants, such as adult children.

	1974 Service		2004 Service	
	Spouse	Non-Dependents	Spouse	Non-Dependents
Gross Benefits	\$ 649,397	\$ 649,397	\$ 661,765	\$ 661,765
Tax	\$ 0	-\$ 65,900	\$ 0	-\$ 67,941
Net Benefit	\$ 649,397	\$ 583,497	\$ 661,765	\$ 593,824
Deduction (SMSF)	\$ 329,315	\$ 329,315	\$ 411,765	\$ 411,765
Value (15%)	\$ 49,397	\$ 49,397	\$ 61,765	\$ 61,765
Net Overall	+\$ 49,397	-\$ 16,503	+\$ 61,765	-\$ 6,176

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It can be seen that the application of the anti-detriment deduction significantly enhances the position when benefits are being paid to a spouse, because of the fact that no tax is payable on the benefits, including the increased benefits whilst, at the same time, the fund is obtaining a significant tax benefit.

For non-dependent beneficiaries, the increased benefit is subject to tax at the rate of 15%, so it is important to give consideration to the viability of increasing the

superannuation death benefit payments.

It can be seen from the table above that the tax deduction significantly mitigates the tax to be withheld from the benefits being paid to the non-dependants, in the circumstances outlined for Stuart.

Conclusion

The trust deed of the SMSF must permit the payment of an increased amount in addition to

any death benefit paid as a lump sum to specific beneficiaries, if the trustee wishes to do so.

For the payment of an increased amount of death benefits to be viable for an SMSF, future taxable income of the fund will be a vital component.

That will enable the trustee to 'claw back' the amount paid out as an increased death benefit by way of carry forward tax losses, until those losses have been extinguished.