

## TAX RELIEF FOR SMSF INCOME STREAMS

The Government legislated to provide tax relief for superannuation funds, following the death of a pension recipient, which explains the ATO's delay in producing a final version of its draft Taxation Ruling TR 2011/D3. We look at how the new regulations may impact super funds and the beneficiaries of deceased pensioners.

When the ATO released its draft Taxation Ruling TR 2011/D3 – Income tax: when a superannuation income stream commences and ceases in July 2011, many in the superannuation industry were disappointed with the conclusions reached by the ATO.

In particular, the ruling that a superannuation income stream ceases as soon as the member in receipt of the superannuation income stream dies, unless the pension automatically reverts to a dependent, resulted in many submissions to the ATO.

It was well documented following the release of TR 2011/D3 that the major impact the ruling would have was the taxation of income and realised capital gains on assets supporting the pension, following the death of a pension recipient. The only relief from that immediate taxation, according to the ATO in its draft ruling, was the certainty provided by a valid automatic pension reversion nomination.

Without a valid automatic pension reversion nomination, even if a new pension was subsequently commenced, income and realised capital gains received in respect of the pension assets during the period from date of death of the pensioner to commencement of a new

pension, according to the ATO, would be taxable.

A scheduled date for the release of a finalised version of TR 2011/D3 was deferred a number of times, and the reason for the delays became clearer in October, 2012.

Despite much speculation of 'horror stories' leading up to the October 2012 Government '2012-13 Mid-Year Economic and Fiscal Outlook', more commonly referred to as 'mini-budget', the Government instead, and much more pleasingly, announced it would legislate to allow a tax exemption to continue for a period of time after the death of the pensioner.

The final version of TR 2011/D3, TR 2013/5, also titled Income tax: when a superannuation income stream commences and ceases, was released in July 2013.

Regardless of the outcome contained in TR 2013/5, much of the 'sting' flowing from TR 2011/D3, the part which suggested the pension would cease following the death of the recipient, unless subject to an automatic reversion, has been made redundant. In particular, the impact of tax on the realisation of assets following the death of a pension recipient has been removed or, at least, significantly reduced as a

result of the Government announcement and subsequent legislation.

The Government subsequently made amendments to the Income Tax Assessment Regulations 1997 through the introduction of Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013. The amending regulations provide a tax exemption, following the death of a member, in relation to assets supporting a pension previously payable to the member:

- if no automatic reversion of the pension occurs; and
- the benefit is paid as either a lump sum or a new income stream; and
- the benefit is paid as soon as practicable after the death of the member.

When the ATO subsequently released the final ruling it, surprisingly, made no reference to the amending legislation. Whilst restating (remembering, in a Taxation Ruling) that a pension would immediately cease on death of a recipient unless it was to automatically revert to a beneficiary, it made no mention of the taxation relief provided by the amending regulations.

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Some of the initial questions answered once the regulations were introduced, and a final ruling released, include:

## 1. What is the position regarding the taxation of benefits in the period 1 July 2007 to 30 June 2012?

The ATO suggested in the draft ruling that it would be effective from 1 July 2007, despite being released in July 2011.

The final ruling restated that it applies from 1 July 2007, but provided relief in that the ATO stated "... it is not appropriate ... to take compliance action ... with regards to when a superannuation income stream ceases on the death of a member before the 2012-13 income year".

The amending regulations also apply in relation to the 2012-13 and later income years.

Effectively, the ruling under TR 2013/5 applies from 1 July 2012, as the ATO will not be reviewing transactions from prior years.

## 2. Why the references to 'deceased estates' in the heading and the body of the Government announcement?

We know that superannuation benefits often do not pass to the estate of a deceased member and, in fact, may be retained within the superannuation environment to provide an income stream to one or more dependents.

Although there was concern following the Government press release that the regulations, when

made, may include some sort of limitation designed to have benefits pass through the estate, those concerns were proven to be unfounded.

The tax relief provided under the regulations applies regardless of whether the benefit is paid by way of a lump sum, either to the deceased estate or directly to beneficiaries, or as a pension.

## 3. The Government press release also refers to 'fund the payment of death benefits'. Do the exemptions also cover the situation where the pension ceases and a new pension is subsequently commenced at the discretion of the trustee?

References to both 'deceased estates' and 'fund the payment of death benefits' raised the above question.

It appears the use of the words caused some confusion, as 'death benefits' includes both income streams and lump-sum payments. The commencement of a new pension within a reasonable period of time will result in the income or realised capital gains, from the assets supporting the pension, received between the date of death of the pension recipient and the commencement of the new pension being treated as exempt current pension income.

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### 4. What about the other issues raised by the ATO in the draft ruling?

Whilst the aspect of the pension ceasing on death certainly received a large amount of attention, the ruling also covered many other issues, including:

- the decision that a breach of the pension standards could result in the loss of the tax exemptions, in respect of that pension, for a full year;
- the fact, regardless of the tax situation, that pensions were considered to cease on the death of the recipient, unless an automatic pension reversion nomination was in place;
- the effect, if that 'cessation' still applies, on proportioning of benefits - will the various pensions, with differing tax components, be mingled together with the deceased member's accumulation funds, on the basis that:
  - the pension has ceased; and, therefore
  - a member may only have 1 non-pension superannuation interest (within a SMSF)?

The final ruling has provided answers to each of the above, namely:

- no change - a breach of the pension standards, such as failure to pay the minimum annual pension, will result in the pension effectively having ceased for that year, with the taxation consequences being loss of the exempt current pension income deductions for the year and, possibly, any

payments made being treated as 'illegal early access' if the recipient was not entitled to draw a lump sum;

- no change - the pension will still cease on the death of the recipient, unless a valid automatic pension reversion nomination was in place;
- change - although the pensions will have ceased, the individual pension accounts (if more than one) will not be merged, will retain their individual taxation components, and will be able to be dealt with separately.

In conclusion, the positive news from the new regulations was welcome for those instances where an automatic pension reversion nomination is either not in place or will be unable to be implemented. We suggest that automatic pension reversion nominations continue to be of significant importance and, where possible, be included in pension documentation.

### More information

Should you have any queries or require more information, please contact the team at Topdocs on 1300 659 242.

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