

TAX AND ESTATE PLANNING FOR SMSF INCOME STREAMS

This technical paper reviews tax and estate planning strategies for SMSF income streams.

"I am not worried about the tax on my super benefits when I am gone - my children will need to worry about that."

Have you ever had a client make a similar statement when you were suggesting strategies to reduce tax payable on the death of the SMSF member/client?

There may be a number of reasons why the client made that statement, such as:

- they are over age 60, so are not taxed on their pension; or
- they consider it to be a fee generating exercise; or
- they either do not see the benefit or, if they do, are genuinely prepared to leave the problem to their children; or
- a combination of some or all of the above.

Cost of doing nothing

Each of those 'objections' may be real (at least in the mind of the client) - what the client may not understand is the amount of tax which planning now may save in future.

Alternatively, they may consider that the cost of taking action now, so as to obtain a benefit at a later date, may be wasted if, for example, they are able to plan the withdrawal of all of their superannuation prior to their death.

The issue really is not so much for the client, but for those left behind and, unfortunately, given the increasingly litigious society we live

in, the adviser may be the one most impacted by the lack of planning, despite their best endeavours.

There have been cases in the courts in recent times where children of a deceased member of a SMSF have initiated action against their deceased parent's adviser, to recover 'lost' entitlements. As the parent is not around to blame, and as the adviser will have insurance cover, the adviser represents a relatively easy target.

What tax and estate planning could be undertaken?

Let us consider the position of Penelope who, after recently turning 60, has changed employment, meaning she can access her superannuation (amounting to \$750,000) tax free. She is divorced and has 3 adult children, none of whom are dependent upon her.

Penelope's employment income is sufficient for her day to day cost of living needs, so she was not intending to commence access to her superannuation until she retires at age 65.

However, she is prepared to listen to suggestions outlining ways to increase the amount left behind for her children, and decrease the amount of tax that will be deducted from their eventual benefit.

You suggest a simple exercise of withdrawing and contributing \$150,000 each year until age 65, and commencing a new pension on the contributed amount, which will produce a potential tax saving of about \$70,000 over that time, as outlined in the table on the following page:

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Current as at 8 August 2013.

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Year	Action	Taxable	Tax Free	Total	Death Benefit Tax (16.5%)
Balance at age 60		\$500,000	\$250,000	\$750,000	\$82,500
Year 1	Pension	-\$100,000	-\$50,000	-\$150,000	
	Contribute		\$150,000	\$150,000	
Year 1 Balance		\$400,000	\$350,000	\$750,000	\$66,000
Year 2	Pension	-\$96,000	-\$54,000	-\$150,000	
	Contribute		\$150,000	\$150,000	
Year 2 Balance		\$304,000	\$446,000	\$750,000	\$50,160
Year 3	Pension	-\$92,160	-\$57,840	-\$150,000	
	Contribute		\$150,000	\$150,000	
Year 3 Balance		\$211,840	\$538,160	\$750,000	\$34,954
Year 4	Pension	-\$88,474	-\$61,526	-\$150,000	
	Contribute		\$150,000	\$150,000	
Year 4 Balance		\$123,366	\$626,634	\$750,000	\$20,355
Year 5	Pension	-\$84,935	-\$65,065	-\$150,000	
	Contribute		\$150,000	\$150,000	
Balance at age 65		\$38,432	\$711,568	\$750,000	\$6,341

Note that the potential death benefit tax payable has been reduced to under \$6,500, a reduction of more than \$76,000 (from \$82,500 to \$6,341) or 93% of the initial amount.

In fact, the total amount of potential death benefit tax payable could have been cleared in the final year, if Penelope drew and re-contributed all of the remaining balance in her initial pension in that 5th year,

triggering the non-concessional 'bring forward' rule in the year of her 65th birthday.

If so, the table of transactions for that year would be as below:

Year	Action	Taxable	Tax Free	Total	Death Benefit Tax (16.5%)
Balance (end year 4)		\$123,366	\$626,634	\$750,000	\$20,355
Year 5	Pension	-\$123,366	-\$84,281	-\$207,648	
	Contribute		\$207,648	\$207,648	
Balance at age 65		\$0	\$750,000	\$750,000	\$0

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As a result of drawing the entire capital supporting the initial pension, the potential death benefit tax has been reduced to \$0.

Whilst the exercise plans for the commencement of a new income stream each year, in reality either:

- a new income stream could be commenced each year; or
- the first of the new income streams (\$150,000) could be reset each year, so as to have only 2 pensions operating, with the one retaining the 100% tax free status of the newly contributed funds being reset annually.

Cost/benefit analysis

Providing the client with a summary, similar to that set out above, will assist in enabling them to understand the wisdom of your recommendation.

Better understanding is likely to overcome many of the initial objections - there are not many instances where a client is happy to pay extra tax, even if it occurs after they have passed away!!

However, if all else fails, it would be wise to obtain some form of written 'do nothing' instruction from your client, for future use, if needed, when a legal situation arises.

Enough about the children - what about the spouse?

Although the long term planning more particularly relates to the eventual benefit passing to the children, there may be an extra step in the process - the reversion of the pension to the spouse on the death of the member/client.

With regards to the interests of the children, putting into action the plans (detailed above) would, potentially, be at least as beneficial, whether conducted during the lifetime of both spouses, or whether only one of the spouses was alive.

The important timing event is the period in which the member or members may recontribute the amounts drawn, generally between aged 60 and 65.

Recalling the ATO's position, stated in Taxation Ruling TR 2013/5, is that a pension will cease on the death of the recipient unless the fund trust deed or the pension documentation provides for the automatic reversion of the pension.

Despite that, the Government has introduced Regulations which provides that, in the event of no reversionary pension instructions, the income and capital gains from assets supporting the pension will not be taxable if paid as a lump sum as soon as practicable after the death of the member.

It is important, when:

- establishing a new income stream, or
- resetting an existing income stream

to make sure any automatic reversion nominations are completed with the new documents. This will ensure the continuance of the pension upon the death of the member/client. The Topdocs pension documentation provides a section for completion of the automatic reversion nomination.

Conclusion

Potentially, the cost of actioning plans to maximise the amount of the benefits to eventually pass to the client's children can be significantly lower (consider the cost of 5 pension resets) than the value of the results to be gained, when compared to doing nothing. Through pro-active recommendations, the plans may benefit not only the client's children, but also you as the adviser.

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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