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DEATH PENSIONS - NEW RULES

An important issue regarding the new superannuation reforms relates to the treatment of pensions following the death of a fund member. In this article, we explore how death benefit pensions are dealt with in the context of the new transfer balance cap regime.

Background – superannuation death benefits

Following the death of a fund member, an SMSF is compelled to pay out the deceased's superannuation benefits to eligible beneficiaries as follows:

- a maximum of two lump sums; and/or
- one or more pensions (referred to in this article as a 'death benefit pension').

Note, an SMSF is only permitted to pay a death benefit pension to a very narrow category of beneficiaries, being any one or more of the following:

- the deceased's current spouse;
- a child under 18;
- a financially dependent child under 25;
- a permanently disabled child of any age; and/or
- a person in an interdependency relationship with the deceased.

This means that an SMSF is generally not permitted to pay a death benefit pension to an adult child.

An advantage of paying a pension compared to a lump sum is that the deceased's assets are retained within the superannuation environment to support the death pension.

TIP–Paying a death pension instead of a lump sum allows a fund with substantial property investments to retain them within the fund instead of having to sell or transfer them out.

What type of death pensions can be paid?

A death benefit pension can be paid to a qualifying beneficiary (typically a spouse) in either of the following situations:

- reversionary pension – the deceased member's pension automatically continues (i.e., 'reverts') to a specifically nominated dependant following the member's death;
- new death benefit pension – a new superannuation income stream is created and paid to a dependant beneficiary or beneficiaries.

HIGHLIGHTS

DEATH PENSIONS - NEW RULES

An overview of how the new rules affect death benefit pensions

UPDATING SMSF DOCUMENTS

With the imminent commencement of the new super reforms, check that all SMSF documents are up-to-date

TRUSTEE Q & A

A 72-year old member is free to retain his super in accumulation phase

TIP–A benefit of a reversionary pension is that the deceased's pension automatically reverts to the beneficiary on the member's death, rather than being subject to the trustee's discretion. This provides more certainty if there is potential for the remaining fund trustees to disagree as to whom and how the death benefits are to be paid.

Death benefit pensions and the transfer balance cap

A reversionary pension will be credited to the beneficiary's transfer balance account in the following way:

- the amount of the credit will be the value of the deceased's pension account on death. Note, this is the market value of assets supporting the deceased member's pension at death; and
- this amount is credited to the reversionary beneficiary's transfer balance account 12 months after the member dies. This delay allows a reversionary beneficiary time to re-arrange their financial affairs.

> *"This can result in the child receiving significant wealth at a relatively young age."*

DEATH PENSIONS – NEW RULES CONT'D

INFO/WARNING–The 'transfer balance cap' applies from 1 July 2017 to limit the level of capital a fund member can transfer into a tax free pension environment. Reversionary pensions commenced before 1 July 2017 will also be subject to the transfer balance cap.

What happens if the reversionary beneficiary exceeds their cap?

Receiving a death benefit pension could result in the member exceeding their transfer balance cap. Options to deal with any excess include:

- stopping any existing pension (i.e., a non-death benefit pension) by returning it to accumulation phase or taking the balance out of the superannuation system altogether; and/or
- stopping all or part of the death benefit pension. Note, unlike stopping a 'normal' pension, no part of a death benefit pension can be returned to accumulation phase – it must be cashed out of the fund.

Death pensions – children

Special rules under the transfer balance cap apply to children who receive death benefit pensions. In practice, such pensions are relatively uncommon.

One issue with a death benefit pension for a child is that the fund must cash out the pension balance to the child when they reach 25, unless the child is permanently disabled. This can result in a child receiving significant wealth at a relatively young age.

UPDATING SMSF DOCUMENTS

With most of the new superannuation changes commencing on 1 July 2017, SMSF trustees need to ensure that the fund's trust deed, pension and other documents are up-to-date and reflect the current requirements of fund members.

In particular, SMSF documents need to allow pension accounts to be restructured in light of the new transfer balance cap regime starting in the new financial year.

As outlined above, new limitations on death benefits under the new regime may also require the distribution of superannuation death benefits and accompanying documentation to be revisited.

Other reasons to review SMSF documents include checking that:

- all contribution types can be accepted by the fund;
- the fund can pay all pensions permitted under the law;
- death benefits can be rolled over to a new fund; and
- ny redundant provisions are removed.

Note, it may not be necessary for a fund deed to be updated. For example, the deed may already be up-to-date or it may adequately deal with current member needs.

Members should also ensure that their investment strategy is reviewed regularly and that it adequately accounts for any changes to the fund's circumstances under the reforms.

ATO UPDATE

With tropical cyclone Debbie causing damage and flooding in Queensland, the ATO has offered support to SMSFs with: lost records, damaged or destroyed SMSF property or problems lodging their tax return. Additional support is available for individuals residing in 'highly impacted postcodes'.

The ATO has published its SMSF statistics for the 2014-15 income year, highlighting that over 577,000 SMSFs hold $622 billion in assets for over 1 million members.

The statistics suggest that the ATO's compliance headaches continue to come from funds that lend money or provide financial assistance to members or relatives. These breaches accounted for 22% of all contraventions made by SMSF trustees.

In terms of regulation, the ATO is currently focused on ensuring that SMSFs complete their annual audit and lodge their tax return. The ATO advises that it will be requesting for persistent non-lodgers to lodge all outstanding returns or be wound up.

The ATO is continuing to finalise its guidance on the new super reforms. Of note, it has recently finalised its views on how the CGT relief applies for SMSFs and the operation of the new transfer balance cap. We expect the ATO to continue releasing new guidance to help trustees transition into the reforms.

SMSF TRUSTEE Q & A

Question

"I currently receive a TRIS of $500,000. Do I need to stop the pension by 30 June 2017 to obtain the CGT relief?"

Answer

No, the ATO advises that a member does not need to cease a TRIS by 30 June 2017 to qualify for the relief.

By way of background, SMSFs currently paying a TRIS can choose CGT relief on an asset-by-asset basis where specific conditions are met. Certain account-based pensions may also qualify for the relief.

The relief seeks to ensure that capital gains accrued before the new rules commence are not taxable when the asset is sold after 30 June 2017.

The Government has allowed CGT relief to qualifying SMSFs currently paying a TRIS because fund earnings on assets supporting a TRIS will be taxed from 1 July 2017. If CGT relief were not available, any capital growth in TRIS assets would be fully taxable from 1 July 2017.

Until now, it has not been clear whether or not a member needed to cease the TRIS to obtain the relief.

However, the ATO has clarified that a TRIS does not need to be returned to accumulation phase before 1 July 2017 to qualify for the CGT relief. In effect, the fund's assets can potentially qualify for the relief even though the TRIS remains afoot.

WARNING–Choosing CGT relief can result in tax arising, even though the underlying asset has not been sold. Hence, individual circumstances need to be reviewed before applying the CGT relief.

Question

"I am 72 with a large super balance, and adequate savings outside of my super fund. Can I leave my super in accumulation phase?"

Answer

Yes, you can leave your super in accumulation phase, instead of drawing out a pension or a lump sum. This potentially allows you to retain a greater level of super savings within the superannuation environment.

A few years ago, super fund members were required to draw down their superannuation savings upon reaching age 65. However, this rule has since been abolished.

Now, the only 'compulsory cashing' requirement under the super laws is death. In this case, the deceased member's benefits are required to be cashed out to the beneficiaries as death pension/s and/or lump sums.

Key dates and reminders

5 June 2017

Due date for eligible non-taxable SMSFs.

30 June 2017

Ensure that:

- planning for the new super reforms is complete;
- minimum pension drawdowns are made by 30 June 2017 to avoid penalties; and
- for individuals intending to make concessional or non-concessional contributions by 30 June 2017 – check that the SMSF receives 'clear funds' by then.

1 July 2017

Commencement date for the following superannuation reforms, including (this list is not exhaustive):

- $1.6 million transfer balance cap;
- removal of tax free income status on TRISs;
- $25,000 annual concessional contributions cap for all individuals;
- current annual non-concessional contributions cap of $180,000 reduced to $100,000. Individuals with total super balances of $1.6m+ will be unable to make non-concessional contributions; and
- abolition of the '10% rule' for most individuals.

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