AUSTRALIAN COMPANY INCORPORATION SERVICES

IS TAX PAYABLE WHEN A SUPERANNUATION INCOME STREAM CEASES?

There has been some discussion in SMSF circles following a draft ruling issued by the ATO in August 2011, that perhaps the ruling introduces a kind of death duty when a member dies while in receipt of a pension.

When a person dies while in receipt of a superannuation pension, there have traditionally been two ways in which that pension could continue to be paid to the deceased member's beneficiary. The first was via a "reversion". This would usually mean that the member nominated one or more people during their lifetime who they wished to continue receiving that pension after their death.

However, even where a person did not nominate a reversionary beneficiary, in most cases the beneficiary could nominate whether or not they wished to continue receiving a pension from the fund or if they wanted to receive a lump sum (or a combination of the two). In this second circumstance, the pension was referred to, not as "reversionary", but as a "death benefits" pension. A reversionary pension is a continuation of the original pension without interruption, whereas a death benefits pension is a second, new pension which commences after a brief period between the original pension ceasing with the member's death and the new pension commencing with the beneficiary nominating that they wished to receive that benefit, in that form.

This new (draft) ruling from the ATO (TR 2011/D3), deals with pensions commencing and ceasing and, more particularly, what is required for a reversionary pension to be effective. It says:

> "A superannuation income stream ceases when there is no longer a member who is entitled, or a dependent beneficiary of a member who is automatically entitled, to be paid a superannuation income stream benefit from a superannuation interest that supports a superannuation income stream."

The change in the ATO's approach revolves around the word "automatically". The effect of the ruling is that a pension ceases when a person dies unless the pension becomes <u>automatically</u> payable to a reversionary beneficiary on death under either the super fund trust deed or the pension agreement. Previous practice was to allow the continuation of the pension if the super fund trust deed or the pension agreement do not prevent the continuation of the pension.

The ruling now means that, if a member was to die and his/her pension was *not* reversionary, and the fund was then to dispose of assets, any income or gains received by the fund would be subject to tax. This represents not so much a change in the ATO approach, but a more stringent application of their stated position on income streams. Previously, the ATO did not, in practice, enforce this position, but it has been their view since at least 2004.

However, if a surviving spouse or dependant commenced a death benefits pension immediately after the death of the member, then the problem ceases to exist. Therefore, the fund should not sell assets after a pensioner's death, unless a reversionary beneficiary exists, or a new death benefits pension has commenced.

If assets are sold after the date of death and before a death benefits pension is commenced, capital gains tax could be incurred. Additionally, there could be a brief period where the fund is not “in pension mode”. Therefore some small amount of the fund’s income might be taxable.

A few suggestions on dealing with this ruling are:

Start all new pensions with a Reversionary Beneficiary.

When pensions are set up, if the documents establishing the pension specify one or more reversionary beneficiaries, the problem is solved. Any pensions will automatically revert to the beneficiary(s) upon the original member’s death.

Add a Reversionary Beneficiary to an existing pension.

Some writers have been concerned that the ATO’s draft ruling indicates that adding a reversionary beneficiary to an existing pension could be construed as ceasing an existing pension and recommencing a new pension. We do not believe this to be the case, however, even if this was to occur, there would be no practical consequences in doing so, because the minute the old pension ceases, the new pension begins.

Start a New Death Benefits Pension.

When a member dies, if their beneficiary is entitled to have the death benefits paid in a pension form, then they can simply commence a new death benefit pension.

ACIS has a Pension Pack which can assist with any of these scenarios. If you have any queries, please call toll-free on 1800-773-477.