bastion SUPERANNUATION SOLUTIONS

SuperNews Spring 2011

New Rules for Investments in Collectables and Personal Use Assets

Legislation outlining new rules for self managed superannuation funds (SMSFs) investing in collectables and personal use assets was recently given Royal Assent.

The new rules allow SMSF trustees to continue to invest in collectables but these investments will be subject to tighter rules as to how they are stored and valued. This is to ensure that these investments are genuinely made for retirement income purposes and not for trustees' personal enjoyment.

The Government recognises that collectables like artworks can be a legitimate investment class, but acknowledges concerns over such assets attracting superannuation's concessional tax treatment while being available for a "personal benefit" (for example, artwork displayed in the home of a super fund member).

The new rules with which SMSF Trustees must comply with when investing in collectables and personal use assets commenced on 1 July 2011.

Collectables and Personal Use Assets defined

The assets defined as "collectables and personal use assets" are outlined in a new section 62A of the Superannuation industry (Supervision) Act 1983 and regulation 13.18AA to the Superannuation Industry (Supervision) Regulations 1994. These items include:

- Artwork (a painting, sculpture, drawing, engraving or photograph, reproductions or property of a similar description or use.)
- Jewellery
- Antiques
- Artefacts
- Coins, medallions or banknotes
- Postage stamps or first day covers
- Rare folios, manuscripts or books
- Memorabilia
- Wine or spirits
- Motor vehicles
- Recreational boats
- Memberships of sporting or social clubs
- Assets of a particular kind, if assets of that kind are ordinarily used or kept mainly for personal use or enjoyment.

New restrictions

The new restrictions from 1 July 2011 encompass the following:

- Trustees cannot enter into a lease or lease arrangement with a related party in relation to investment involving a collectable and personal use asset. This includes informal arrangements where the related party uses or controls the use of the asset and arrangements where no rent is payable in exchange.
- Collectable and personal use assets cannot be stored in the private residence of a related party but the item can be stored in premises not owned by a related party. A record of the reasons for the decision on where to store such items must be kept by the Trustee to ensure that SMSF trustees give consideration to what is appropriate storage for maintaining the asset as an investment that produces retirement income rather than one that provides current day enjoyment. This record of the decision made must be kept for ten years.
- Collectable and personal use assets must be insured in the name of the fund within seven days of acquisition. This would not apply to memberships of a sporting or social club.
- A member or other related party cannot use an item of jewellery, a motor vehicle, a recreational boat or a membership of a sporting or social club that is held by the fund.
- Trustees can only dispose of such collectable or personal use assets to a related party at a market price determined by a qualified independent valuer. This ensures that a related party does not receive current day benefits from such a transaction.

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Transitional arrangements

There are transitional arrangements for existing collectables and personal use assets held by a fund on 30 June 2011. Where these assets were acquired prior to 1 July 2011, the fund has until 1 July 2016 to comply with the new rules or dispose of the relevant asset.

For many SMSF trustees who held these investments prior to 1 July 2011, it is business as usual. However, for these particular investments Trustees will still need to ensure:

- They are consistent with the overall investment strategy of the fund
- Commercial lease agreements are prepared where assets are leased to a related party
- The value of the asset leased to a related party does not represent more than 5% of the fund's assets.

Sooner or later, and certainly well before 1 July 2016, these SMSF trustees will need to consider what action, if any, they will need to take to comply with the new regulations.

When a pension starts and stops

In mid July the Australian Taxation Office (ATO) released draft taxation ruling TR 2011/D3 which presents the ATO's views on when a superannuation income stream commences and ceases. At this stage the ruling is draft and the ATO has invited industry comment. It is proposed to apply from 1 July 2007 and clarifies the ATO position on a range of issues.

The ruling is important given that SMSF assets supporting pensions are exempt from tax and when a pension stops the exemption ceases.

Overview

The draft Ruling will apply to members with an accumulation interest in their taxed complying superannuation fund who commence a superannuation income stream on or after 1 July 2007 and the superannuation income stream is taken to be a pension in accordance with the Superannuation Industry (Supervision) Regulations.

The draft Ruling discusses when a superannuation income stream commences and when it ceases, and when a superannuation income stream is payable. These concepts are relevant to determining the taxation consequences for both the superannuation fund and the member in relation to superannuation income stream benefits paid. The calculation of the tax payable by the fund includes capital gains tax.

When an income stream starts

The ruling states a superannuation income stream commences on the first day of the period to which the first payment of the superannuation income stream relates and this day is determined by reference to:

- the terms and conditions of the superannuation income stream agreed by the trustee and member
- the rules of the superannuation income stream as set out in the superannuation fund's trust deed, and
- the relevant regulations of the Superannuation Industry (Supervision) Regulations 1994 (SISR).

Basically, this means a pension starts when the pension documents say so and therefore it will be very important to make sure pension documents specify a valid start date to avoid any confusion.

It cannot be before the member and the trustee agree to the terms of the pension or where the pension is funded from contributions and rollovers, before these are received by the fund.

When an income stream ceases

The ruling specifies that when a pension income stream has ceased needs to be determined by reference to the relevant superannuation fund's trust deed, the relevant requirements of the SISR and the particular facts and circumstances of the payment of the member's, or dependant beneficiary's, benefits.

A number of common circumstances as to when a pension ceases were outlined:

1. *Failure to comply with the pension rules and payment standards*

   When the trustee does not comply with any of the SISR payment standards the pension will cease. For example if the trustee does not make the required minimum payment the pension will be taken to have ceased on 1 July of the year of the non-compliance.

   If in the following income year the pension rules are again complied with this would result in the commencement of a new superannuation income stream and tax free and taxable components must be re-apportioned at that time.

2. *Exhaustion of capital*

   If the account supporting the pension runs out;

3. *Upon full commutation of the pension*

   When the trustee receives a valid request from the member to fully (but not partially) commute the pension for an entitlement to a lump sum.

4. *Death of the Member*

   A pension ceases upon a member's death except where the pension is reversionary to another beneficiary or there is a valid binding death benefit nomination in place that specifies the benefit must be paid as a pension.

To be considered that a pension is reversionary and has automatically transferred, the rules for the pension must specify the person (eg a spouse) to whom the benefit will be paid and the form of an income stream.

This means that where a pensioner wishes their death benefit to continue to their spouse or other beneficiary, relying on the trustee's discretion about the death benefit leaves a gap between the person's death and the commencement of the death benefit pension which means the deceased member's account is no longer in pension phase.

Taxation Implications

When a fund is wholly in pension phase, the taxable income is exempt and the capital gains/losses are ignored. Should all or part of the fund's assets cease to support a pension, taxable income (including capital gains) becomes assessable for that period.

This would mean that beneficiaries may pay capital gains and income tax liabilities on the income from assets previously supporting the pension.

Where an investment asset has been held in a fund for many years, the capital gains tax bill could be substantial and the trustees would not have been expecting to pay capital gains tax because the member is in pension phase and no tax provisions will have been made by the fund for this purpose.

A pensioner who wishes their death benefit to continue being paid as a pension to their spouse or other beneficiary should consider making the pension reversionary to their surviving spouse or other beneficiary, or make a binding death benefit nomination which specifies the beneficiary and that the pension must continue to be paid to that person.

The basis of the pensions may need to be reviewed with an individual's financial adviser to ensure the basis is appropriate and whether binding nominations are required.

It is also important to ensure minimum pension payments are made and for individuals with transition to retirement income streams the 10% maximum limit is not breached as either of these scenarios would result in cessation of the pension and loss of associated tax concessions.

Refund of excess concessional contributions

On 17 August the Government released a consultation paper to the industry for comment regarding its announcement in the May 2011 Federal Budget that eligible individuals will be provided with the option of having excess concessional contributions taken out of their superannuation fund and assessed as income at their marginal rate of tax, rather than incurring excess contributions tax.

It is proposed this measure will apply where an individual has made excess concessional contributions of up to $10,000 (not indexed) in a particular year and is only available for breaches in respect of 2011/12 or later years, and only for the first year in which a breach occurs, commencing from 2011/12.

Excess contributions tax is incurred where an individual exceeds their concessional contributions cap. Concessional contributions include compulsory superannuation guarantee payments, salary sacrifice contributions, and other deductible contributions. Excess concessional contributions are taxed at 31.5 per cent, in addition to 15 per cent tax when contributions are made to the fund.

This measure will assist individuals who have breached the cap for the first time, by $10,000 or less, giving the option to have these contributions refunded and taxed at their potentially lower marginal tax rate rather than the 46.5% effective excess contributions tax rate.

Update: Changes to the tax deductibility of total and permanent disability premiums

In our previous SuperNews we outlined developments regarding the tax treatment of total and permanent disability (TPD) insurance premiums paid by super funds.

From 1 July 2011, a superannuation fund trustee will only be able to claim a tax deduction for the component of a TPD premium that would result in the fund being liable to provide a 'disability superannuation benefit' as defined in the tax act. This definition effectively requires that a person must be unlikely to be gainfully employed in any occupation for which they are reasonably qualified.

Legislation relating to deductibility was passed by the Senate in June 2011 with a consultation paper issued to Industry for comment. The table below sets out the proposed deductibility percentages in the consultation paper. When finalised the percentages will be prescribed in regulations.

TPD Definition	Deductible portion of premium
Any occupation insurance	100%
Any occupation insurance with loss of limb add-on	90%
Own occupation insurance	60%
Own occupation insurance with loss of limb add-on	50%
Inability to perform activities of daily living insurance	60%
Inability to perform activities of daily living insurance with loss of limb add-on	50%

Minimum pension payment special relief reduced for the 2011/2012 financial year.

In the 2011-12 Federal Budget, the Government announced a reduction in the pension draw-down relief for the 2011-12 financial year with the minimum payment amounts for account-based, allocated and market linked (term allocated) pensions reduced by 25% for 2011-12. The minimum payments amounts will then return to normal in 2012-13

The table below illustrates the 25% reduction in the minimum pension level that applies for the 2011-12 financial year. The table also shows the required minimum pension for each $100,000 of an account balance.

	Reduced Minimum Limits for 2011-12 Financial year		*All Financial years from 1 July 2012*	
Age	**Minimum payment as % of account balance**	**Annual Pension Level for each $100,000**	**Minimum payment as % of account balance**	**Annual Pension Level for each $100,000**
55 - 64	3 %	$3,000	4 %	$4,000
65 - 74	3.75 %	$3,750	5 %	$5,000
75 - 79	4.5 %	$4,500	6 %	$6,000
80 - 84	5.25 %	$5,250	7 %	$7,000
85 - 89	6.75 %	$6,750	9 %	$9,000
90 -94	8.25 %	$8,250	11%	$11,000
95+	10.5 %	$10,500	14 %	$14,000

A 50% reduction in minimum pension levels previously applied for the 2008-09 to 2010-11 financial years. The Federal Government in March 2009 legislated relief from the minimum draw down percentages for pensions for the 2008-09 year with this relief extended to also apply for the 2009-10 year and then subsequently the 2010-11 year.

The relief was originally introduced to address concerns that due to the global recession and factors outside the control of trustees and members, the value of many funds has decreased making it difficult for some funds to find the cash for pension payments.

If the pension commences on or after 1 June then no minimum payment amount is required to be paid in that financial year. When a pension starts on a day other than 1 July, the pension limit and the annual pension amount will be calculated on the number of days the pension has to run during the remainder of the first financial year.

Please note that where a pension has been paid in excess of the reduced minimum limits, the minimum will be the amount paid with no refund allowed.

Increased SMSF levy

The SMSF Supervisory Levy has increased to $180 for the 2010-11 financial year. Previously the SMSF levy was $150.

The $30 increase in the SMSF levy will be used by the Government to provide $40.2 million over 5 years to the ATO and $8.4 million over 4 years to the ASIC to implement a range of measures relating to the SMSF Stronger Super reforms.

About Bastion Superannuation Solutions

Bastion Superannuation Solutions specialises in the provision of administration and compliance services to self managed superannuation fund trustees and advisers.

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Our range of services include**:**

- Self managed superannuation fund establishment
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Bastion Superannuation Solutions Pty Ltd
AFSL 278 280 ABN 70 105 016 984
Level 3, 400 Queen Street, Brisbane
GPO Box 1859 Brisbane Qld 4001

Phone: (07) 3004 1100
Facsimile: (07) 3221 9811
Email: info @bastionsuper.com.au
Website: www.bastionsuper.com.au