EMERSON RANDELL YOUNG

SMSF NEWSLETTER

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SPECIAL POINTS OF INTEREST:

- **ATO will have expanded penalty powers from 1 July 2014**
- **Re-contributing pension payments can be tax-effective**

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NEW PENALTY REGIME FOR SMSF TRUSTEES

Legislation has given the ATO new powers to penalise SMSF trustees who breach their obligations. The changes commence on 1 July 2014.

Currently, the ATO only has a limited range of penalties to deal with SMSF trustees who break the rules, and these penalties are difficult and time-consuming for the ATO to manage. Hence, some trustees are currently not being held accountable for failing to meet their obligations under the law.

WARNING–The ATO has advised that trustees who do not correct existing law breaches before 1 July 2014 are exposed to penalties under the new regime.

Overview of the ATO's new SMSF penalty regime

From 1 July 2014, the ATO will have three new powers to deal with SMSF trustees (or director/s of a corporate trustee), who contravene the superannuation rules:

1. Require you to correct the breach – the ATO can write to you instructing you to fix the breach within a specified time limit. The ATO will also request evidence proving that the breach has been rectified.

2. Make you do a course – the ATO may require you to complete an education course by a certain date if it believes that you lack knowledge about your trustee obligations.

The course will be free, but you must personally pay any travel or other out-of-pocket costs (e.g., internet fees). In other words, these costs cannot be reimbursed by your SMSF.

If you do not comply with the ATO's requests outlined above in 1. and 2. you could potentially be fined up to $1,700 and incur penalties described at 3. below.

3. **Monetary penalties** – as an SMSF trustee (or director of a corporate trustee) you may also be **personally liable** for monetary penalties of between $850 and $10,200 for defined breaches of the superannuation laws.

Some broad examples of the breaches that will attract a penalty from 1 July 2014 are described in the table below. Not every single breach of the superannuation rules results in a penalty. Further, the ATO may remit all or part of any penalty imposed.

If...	the penalty is...
your fund **lends money** to you as a member (or a relative)	$10,200
your fund **borrows money** (exceptions apply)	$10,200
your fund does not take reasonable steps to comply with the **in-house asset rules** (e.g., you stay in a holiday house owned by the fund)	$10,200
you don't keep necessary **trustee minutes** for 10 years	$1,700
you fail to complete a required education course (2. above)	$850

These penalties are personally payable by you as trustee (or director of the corporate trustee). This means that your SMSF cannot pay or reimburse the penalty to you.

Higher penalty for individual trustees

Generally speaking, individual trustees will be exposed to higher monetary penalties, compared to a company trustee. This is because **each individual trustee** may incur a penalty, whereas a company trustee will generally only incur one penalty.

EXAMPLE–Jill and Merryn fail to ensure that financial accounts are prepared for the 2015 income year. A penalty of $1,700 is imposed on each individual trustee ($3,400 fines in total).

In contrast, the corporate trustee would have received a penalty of $1,700 only. Jill and/or Merryn must pay the penalty.

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RE-CONTRIBUTION OF PENSION PAYMENTS

One strategy to consider is re-contributing pension payments back into your SMSF. This strategy can increase your level of superannuation savings available in retirement, and can also provide tax savings for your estate.

Background - tax treatment of pension payments

The tax treatment of a pension payment received by you can generally be described as follows:

- **Tax free component** – this component is always tax free in your hands, regardless of your age when you receive it. Similarly, this component will **always** be tax free when paid to your beneficiaries upon your death.
- **Taxable component** – in contrast to the tax free component, the taxable component is generally subject to tax, unless an exclusion applies (e.g. you are aged at least 60 when you receive the 'taxed element' from your fund).

So, why is re-contributing pension payments tax-effective?

In essence, the re-contribution strategy works by converting the taxable component of your pension payment into the tax free component.

That is, when you re-contribute your pension payment, it will generally be a non-concessional (i.e., after-tax) contribution. These contributions form part of the tax free component.

In summary, the pension payment **reduces** your taxable component, whilst the re-contribution **increases** the tax free component.

WARNING– This strategy won't work if you only have the tax free component in your pension account.

I am at least 60, and my pension payments are tax free anyway – how does this help?

The re-contributions can potentially reduce the tax payable on death benefits received by your beneficiaries following your death.

For example, if an adult child who is not financially dependent on you receives a lump sum death benefit from your superannuation fund following your death, they would currently pay tax at a rate of 16.5% on the taxable component of the death benefit.

Given zero tax is paid on the tax free component, re-contributing the pension payment could potentially save tax of up to 16.5% for certain beneficiaries (e.g. adult children).

EXAMPLE–Jeremy, aged 62, currently has a pension account balance of $300,000. His superannuation balance comprises only of the taxable component.

During the 2014 income year, the fund makes a pension payment of $50,000 to Jeremy, which he then re-contributes back to his SMSF. If Jeremy were to die, and all of his superannuation benefits were paid to his adult child, the savings to the child could be up to:

16.5% x $50,000 = **$8,250**

NB. This is a simplistic example just to illustrate the potential tax savings.

Other points to consider

Some of the points to be aware of are:

- **Work test must be met if you are aged 65+** – you must have been employed for at least 40 hours in 30 consecutive days in the income year in which the re-contribution is made. Broadly, you cannot re-contribute once you reach age 75.
- **Contributions cap** – the re-contribution will count towards your relevant contributions cap (e.g., $150,000 non-concessional contributions cap for the 2014 income year).
- **Treatment of re-contribution** – the re-contributed pension payment cannot be added to your pension account, but instead will form part of your accumulation account.
- **Other tax consequences** may apply, depending on your situation.

This strategy is complex, so you may want to contact us first to ensure that all relevant issues are addressed.

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