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entertaining the law

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Pre-1 July 2017 SMSF Transfer Balance Cap Commutations:

You snooze... SMSF clients lose…

Under the new **SMSF Transfer Balance Cap** measures, from **1 July 2017** the amount a SMSF member can have in a pension account is capped at **$1.6m**. Members already in pension phase with balances exceeding this cap must transfer assets out of pension phase and back into accumulation phase **before then** to get under the cap. This is commonly known as an **internal commutation**.

Avoidable and costly **tax consequences** apply if you do not get this right by 30 June 2017. And that is just 2 weeks away!

If you have SMSF clients and you are not already busy attending to this right now… **get busy**!

So, what do you need to do right now (i.e. before 1 July 2017)?

Here is a start:

- Identify SMSF clients with a member having a pension account(s) of $1.6m or more.
- Telephone them, note the changes, and explain that they need tax/ legal/ accounting advice and assistance to comply with the law (or be prepared to live with the financial consequences of not doing so).
- Compile all existing trust deed, pension and commutation documentation.
- Perform due diligence on this documentation to ensure you can proceed as planned. Is it effective? Does the Trustee have the appropriate powers? Does the Trustee have too much discretion for an effective reversionary pension? Is all documentation signed and dated? Etc. If there is a documentation problem, take advice and fix it. Now.
- If more than one pension exists, having regard to all relevant factors, including the components of the pension(s) and the circumstances of the member, determine which pension(s) to commute and by how much.
- Get commuting!

An effective internal commutation would usually require:

- A valid existing pension including pension establishment documentation and a valid power to establish that pension in the Trust Deed.
- A valid power to commute (fully/ partially) in the Trust Deed.
- An effective Member Commutation Request and a Trustee Resolution in respect of the commutation **in writing** and occurring (i.e. prepared, dated and executed) **before 1 July 2017.**
- Appropriate accounting entries and financial statements reflecting the same.

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TRISs - HOT OFF THE PRESS

On 15 June 2017, Parliament passed legislation enabling TRISs to be in the retirement phase where the recipient of the superannuation income stream has satisfied a relevant condition of release with a nil cashing restriction. An individual must also notify their superannuation income stream provider that they have satisfied a condition of release with a nil cashing restriction, other than the condition related to attaining age 65. In these circumstances, the superannuation income stream provider becomes eligible for the pension earnings tax exemption at the time it is notified.

This is the 'automatic' TRIS conversion that has been much talked about but, until now, not legislated.

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The ATO has released a number of *Law Companion Guidelines* and *Practical Compliance Guidelines* with prescriptive requirements that should be followed. **Ignore them at your peril.**

You can expect a lot of ATO oversight in this space. Given the complexity and amounts, the potential for **ATO "gotcha" moments** is frightening.

Some important things to note:

- An internal commutation will not affect the **proportions** of tax-free/ taxable components of the superannuation income stream if only partially commuted.
- Although there are usually no immediate tax implications arising from an internal commutation, the new CGT transitional relief measures permit an **adjustment in CGT cost base to market value** if properly elected and implemented.
- After 1 July 2017, there are considerable practical, timing and taxation advantages in establishing **reversionary pensions** (as opposed to non-reversionary) in the right circumstances. There are **strict criteria for reversionary pensions** required by the ATO (e.g. no trustee discretion or conditions). So, you need to get the paperwork right.
- You can only commute a pension that is a pension! If the existing pension paperwork is non-existent or deficient, or there is **no valid power in the Trust Deed** for that pension, you need to fix this. Now.
- You need to be quick off the mark from 1 July 2017 (and before the due date for lodgement of the SMSF tax return) as regards electing (or not) to take up the **transitional CGT relief** on some or all SMSF assets the subject of the commutation.
- From 1 July 2017, **TRISs** will lose all of their previous tax shelter (subject to the transitional CGT relief measures). The only reason we can see that you might continue a TRIS is if you wish to access your superannuation early, without a condition of release being satisfied.
- **Contribution caps** are being restricted in a big way after 1 July 2017. This may be your last chance to contribute larger amounts to a SMSF other than in respect of small business concession amounts in the future.
- Don't forget to consider and implement **best practice succession planning** (e.g. DBNs/ pension documentation/ powers of attorney/ wills).

Finally, **do not give legal advice** and **do not prepare legal documentation** yourselves unless you are a lawyer. We anticipate **significant litigation in the future** in this space as a result of poor choices and poor/ casual advice and documentation from well-meaning advisers.

At **Baggiolegal**, we are lawyers that are **superannuation, SMSF and taxation experts**

We have developed **simple and effective commutation and pension documentation** to address the 1 July 2017 changes. We are working with a number of accounting and financial advisory firms to ensure they meet their obligations and their client's expectations in this space

We can help you too

Call us if you need assistance in the lead up to 1 July 2017