

#INC2019

Dealing with reserves in an SMSF

Are they in starting line up, or left on the bench?

Mark Ellem, Executive Manager, SMSF Technical Services, SuperConcepts
Craig Day, Executive Manager, Technical Services, Colonial First State



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Craig Day

Craig is the Executive Manager, Technical Services with Colonial First State's technical services team, FirstTech, and has over 15 years' experience in the financial services industry. As part of the FirstTech team, Craig is responsible for providing specialist technical support to Colonial First State's business and to analyse and communicate technical issues and strategy to financial advisers and their clients. Craig is also a regular speaker at industry and corporate functions, provides media commentary in relation to Australian superannuation and retirement planning issues and is actively involved in providing ongoing professional education and training. Craig holds a Bachelor of Science and he is an SMSF Specialist Advisor™ with the SMSF Association.



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Mark Ellem

Mark holds the position of Executive Manager, SMSF Technical Services with SuperConcepts, providing technical and compliance support on SMSFs to financial advisers, accountants and SMSF trustees, as well as ensuring that SuperConcepts' leading SMSF administration and compliance platform, SuperMate, is compliant with the latest superannuation and taxation rules.

An accredited SMSF Specialist Advisor with the Self Managed Super Fund Association, he is also a Fellow of CPA Australia and the Institute of Public Accountants (IPA), as well as being a Registered Tax Agent.

Prior to his current role with SuperConcepts, Mark spent considerable time in accounting practices and SMSF administration companies, including running his own accountancy practice and SMSF administration and compliance advice company for ten years.



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Reserves – what are they?

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SIS reserves

Amounts separate to member accounts

Set aside for clearly stated purpose associated with future contingencies and demands

Excludes

- accrued expenses
- provisions for liabilities from past event
- accounting constructs (suspense accounts)

Tax reserves

Wider meaning:

Includes SIS reserves

- administration reserves
- anti-detriment reserves

Accounting constructs

- suspense / unallocated contribution accounts

Types of reserves

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Relevance to SMSFs?*

SIS

~~Administration reserves~~

~~Investment reserves~~

~~Operational risk reserves~~

~~Insurance reserves~~

Anti-detriment reserves

Tax

Contribution reserves / accounts

Pension reserves

DB pension 'left overs'

Requirements

Permitted under governing rules

Clearly articulated purpose


Investment strategy

Sole purpose

Allocation in accordance with Div 7.2

Complying lifetime / life expectancy and flexi pensions only

SMSFRB 2018/1

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Issues

ATO closely scrutinise any reserves

Demonstrate use of reserve / account is not part of strategy to circumvent super or tax laws to obtain a tax advantage

Amnesty for pre 1 July 2017 arrangements


Implications

Allocate existing reserves


Progressive allocation permitted to avoid concessional cap issues

Don't establish new SIS reserves

- 690 funds reported new reserves worth \$650m in 17/18!
- were they all SIS reserves?

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Contribution reserves

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Use permitted subject to complying with TD 2013/22

Allocation counts against relevant cap

Exercise caution near cap thresholds

Don't split single contributions

Reporting

Example

Member balance: \$1.35M


Makes \$100k NCC on 25 June 2019

Trustee allocates on 1 July 2019


TSB = \$1.35M

NCC for 2019-20: \$300K


Part IVA?

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DB pension reserves


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| Use permitted | Allocations don't count towards CC* | | |
|--|---|--|--|
| <p>Complying:</p> <ul style="list-style-type: none"> - lifetime - life expectancy - flexi pensions <p>Not ACB</p> | <p>Amount allocated to satisfy current pension liability</p> <p>Accounting?</p> | <p>On commutation of existing DB pension</p> <ul style="list-style-type: none"> - used to start new income stream - Complying LT/LE - TAP only - Flexi pensions - ABP permitted | <p>On commutation due to death</p> <ul style="list-style-type: none"> - amount allocated to satisfy pension liability, or - amount allocated paid as death benefit lump sum <p>Flexi pensions only</p> |

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* Reg 292.25-01 Income Tax Assessment Regulations 1997

DB pension 'left overs'

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Can arise in following situations:

- Death of member receiving lifetime pension
- Life expectancy pension reached end of term
- Member commutes lifetime / life expectancy pension and capital exceeds permitted commutation value


Allocations

DB pension reserve allocation exemptions do not apply


Counts against concessional cap unless

- fair and reasonable and
- less than 5% of member's interests

Can trustee allocate progressively?

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Avoiding and minimising reserves

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Lifetime pension

Example

Fred has non rev complying lifetime - \$20,640 pa

\$380k capital backing

Fred commutes and commences TAP (min term 8 years) 1st annual payment \$20,460

On death, no reserve - residual TAP can be paid as death benefit

Life expectancy pension


Example

Fred has non rev Life expectancy - \$20,640 pa, 3% indexing. term ends 1 Feb 2019


\$380k capital backing

Prior to end of term Fred commutes and commences TAP

Amt used to commence TAP \$144,480 (\$20,640 x 7) - \$235,520 left in reserve

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Dealing with reserves

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Maximising allocations

If 4.99% < remaining cap – allocate amount equal to remaining cap

If 4.99% > remaining cap – allocate 4.99%

Allocate amount that results in nil tax assessment

Case study

Joan (77) member of SMSF
ABP \$680,000


Had DB life expectancy pension

- ceased last year
- \$75,000 residual

Wants to allocate 'left over' amount asap

How much should be allocated?

- \$25,000?
- \$33,660 (4.95%)?
- full amount?

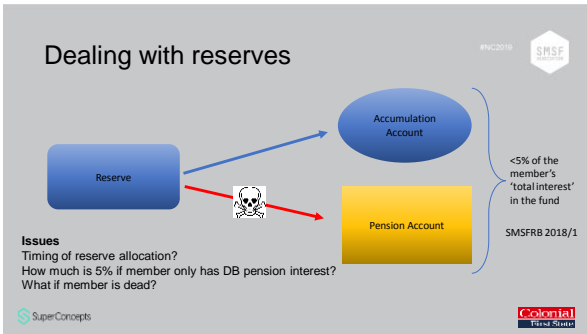
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Dealing with reserves

#MC2018 SMSF

| | | |
|------------------------|----------|--|
| Allocate from reserve | \$75,000 | |
| Less: contribution cap | \$25,000 | |
| Excess concessional | \$50,000 | Count toward NCC as not refunded |
| Joan's income | | |
| Excess CC | \$50,000 | |
| Prime tax ¹ | \$ 7,797 | |
| Fund tax offset (15%) | \$ 7,500 | Not paid by fund. Personal tax offset (s.291.15 ITAA 97) |
| Net tax | \$ 297 | |
| < 5% rule (4.95%) | \$33,660 | |

SuperConcepts © Using 2017/18 personal tax rates - includes medical levy & credits. CC change Colonial First Super



Dealing with very large reserves

#MC2018 SMSF

Case study...

Joan is member of SMSF
Age 77
Has two pensions
- ABP \$680,000
- DB life expectancy pension - ceased at end of last year
- **\$450,000 residual**
Joan's concessional cap
- \$25,000

Joan has 25 year old granddaughter Sophie
- student with no income
- concessional cap \$25,000
Joan would like to help Sophie out with her university fees

What could Joan do?

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Dealing with very large reserves

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| | | |
|------------------------|-----------------------|---------------------------------------|
| Allocate from reserve | \$75,000 | |
| Less: contribution cap | \$25,000 | |
| Excess concessional | (\$50,000) | Refund up to 85% to Sophie (no NCC) |
| Sophie's income | | |
| Excess CC | \$50,000 | |
| Prime tax ¹ | \$ 7,797 | |
| Fund tax offset (15%) | (\$ 7,500) | Not paid by fund. Personal tax offset |
| Net tax | \$ 297 | Joan + Sophie |
| Total allocation | \$150,000 | |
| Cash to Sophie | \$42,500 | University fees? |

Dealing with very large reserves

#MC2019 SMSP

Reserves and investment return
Does trustee always need to allocate return to reserves?

- what if level of reserves sufficient?
- what if purpose of reserve now redundant (anti-detriment)?
- what if reserve a tax reserve
 - unallocated contributions account
 - DB pension 'left over' amounts

Reserves and fund costs
Can trustee pay fund costs from reserves?

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Common questions

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Does work test apply for over 65s?
Allocation not contribution for SIS purposes
Work test does not apply

Do allocations need to be grossed up for contributions tax?
Required where amount allocated a substitute for employer contribution
Corporate funds where employer has previously funded future contributions
Not applicable

Do only excess amounts count towards cap?
No – if allocation counts, the full amount counts
Not just excess amount

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Top tips for dealing with reserves

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1. Identify funds with reserves & confirm purpose - does it align with SMSFR 2018/1?
2. Read the SMSF trust deed
3. Can the reserve be allocated in full now?
4. Consider adding new members to the SMSF
5. Ensure members have an accumulation account with a balance to add reserve allocations post death
6. Review accounting for reserves - adding share of earnings & deducting fund expenses

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.....And the final word

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Communicate to SMSF clients the issues with reserves
Prepare & implement a plan to deal with reserves

.....don't be left on the bench
Thank you!

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