



# SMSF Association National Conference 2019

Has your client actually retired? The 5 things everyone gets wrong, and everything you need to master this vital question

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## Introduction

'Retirement' historically has always been important because it:

- is a condition of release with a 'nil' cashing restriction (SISR sch 1 item 101)
- turns all benefits into unrestricted non-preserved benefits (SISR reg 6.12(1))
- therefore allows withdrawals with no maximums
- allows non-money (ie, *in specie*) lump sum withdrawals. Remember:
  - the *Superannuation Industry (Supervision) Regulations 1994* (Cth) allow lump sums to be paid as in specie (SISR reg 6.01(2)) and
  - ATO state that pensions payment can't be in specie (SMSFR 2008/2 [73]).

But why is it **NOW** so critical?

Of course, it is **NOW** so critical because:

- Before 1 July 2017, an SMSF's income was exempt from income tax to the extent its assets were being used to pay account-based pensions or transition to retirement income streams
- Now, an SMSF's income is only tax exempt to the extent its assets are being used to pay account-based pensions or transition to retirement income streams that are 'in the retirement phase'
- Before 1 July 2017, there was basically no limit on how much you could have funding a pension
- Now, your transfer balance account gets a transfer balance credit when you start to be a retirement phase recipient of a superannuation income stream

Yet, there are various implicit assumptions about retirement. In the presentation I will address those assumptions and seek to shed new light on them.

## Definition of retirement

Firstly, we must consider the definition of retirement. Regulation 6.01(7) of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) provides:

*For the purposes of Schedule 1, the retirement of a person is taken to occur:*

- (a) *in the case of a person who has reached a preservation age that is less than 60—if:*
  - (i) *an arrangement under which the member was gainfully employed has come to an end; and*
  - (ii) *the trustee is reasonably satisfied that the person intends never to again become gainfully employed, either on a full-time or a part-time basis; or*
- (b) *in the case of a person who has attained the age of 60—an arrangement under which the member was gainfully employed has come to an end, and either of the following circumstances apply:*
  - (i) *the person attained that age on or before the ending of the employment; or*
  - (ii) *the trustee is reasonably satisfied that the person intends never to again become gainfully employed, either on a full-time or a part-time basis.*

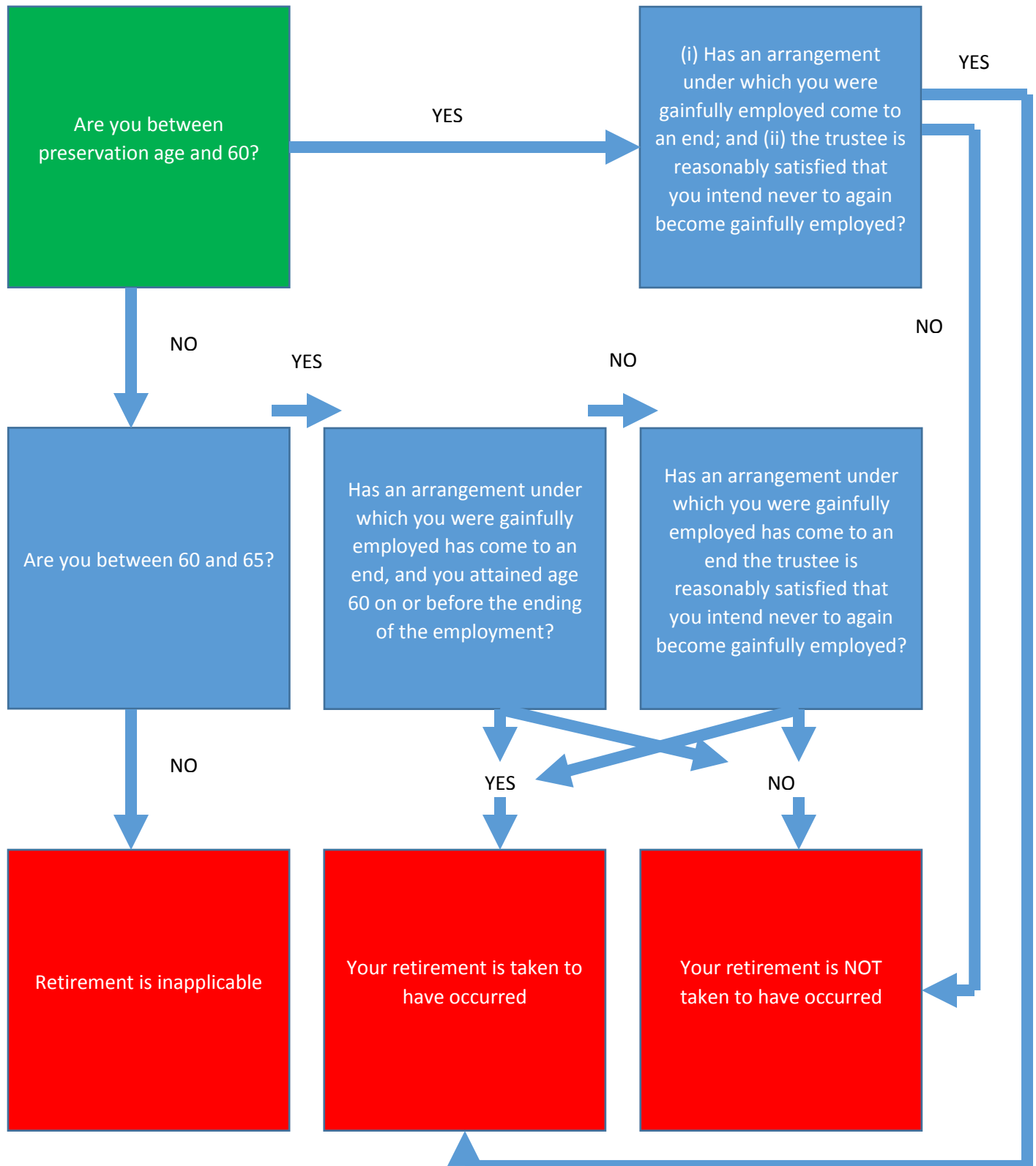
A close inspection of this definition of retirement reveals that there are three different methods under which a person's facts can give rise to retirement:

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- **Method 1 (relevant if aged between preservation age and 60):** (i) An arrangement under which you were gainfully employed has come to an end; and (ii) the trustee is reasonably satisfied that you intend never to again become gainfully employed
- **Method 2 (relevant if aged between 60 and 65):** An arrangement under which you were gainfully employed has come to an end and the trustee is reasonably satisfied that you intend never to again become gainfully employed
- **Method 3 (relevant if aged between 60 and 65):** An arrangement under which you were gainfully employed has come to an end, and you attained age 60 on or before the ending of the employment

Alternatively, the definition — and its different methods leading to ‘retirement’ — can be expressed as a flow chart as follows:

## Flowchart for navigating retirement



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In the presentation, I refer to a helpful case study regarding Charlie and 'Crackle', which the ATO produce. Their case study considers whether retirement has occurred for the purposes of reg 6.01(7) of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) ('SISR').

The case study is available at <https://www.ato.gov.au/super/self-managed-super-funds/in-detail/smsf-resources/smsf-case-studies/establishing-whether-gainful-employment-has-ceased/>, however, for ease of reading, I extract it in full here:

## **RETIREMENT – ESTABLISHING WHETHER GAINFUL EMPLOYMENT HAS CEASED**

### **Case study scenario**

*Charlie is 57 years old and a beneficiary of the Crackle discretionary trust (Crackle). Crackle carries on a smash repairs business. Charlie has been an employee of Crackle for nearly 20 years. For the 2016 income year, Charlie ceases his employment with Crackle. He is paid out any accumulated leave entitlements owed to him.*

*Charlie no longer has an employment contract with either Crackle or any other entity (related party or arm's length). The directors of the corporate trustee of the SMSF of which Charlie is a member, are satisfied he never intends to be gainfully employed on either a full-time or a part-time basis. Charlie's SMSF commences to pay Charlie an account-based pension.*

*However, after Charlie's employment has ceased, Charlie continues to perform substantive duties for Crackle (much the same as when he was an employee). Charlie receives distributions of trust income from Crackle.*

### **Analysis**

*The superannuation definition of 'retirement' for a person under the age of 60 is determined by establishing whether they have ceased to (and never intend to again) be gainfully employed.*

*Passive investment income (such as the receipt of rent, trust distributions or dividends) would not normally affect the retirement definition, as the income received is not a direct result of actions or exertion by the member in a particular task.*

*However, where a business is operated through a family trust or private company, like in Charlie's example, we may need to have a closer look at the arrangement before we can determine that Charlie has satisfied the retirement condition of release. This is because any evidence that he was still performing substantive duties for Crackle could indicate there is an on-going relationship between the two.*

*It's unusual for a business like Crackle to allow someone who is not employed or contracted to assist in running the business, without an agreement or understanding in place. If Charlie's work leads to increased turnover for the business, resulting in larger trust distributions or a disproportionate increase in dividends, the Commissioner could take a view that the arrangement under which Charlie was 'gainfully employed' has not 'come to an end' as he is still receiving 'gain or reward' from distributions from the Crackle Discretionary Trust.*

*As each business and arrangement is different, it would always have to be decided on a case-by-case basis what 'substantive duties' would entail. However, the following factors may be taken into consideration:*

*> the time spent by Charlie assisting the business – the trustee must be satisfied Charlie does not intend to work more than 10 hours a week in the future*

*> the expectation/understanding/agreement that Charlie will receive "reward" for his efforts, even if it not in the traditional form of salary and wages*

*> whether the amount received is linked to Charlie's direct or indirect performance*

*> whether the payments received are referred to in Crackle's trust deed*

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> whether the business would be able to operate (or earn as much income) if Charlie was not performing these duties

### **Result**

*Although Charlie's employment contract was terminated and he has been paid his leave entitlements, the fact he continues to assist Crackle, performing essentially the same duties he did as an employee, warrants further consideration. Based on the facts available, the Commissioner cannot be certain Charlie has satisfied the retirement condition of release.*

### **How this may affect you**

*If you are under the age of 60 and thinking of starting a super pension, extra care should be taken to ensure you have satisfied your trustee (and if required, the ATO) that you have ceased to be gainfully employed and do not intend to be gainfully employed in the future*

The above case study is premised on Charlie actually being employed by Crackle, without expressly considering what constitutes 'employment'.

For many, the addition of the following facts could make the case study more relevant to their own clients' situations:

- Charlie has attained his preservation age (this was obvious in 2016 when the example was first published by the ATO, but it's not obvious now).
- Prior to Crackle's business commencing 20 years ago, Charlie was an arm's length employee of another smash repair business (run by an entirely unrelated party). It was during that employment with that other smash repair business where Charlie learnt the 'trade' and gave him the confidence to open his own business via Crackle.
- Similar to Mr and Mrs Davies and their discretionary trusts in *Davies and Commissioner of Taxation* [2009] AATA 297, at all times in respect of Crackle:
  - Charlie does not have a written contract of employment with Crackle;
  - Charlie has never received a regular wage from Crackle, instead he drew money from the business account for living expenses on an *ad hoc* basis;
  - Charlie did not receive any salary or wages (assume Charlie has never always disclosed any drawings from Crackle in item 1 (ie, salary or wages) of his personal income tax return, and instead he has always disclosed drawings later on as trust distributions);
  - Crackle has never made any PAYG income tax or superannuation payments for Charlie;
  - Crackle has never taken out any workers compensation insurance for Charlie.
- Other than the work that Charlie has been doing for Crackle, there is no prospect whatsoever that Charlie will ever work for any other entity or be self employed.

Naturally, the relevant limb in the definition of retirement that applies is reg 6.01(7)(a) (ie, Charlie has reached a preservation age that is under age 60).

Regulation 6.01(7)(a) has two components that need to be fulfilled.

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The first component is whether 'an arrangement under which the member was gainfully employed has come to an end' (reg 6.01(7)(a)(i)). I dare say that this is satisfied by the cessation 20 years ago of the employment that Charlie was engaged in as an arm's length employee of the other smash repair business run by an entirely unrelated party. I acknowledge that on its face it seems odd that a cessation of employment so long ago could be relevant, however, that is consistent with the pure text of the legislation, and also the following comments by APRA (APRA Prudential Practice Guide *SPG 280 – Payment standards for regulated superannuation funds and approved deposit funds* (4 April 2012 version) [19]–[20]) (emphasis added):

There are two alternative age-related definitions of retirement under Regulation 6.01(7) of the SIS Regulations.

Under the first definition, where a member has reached their preservation age that is less than 60, their 'retirement' occurs when:

(a) an arrangement under which the member was gainfully employed has come to an end. ***This may have occurred at any time, including prior ... their preservation age;*** and

(b) the trustee is reasonably satisfied that the member intends never again to become gainfully employed either on a full-time or a part-time basis (i.e. for 10 or more hours per week).

(Note that APRA has since replaced the above version of SPG 280 with a newer version that does not contain the above quote, without APRA commenting as to why it did this or whether it now disagrees with the above quote. I am inclined to suspect that APRA still agrees with the above quote and that APRA now considers the above quote somewhat obvious, so that when it reissued SPG 280 it did not feel the comments warranted repeating.)

The second component is whether the trustee is reasonably satisfied that the person intends never to again become gainfully employed (reg 6.01(7)(a)(ii)). In *Davies*, the work that Mr and Mrs Davies were doing work for their discretionary trusts but that work did not constitute employment, with the AAT noting:

... no contract of employment is to be implied merely from the fact that one person performs work for or provides services to another. Modern commercial life abounds with arrangements for the performance of work or services for others by persons who are not employees.

Applying the same principle here, Charlie is not employed by Crackle. Also, based on the additional facts, I feel there is no prospect that Charlie will ever work for any other entity or be self employed. Accordingly, I suspect that the trustee could be reasonably satisfied that Charlie intends never to again become gainfully employed, which would satisfy the second component. Assume that the trustee is indeed reasonably satisfied.

Due to the inclusion of the additional facts listed above, I suspect Charlie satisfies the definition of 'retirement' in reg 6.01(7), despite still 'working' in Crackle's business.

### Important warning

As set out above, legal reasoning can be put forward for Charlie's situation (once the additional facts are added) to constitute retirement.

However, these matters can be very fact dependent.

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Furthermore, I note:

- This is a very important area of law: if a mistake is made, a serious contravention (eg, early release) can occur, with very serious negative implications.
- If the ATO is going to disagree with an interpretation regarding a particular course of conduct, naturally a client would want to know this before the client engages in the course of conduct.
- **Very importantly (hence this bolding), there is a real chance that the ATO might disagree with my interpretation regarding what constitutes employment, self-employment and retirement.**

Therefore, I stress that before applying to a real client, ATO input should be sought, along with the important caveat to the client that the ATO might give a negative response.