Horizon Management Client Newsletter

Winter 2015

Welcome to the Winter Edition of the Horizon Management Newsletter.

What's been happening in the industry?

Insure for your SMSF's success

An important question for trustees is the right type and level of insurance.

Does your fund have enough life insurance to cover debts and the future needs of family if members were to pass away? What if you were to suffer a traumatic event that resulted in large medical expenses?

These are important considerations. As the trustee of your own fund you are responsible, and ultimately liable, if something goes wrong.

As a result of legislative changes effective from 1 July 2014, an SMSF is not able to own a new insurance policy if the event insured under that policy did not correspond with a superannuation condition of release.

This means that where an insurance policy is held through an SMSF for the benefit of a member, if the policy were to pay out to the fund the member should have access to the insurance proceeds.

On the face of it, this change makes sense. The last thing you would want as a member is to think you had done the right thing only to find you couldn't access the funds when you most needed them.

Perhaps the biggest concern in this area was where members had taken out total and permanent disability (TPD) insurance based on "own occupation". Under these policies, the benefit would be paid out where the member was no longer able to work in their particular occupation.

However, if, based on their education, training and experience, the person was still able to work in another occupation, then often the funds would not be able to be paid. This is because the TPD definition for the release of benefits from an SMSF requires that the member is no longer able to be employed in "any occupation" based on their education, training and experience.

Don't sit still

You might ask why this issue is relevant now if the change was made over 12 months ago. The answer is that any good financial plan needs to be reviewed on a regular basis – it should never sit still.

SMSF trustees are required to review their investment strategy on a regular basis, and this should cover the needs of the members, including insurances.

When it comes to insurance, many people could (or should) ask: do I have enough? But it's equally relevant to consider if you have too much. If a member's investment has performed well, do they have more insurance than required? Lowering the level of coverage should lead to a lower level of premium, meaning there is more left for investment within the fund itself.

New ATO decision highlights tax benefit for SMSFs

A recent ATO interpretative decision (ATO ID 2015/17) has provided increased flexibility for SMSF trustees in regard to the tax treatment of life insurance cover taken out inside the fund. The decision allows SMSF trustees to elect to claim a tax deduction for the 'future service portion' of the death benefit or life insurance payout.

The 'future service portion' deduction is a calculation based on the member's balance at death, the amount of life insurance, the date of death and the day that member would have reached retirement age (generally 65 years). The portion between the date of death and retirement age can be claimed as a tax deduction by the fund.

The choice to claim the 'future service portion' deduction can be made after the member in question has died and must be included in the tax return for the financial year in which the death benefit is paid. The choice can still be made even if the insurance premiums were claimed as tax deductions in the preceding year.

Once the choice to claim a tax deduction for the 'future service portion' has been made, the fund will no longer be able to claim a deduction for the insurance premiums paid for all fund members.

"Choosing to claim a deduction for the future service portion can provide the fund with a significant tax loss which can be offset against current or future assessable income," Townsends Business and Corporate Lawyers special counsel Michael Hallinan said.

ATO getting tough on "serial non compliers"

The ATO will take a tougher stance against persistently non-compliant SMSF trustees and will increasingly make use of its new penalty powers in the 2015-16 financial year.

On top of targeting "serial non-compliers" in the 2015-16 financial year, the ATO will specifically be chasing SMSF trustees who fail to deliver on agreements in enforceable undertakings.

The ATO's Assistant Commissioner for SMSFs, Kasey Macfarlane, noted "In these circumstances, the powers we gained on 1 July 2014 will increasingly come into play,"

The powers allow the ATO to impose administration penalties on trustees for certain SIS Act breaches. Additionally the powers allow the ATO to direct SMSF trustees to fix a breach and to undergo education in the event of a breach.

The ATO will also be taking a harder look at individuals who enter the SMSF sector with poor personal taxation lodgement histories, and no income or limited income.

Further, SMSFs that have significant changes in assets and income, outside the previous pattern of the fund and without obvious reason, will be on the ATO's radar.

SMSFs with overdue annual returns will also be on the agenda, as will those that have breaches reported in auditor contravention reports that have not been rectified.

The ATO will also keep an eye on SMSF pensions, particularly inappropriately-claimed deductions when a fund is in pension phase.

Don't slip up with your binding death benefit nominations

A binding death benefit nomination is a tool that can help make sure that estate planning intentions are followed through. However a recent court case highlighted the importance of the correct wording of binding death benefit nominations for all SMSF trustees.

The court case - Munro & Anor v Munro & Anor

A Queensland Supreme Court case earlier this year involved the validity of a binding death benefit nomination. In this case the binding death benefit nomination had been executed by Barrie Munro who had been a practising solicitor before his death in 2011.

The case involved Mr Munro's second wife, Suzie, and his two daughters from a previous marriage.

The binding death benefit nomination would have paid Mr Munro's super benefits to his estate, which would have seen this money paid directly to Suzie and, via testamentary trusts, to his two daughters. The will said that any money paid directly from a super fund to Suzie would offset what she was entitled to under his will.

After Mr Munro had died, he was replaced as a trustee of the fund by his wife's daughter, Angela Pooley, who it appears wasn't related to him.

Suzie and Angela decided that his binding death benefit nomination was invalid and they intended to exercise their discretion as to how his benefit should be paid from the fund.

The result

The court decided the binding death benefit nomination was invalid because it nominated the "trustee of his deceased estate".

Even if the intention of those words was clear to most people, it was not a legally appropriate definition. The only way the benefit could have been paid to his estate was if the binding death benefit nomination had made reference to his legal personal representative.

The lesson

The key lesson from this case is that, if a practising solicitor can get a binding death benefit nomination wrong, then what makes anyone else think they don't need legal advice when completing one of these documents?

Please note that a service to clients Horizon Management performs an annual review of permanent documents to ensure beneficiary nominations and fund deeds are up to date.

ATO cautions on deeds, outlines 12 month focus areas

The ATO has drawn attention to a "surprising" number of outdated trust deeds which prevent members from establishing pensions and to its SMSF compliance program for the next 12 months.

The ATO's Assistant Commissioner for SMSFs Kasey MacFarlane recently said one of the key considerations that needs to be made by practitioners when establishing a pension is whether or not the terms of the fund's trust deed allow for the establishment of a certain type of pension.

"We're still surprised how many older deeds…… don't provide for recent changes to legislation and sometimes even prohibit certain types of income streams that are otherwise now permissible by legislation" said Ms MacFarlane.

"A particular example that comes to mind is transition-to-retirement pensions."

She also stressed the importance of SMSF trustees correctly determining the value of assets that will support a pension, ensuring they reflect market value.

"Getting the valuation right ensures that trustees will not be at risk of miscalculating the required annual minimum pension drawdown for the member(s) which impacts on an SMSF's ability to claim exempt current pension income" she said.

There can be significant income tax consequences if minimum drawdowns are incorrectly calculated.

She also discussed some of the other focus areas for the ATO over the next 12 months.

"We'll be looking at circumstances where they are inexplicable and significant [as well as] out-of-pattern changes in an SMSF's assets or income," she said.

The ATO will also be looking at related-party transactions or arrangements that appear to be on non-commercial terms and limited recourse borrowing arrangement loans that have been incorrectly structured.

Another area of focus is the promotion of arrangements that seek to gain a present day benefit for the member, including housing benefits, cosmetic surgery and holidays.

"All of those issues are potential indicators that an SMSF may not be being used for the sole purpose of providing retirement benefits for your members," she said.

"It's important to keep in mind that ultimately all of the obligations that apply to SMSFs are designed to protect and guard SMSFs and members' retirement savings and income."

No change to drawdown rates

The government has announced it will maintain the current drawdown rates nearly a year after a discussion paper explored changing the minimum withdrawal rates.

Social Services Minister Scott Morrison said there would be no changes to the current rates as the government is keen to ensure maximum stability and certainty for superannuation.

SMSFs forfeiting 'tax advantages' with property

SMSF investors could be missing out on significant tax advantages by simply being unaware of the deductions they can claim.

BMT Tax Depreciation's Bradley Beer noted that while many SMSF trustees are taking full advantage of the tax benefits associated with property depreciation, many investors "aren't doing it properly".

He pointed to several areas where SMSF investors are potentially missing out on significant deductions.

"Common or shared areas in unit complexes are often missed. An SMSF may also invest in a commercial property because they run a business from that property and hold it in their SMSF. Sometimes people think because it's their own property and they're running a business from that maybe they're not able to claim deductions but they actually are," Mr Beer said.

"The myth that old property doesn't get it would be the most common. Older property still gets depreciation, it just doesn't get as much," he added.

Horizon Management encourages SMSF investors to have a proper depreciation schedule to ensure they maximise their tax deductions each financial year.

Accessing super: Preservation age now 56

Turning 55, retiring and accessing your super is now a retirement planning strategy from the past. Since 1 July 2015, Australians turning 55 will have to wait at least another year before they can access super benefits.

The key trigger when accessing superannuation benefits is reaching preservation age AND retiring. Up to 30 June 2015 those turning 55 also had a preservation age of 55 years, i.e. those born before 1 July 1960. Anyone who turns 55 on or after 1 July 2015 has a preservation age of at least 56 years.

Even the increasingly popular transition-to-retirement pension, allowing you to access 10% of your super benefits each year as pension payments without retiring, can only be started once you reach your preservation age.

Reminder to submit your documents

If you haven't already done so this is a reminder to trustees to submit their documents to enable us to complete your end of year financials.

We look forward to receiving those documents in the near future.

Please contact us if you have any questions in relation to any of the matters discussed in this newsletter

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