



Australian Taxation Office
Mr Andrew Allan
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Dear Andrew,

**DRAFT TAXATION RULING 2011/D3 (“TR 2011/D3”) – INCOME TAX: WHEN A SUPERANNUATION
INCOME STREAM COMMENCES AND CEASES**

SISFA is an association that has represented the interests of the self-managed superannuation fund (SMSF) sector for over 13 years and is the original SMSF advocate association representing all participants in the sector, including administrators, accountants, auditors, lawyers, actuaries and financial advisers.

SISFA has made several submissions on this important issue since early 2008, including a joint industry submission signed off by SISFA, IFSA, CPAA, ICAA, SPAA and the FPA, dated March 2009, which in SISFA’s view contains the correct legal analysis of when a superannuation income stream ceases, following the death of a pensioner to which the beneficiary is not a tax dependant.

Further to the March 2009 submission, to which it is noted there has been no response (copy attached), SISFA submits in respect of TR 2011/D3 as follows. All references to paragraph numbers in this submission are to paragraphs in TR 2011/D3.

The meaning of ‘income stream’

At paragraph 48, the ATO correctly states the term “income stream” takes its ordinary meaning in the context in which it appears. However, the analysis which follows is inappropriate given that it takes a microscopic approach in breaking down each of the terms in the expression “income stream” rather than considering the ordinary meaning of that phrase in its context.

An “income stream” is a reasonably well understood concept in the superannuation industry and does not require the expression to be broken down into its component parts. In breaking down the phrase, it creates inappropriate outcomes.

Even if it were correct to consider the terms “income” and “stream” in isolation, the analysis in paragraph 49 is too restrictive. Firstly, the definition of “income” drawn from the Macquarie Dictionary

is the definition of the noun “income”, when the word in the expression ‘income stream’ is in fact an adjective.

Additionally, the draft ruling ignores other definitions of income both in the Macquarie Dictionary and those more generally accepted in the superannuation and tax context, and in particular that income is often considered to be merely something that comes in, without necessarily having to have the nature of a periodic receipt.

In relation to a “stream”, arguably a pension would never satisfy that definition because there is always a break between payments. It can never be said with certainty after one payment whether there will be a subsequent payment despite the intentions of the parties. The concept envisages some unbroken series of items or events, whereas a pension is more akin to turning a tap on and off.

What is a pension?

The draft ruling also fails to properly acknowledge that the requirements of subregulation 1.06(1) are merely requirements to be “provided under the rules of a superannuation fund”. That is, the requirements of that subregulation are not a statutory codification of what a pension is for the purposes of the SISR.

Rather a pension, in addition to the legislative requirements of subregulation 1.06(1), must be established under and governed by the terms of the superannuation fund deed, the pension documentation and the product disclosure statement (**PDS**). That is, the pension is a contractual relationship between the trustee of the superannuation fund and the member.

It is this documentation that will determine when a pension commences and ceases.

Given that the concept of a superannuation income stream is dependent on whether there is a pension for SISR purposes (and as governed by the contractual relationship between the superannuation fund trustee and the member), the remainder of this submission will refer to pensions and superannuation income streams interchangeably.

When does a pension commence?

SISFA agrees with the position taken in the draft ruling in relation to when a pension commences by virtue of the contractual relationship between the superannuation fund trustee and the member. This is consistent with our view of the nature of a pension.

When does a pension cease? - general comments

It is puzzling why the draft ruling's position in relation to when a pension commences differs so much from its position in relation to when a pension ceases. While the draft ruling rightly takes the view the pension commences according to the contractual relationship between the superannuation fund trustee and the member, it takes a different view in relation when a pension ceases. That is despite acknowledging that the reference to the fund's trust deed is one of the factors to determine when the pension ceases (at paragraph 83),

It is SISFA's view that it is the contractual relationship between the superannuation fund trustee and the member created under superannuation fund trust deed, the pension documents and/or the PDS that govern when a pension commences and ceases.

When does a pension cease? - failure to make a minimum payment

We agree with paragraph 85 of the draft ruling that a superannuation income stream (within the meaning of pension as defined under SISR) must meet the requirements of subregulation 1.06(1) SISR and thus the requirements of sub-regulation 1.06(9A) SISR.

However, in paragraphs 86 and 87 the ATO expresses the view that the requirements of sub-regulation 1.06(9A) SISR will not be met if the rules of a superannuation fund "simply include a reference to or reproduce the terms of" (paragraph 87) the relevant standard and the rules are not "met or given effect, in practice" (paragraph 87). It is submitted the view of the ATO as expressed is not supported by the law; as stated by the ATO in paragraph 86 "the rules of the superannuation fund meet the relevant standards if the rules "ensure" that the payment is made at least annually and "ensure" that the other requirements as outlined in that subregulation are met." If the rules of a superannuation fund are couched in terms that ensure or secure that the standards are met that is all that sub-regulation 1.06(9A) and therefore sub-regulation 1.06(1) require. The law contained in the sub-regulations referred to does not state that if the rules of a superannuation fund concerning the payment of a pension are not complied with that the relevant benefit paid will no longer be taken to be a pension. In SISFA's view regulation 1.06(9A) SISR does not require hindsight to be applied to determine whether a benefit paid will be taken to be a pension and therefore an income stream.

Again, the obligation to include the standards into the contractual documentation of the pension, supports the view that a pension is a contractual obligation between the superannuation fund trustee and the member.

That contractual obligation to pay a pension will (if the contractual documentation so provides) continue even if the minimum pension payments are not made in a particular year. It would be expected that given that the standards are required to be incorporated into the pension contract that the member would be legally entitled to the minimum payment and could sue for it, again supporting the view that a pension will continue to exist even if the minimum pension payments are not made.

It should be noted that if the ATO continues with its current view several adverse outcomes could occur, including:

- That the superannuation fund would retrospectively go out of 'pension phase' for the year in question, causing the fund trustee to go back and unwind the tax and accounting position of the fund and potentially to lodge amended assessments.
- If the member had not met a full condition of release, then the member could be in breach of the SIS law by accessing their benefits other than in the form of a transition to retirement scheme (ie, by receiving what will now be deemed to be lump sums).

- If the member is aged less than 60, the member may need to lodge amended assessments as they will be deemed to receive lump sums rather than pension payments and consequently the tax treatment of those payments would change.

When does a pension cease? - commutation

In paragraphs 101 to 104 it is stated, correctly in SISFA's view, that whether a superannuation income stream has been commuted is to be determined by superannuation fund rules and/or agreement between the fund trustee and the member. This is consistent with SISFA's view that a pension is a contractual relationship between the fund trustee and the member. Accordingly the questions of whether a commutation has occurred and when it occurs must be determined in light of that contractual relationship.

SISFA disagrees with comments in paragraph 105 that a pension ceases upon receipt by the trustee of a valid request that it be fully commuted. This is because:

- This view is inconsistent with the contractual nature of the pension (as acknowledged in paragraphs 101 to 104). It is that contractual relationship that will determine when the commutation takes effect. That is, the time when the member can legally enforce an obligation on the trustee to commute the pension.
- Many deeds do not give an automatic right to commute a pension but rather a commutation may be conditional upon a certain condition being met or the trustee may have a discretion as to whether it will commute the pension. In these circumstances, the pension will not be commuted upon receipt of the request by the trustee; the pension will continue until it is commuted in accordance with the contractual obligations under which it was established.
- This view on commutation is inconsistent with the view expressed in TR 2011/D3 on when a pension commences. The view expressed is that a pension commences at the time dictated by the contractual terms. In contrast, the view of when a pension ceases has a fixed point unrelated to the contractual relationship between the parties.
- Paragraph 105 does not include any legislative or common law support for the views expressed.

When does a pension cease? - death

Although SISFA broadly supports the views set out in paragraphs 109 to 115, SISFA disagrees with the views in paragraphs 115 and 116 that a pension ceases when no beneficiary automatically receives the balance of the pension or there is no qualifying beneficiaries left to receive the benefit in the form of the pension.

Again, it is SISFA's view that whether a pension exists after the death of a member is determined by the contractual relationship between the superannuation fund trustee and the member and the governing rules of the superannuation fund. For example, if the rules of the superannuation fund provide that upon death the pension obligations of the superannuation fund trustee cease and the member's pension benefits must be moved from a pension account to an accumulation account, then it could be said that the pension ceased at death. However, if the superannuation fund documentation provides

that the pension continues until such time as there is a nil balance in the pension account of the member and that the trustee has the power to pay the pension benefits to the member's dependants or legal personal representative (whether in the form of a pension or lump sum), then the pension exists until that time.

Reasons why SISFA believes the view in TR 2011/D3 on when a pension ceases are incorrect include:

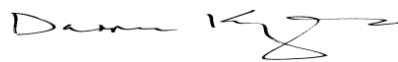
- The view is inconsistent with the contractual nature of the superannuation income stream (as acknowledged in paragraphs 101 to 104 relating to commutations). It is that contractual relationship that will determine when the pension ceases after the death of the member. That is, when is there no longer a pension benefit to the payment of which the beneficiaries of the fund could successfully seek to enforce.
- The view expressed in TR 2011/D3 that pensions cease upon the death of a member is inconsistent with the view expressed that a pension commences when the member has a contractual right to the pension..
- TR 2011/D3 fails to refer to any support at law, for the views expressed.
- A superannuation benefit paid will be taken to be a pension for the purposes of SISA and therefore an income stream if in addition to all other relevant requirements the rules of the superannuation fund ensure that the standards in sub-regulation 1.06(9A) SISR are met. Whether the standards are in fact met is not determinative of the question.

If you wish to discuss this submission further, please do not hesitate to contact Phil Broderick on 03 9274 5286 or Darren Kingdon on 07 3211 1132.

Regards,



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Technical Committee, SISFA
31 August 2011



Darren Kingdon
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Rob Jeremiah
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