# When Does A Superannuation Pension Commence Or Cease?

The Australian Taxation Office (ATO) has issued a Draft Taxation Ruling TR2011/D3 entitled *"Income Tax: When a Superannuation Income Stream Commences or Ceases"*.

The Draft Ruling addresses the ATO's view of when a pension commences or ceases. Tax consequences clearly flow from the ATO's view, but none of the tax consequences are addressed in the draft ruling.

**Death of the Member**

A pension recipient is usually able to arrange for their pension to 'revert' (i.e. continue to be paid) to a dependant on the member's death. The pension does not stop on the member's death.

If the pension is not reversionary, or there is no one to whom the pension can revert, the draft ruling states that the pension ceases immediately upon the death of the member. This means that the tax exemption which the superannuation fund enjoys because it is paying a pension also ceases.

There may be capital gains tax arising from the sale of fund assets to pay a lump sum death benefit. Distributing fund assets in-specie is a deemed sale for capital gains tax purposes.

Income earned by the fund on the deceased member's entitlement between the date of the members death and paying the benefit will also be subject to tax in the fund.

Furthermore, the death benefit is a lump sum benefit and the taxable portion of this benefit will be taxed at 16.5%.

**Failing Pension Rules**

The Draft Ruling states that if the fund fails to pay the minimum required pension in a year (or it pays more than the maximum where there is a prescribed maximum) the pension is taken "for tax purposes" to have ceased on the first day of the year in which the correct payment was not paid. This is regardless of whether the fund still has a legal obligation to pay the pension to the member.

The tax consequences of applying this view are:

• Income and capital gains arising during the year from assets that the fund thought were supporting a pension will become subject to tax in the fund.

• Pension payments made by the fund during the year will be regarded as lump sums paid by the fund. This is of no consequence to a pensioner over age 60 but could have a significant adverse tax outcome for pensioners between age 55 and 60.

• The fund is taken to commence a new pension on the first day of the next year, so long as the fund pays the correct pension in the next year. This new pension will have tax and tax free components calculated at the commencement of the next year, which could be quite different to those of the old pension. This could have significant estate planning implications.

This draft ruling appears not to take into consideration that a pension starts, stops and its terms are by reference to equity law (trust law) and contract law (the pension agreement between the member and the fund trustee is in the nature of a contract).

It would appear that the ATO is trying to deem when a pension stops and starts for tax purposes even though the pensions actually continue to exist under all other law.

The dependants of a deceased member should also be given a reasonable time to organise the deceased's affairs before being levied with additional tax. This is particularly so for self managed superannuation funds as these funds usually have to sell or transfer a substantial amount of fund assets to pay out the death benefit. The draft ruling does not allow for this.

A fund may fail to pay the minimum pension by accident or only by a few dollars. The outcome, that all income and capital gains for the year is taxed seems particularly harsh.

This draft ruling is said to take effect from 1 July 2007. It is taken therefore to apply to pensions that have commenced and ceased over the last four plus years.