

Tech Time



Perpetual's monthly technical guide

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Transition to Retirement – watch for preservation components

Advisers should be careful when advising clients to commence a transition to retirement (TTR) income stream where the client's superannuation benefit contains unrestricted and/or restricted non-preserved components. If these components are rolled over to a TTR, they will be paid to the client as part of their regular income stream and the client may lose access to lump sum withdrawals.

Starting a TTR income stream

A superannuation fund member may commence a TTR income stream if they have reached preservation age, currently 55. This allows the member to access up to 10% of their preserved superannuation benefits as a TTR income stream without having to meet a general condition of release, such as permanent retirement after preservation age, leaving gainful employment after age 60 or reaching age 65.

If the member meets a general condition of release after starting a TTR income stream, it will become a regular account based income stream, ie the 10% restriction on withdrawals will cease to apply.

Preservation components

While a TTR income stream allows a member to access their preserved superannuation benefits, it is possible to also rollover unrestricted and restricted non-preserved benefits to a TTR income stream. Where either of these components is rolled over

to a TTR income stream together with a preserved component, the Superannuation Industry (Supervision) (SIS) Act (Reg 6.22A) states that income payments are drawn in the following order:

1. Unrestricted non-preserved component
2. Restricted non-preserved component
3. Preserved benefits.

Example

Harry, aged 55, rolled \$1,000,000 over to a TTR income stream on 1 July 2010. His benefit consists of the following preservation components:

Unrestricted non-preserved	\$30,000
Restricted non-preserved	\$40,000
Preserved	<u>\$930,000</u>
Total	\$1,000,000

He elects to draw 10% of his account balance for the 2010/11 financial years (\$100,000). The amount of income paid to Harry will consist of the following preservation components:

Unrestricted non-preserved	\$30,000
Restricted non-preserved	\$40,000
Preserved	<u>\$30,000</u>
Total	\$100,000

By 30 June 2011, he will no longer have any unrestricted or restricted non-preserved superannuation benefits.



Tech tip: When advising clients to commence a TTR income stream, advisers should ensure that only preserved benefits are used. Unrestricted and restricted preserved benefits should be kept separate, so as not to lose access to them. Unrestricted non-preserved benefits may be used at any time to commence a regular account based income stream or as a lump sum withdrawal.

Limited recourse borrowing arrangements – related party loans

A recent Australian Taxation Office Interpretative Decision (ATOID 2010/162) looked at the application of arm's length provisions of the SIS Act to limited recourse borrowing arrangements. The ATOID suggests that where members or related parties provide the financing, they could charge a lower interest rate than would be payable to a commercial lender but not a higher interest rate.

Before relying on this ATOID, advisers should bear in mind:

- The ATOID considers the arm's length provisions of the SIS Act but not the general anti-avoidance provisions of Part IVA the Income Tax Assessment Act 1936
- ATOIDs are not binding on the Australian Taxation Office (ATO).

SIS Act arm's length provisions

Section 109 of the SIS Act provides that where parties are not dealing at arm's length, a transaction must be no less favourable to the superannuation fund than it would be if the parties were dealing at arm's length. It does not apply if a transaction is more favourable to the superannuation fund.

Example

Sally is the sole member of her self managed super fund (SMSF). She lends the fund money to purchase an asset under a limited recourse borrowing arrangement. Assuming a commercial lender would charge 9% pa for an identical loan, Sally could not charge her superannuation fund 10% pa as this would breach s109 of the SIS Act, however this provision would not prevent her from charging 8% pa.

Part IVA

Part IVA may apply where a taxpayer obtains a tax benefit as a result of a transaction and the dominant purpose of the transaction was to obtain a tax benefit. The provision allows the ATO to reconstruct a transaction to disregard the tax benefit.

If a related party charged a superannuation fund a lower than arm's length interest rate, it may be argued that the related party has obtained a tax benefit, ie the related party has received less interest income than would have been the case if they had charged an arm's length interest rate.

Example

Sally lends her SMSF \$400,000 to purchase a property under a limited recourse borrowing arrangement. She charges interest of 8% pa, however, the arm's length interest rate for this particular loan is 9% pa. The ATO could argue that Sally has only received interest income of \$32,000 where she should have received \$36,000. Sally could be issued with an amended tax assessment increasing her income by \$4,000. In addition, a penalty of up to 50% of the additional tax payable could be imposed, although the actual penalty will depend on the degree of culpability and the extent to which the taxpayer cooperates with the ATO.

What is an arm's length interest rate?

An arm's length interest rate is the rate that would be charged by a non-related lender on a loan with identical terms and conditions. It can be expected that a loan for a limited recourse borrowing arrangement would have a higher interest rate than an 'ordinary' loan to compensate the lender for the additional risk.



Tech tip: Advisers should be aware that, unlike Rulings and Determinations, ATOIDs are not binding on the ATO. They are a statement of opinion by the ATO about a particular transaction and, as previously noted, they may only examine one aspect of a particular transaction.

This analysis has been prepared by Perpetual Investment Management Limited (PIML) ABN 18 000 866 535, AFSL 234426 Perpetual Superannuation Limited (PSL) ABN 84 008 416 831 AFSL 225246 RSE L0003315 for the use of financial advisers only, it is general information and is not intended to provide you with financial advice. The technical interpretations expressed in the article are the opinions of the author at the time of writing and do not constitute a recommendation to act. Any information referenced in the article is believed to be accurate at the time of compilation and is provided by Perpetual in good faith. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information.

Further information

Adviser Services 1800 062 725

Investor Services 1800 022 033

Email investments@perpetual.com.au

www.perpetual.com.au