

## DIY Super Smart Money

Expert view

## Pay the minimum to avoid grief



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All superannuation funds have the scope to tailor pension arrangements. But do-it-yourself funds often lead the way when it comes to more innovative strategies.

Ipac South Australia's superannuation strategist, Peter Crump, says this is because it's usually easier to implement a strategy through a DIY fund, especially anything new.

It's also easier to adapt to changes to super rules, which on the pensions front are topical with the Australian Taxation Office's draft ruling on the tax treatment of pensions in various circumstances. One of these circumstances is the situation where funds pay members multiple pensions.

A multiple pension strategy is often associated with another

popular DIY strategy: withdrawing super under a transition to retirement pension then recontributing this money as after-tax contributions. The withdrawals are then accumulated separately over a period of time and, where possible, added to with more after-tax contributions. These amounts are used to start a second pension with a significant proportion of non-concessional super.

Having a pension with a large non-concessional proportion creates a superannuation interest that can be very tax effective, given this proportion of income will be tax free, says DIY super administrator Heffron principal Meg Heffron.

For someone aged from 55 to less than 60, having two pensions can allow a retribution strategy to be pursued through the pension with the higher proportion of taxable income and an income withdrawal strategy that focuses on the non-concessional dominated pension.

Once a member reaches 60, when all pension payments become tax free, the pension that is used for income purposes becomes the one with the greatest taxable proportion, while the mostly tax-free pension is limited to minimum withdrawals.

The requirement to take a minimum amount from each pension is an issue that has been highlighted by the ATO draft ruling, which contains a view that any failure to pay the minimum can have some serious consequences.

One of them is the pension ceasing to be an investment tax-free income stream from the beginning of the year the pension is underpaid. To be classified as a concessional pension, with the major concession being tax-exempt investment

### Set up a third small pension with taxable income that will act as 'fall guy'

income, an essential requirement is the payment of a minimum pension based on the fund's July account balance at least annually. This minimum in a normal year ranges from 4 per cent for those aged from 55 to 64 up to 14 per cent for those older than 95.

Crump says the risk associated with a DIY fund not paying its members the minimum annual pension can have a substantially negative outcome. Even if it is only a small error it can have large

consequences. While it is still only a draft view, given it is contained in a draft ruling, Crump says the possibility of it becoming the rule is high. It makes it increasingly important for all DIY fund trustees to pay attention to making sure that all pensions satisfy the minimum annual payment requirements.

Another potential consequence is the prospect of this penalty flowing on to other pensions, resulting in them also losing their concessional treatment. Heffron says that being

tardy about paying the minimum pension can undo all the work and trouble a fund may have gone to in organising a tax-effective pension arrangement through transition to retirement strategies and establishing multiple pensions.

If the view expressed in the draft ruling is accepted, underpaying the minimum can mean a pension has stopped and where this occurs all the fund pensions may be caught.

This will result in them losing their exempt pension income entitlement

for the year. The only protection from this potentially significant risk is to make sure the minimum is paid each year for each pension.

One possible strategy where a fund follows a multiple pension approach with one pension that has more taxable super and the other with a higher tax-free proportion is to set up a third small pension with taxable income that will act as "fall guy".

Should the fund ever underpay the minimum, the underpayment should be attributed to the smaller pension account, which loses its exempt tax status and is sacrificed to protect the larger pension. As long as there are adequate pension payments to satisfy the minimums for the larger pensions, says Heffron, they should be able to continue. It is important they are not stopped for failing to pay the minimum.

The other major risk if more than one pension fails to pay the minimum or the fund is still an accumulation account with taxable super is the pension losing its individual tax status and being obliged to combine with the others that may be largely taxable. So if a largely tax-free pension misses the minimum it could find itself combined with a fully taxed pension.