Important Considerations in a Market Downturn

With significant portfolio losses a reality for many in the SMSF sector, times like these provide unique strategy opportunities for SMSFs that only come along as a result of serious global events. We have identified some issues for you to keep your eye on over the coming period and highlighted some that require Government or Regulatory intervention in addition to those announcements made already - please see our bulletin here.

Stopping Pensions

In times like these, many people consider commuting (ceasing) part of all or their pension, as a way of reducing the amount they have to take out of the superannuation environment. But this might not be such a great idea without carefully considering the purpose for commuting a pension and understanding the associated issues.

Obviously where we experience such a significant downturn, its right to consider whether retirees will still have enough in their fund to last. Further, with reduced returns the tax benefit of having funds allocated to a tax exempt pension may also be reduced. Also of course, capital losses realised when the superannuation fund is in full pension mode cannot be retained or carried forward for future use.

But let's be very clear, there are things that will need to be carefully considered though, such as:

- There would be a requirement to draw down a prorated minimum before commuting
- Stopping a pension while asset values are low and then recommencing later, when they're higher, could adversely affect an individual's Transfer Balance Account
- Tax free components that have been successfully quarantined in a pension account may be compromised if combined with other taxable components
- If the decision is made purely to avoid paying tax, the (Part 4A) anti avoidance provisions may apply
- We have already seen some proactive relief from the government cutting minimum requirements in half.

Offsetting deferred gains applicable to transitional CGT relief

Any asset that had its cost base reset under CGT relief, prior to 1 July 2017, that resulted in a deferred capital gain can offset the gain when the asset is realised with losses from the realisation year (i.e. this year). Further, whilst losses might not be considered all that attractive, they can have a greater tax significance in a post transfer balance cap environment where accumulation benefits exist.

Modifying the tax free value of income streams

Outside of disability superannuation benefits there are no legislative ways to adjust an individual's tax free benefits in super. Taxable components in a pension are proportionate and those proportions are reflected in all payments made and investment returns allocated. If members have an accumulation interest with a tax free component, this component is fixed whilst the taxable is likely to be dropping in a falling market. Commencing a pension may not be considered ideal in a falling market but it may also result in a higher tax free component leading to a potential tax savings on the death of the member. Similarly, by commuting a pension back to accumulation all the investment risk shifts to the taxable component, which may shrink in a negative return environment. This could result in a future pension having a higher tax free percentage. There are obviously transfer balance account risks with commuting and recommencing.

Matters that need Government intervention

In addition to reducing the minimum pension obligation for 2019/20 and 2020/21, and providing access to super for those in financial need, there are three significant matters that require external intervention that we think should be on your watchlist:

1. **Transfer Balance Cap debits for investment losses**
   The transfer balance cap does not incorporate investment gains or losses, however, the Government made it clear when the legislation was released that they would review the impact to retirement savings in the event of a macroeconomic shock given that transfer balance cap restrictions may not allow retirees to recoup losses. Needless to say we are seeing a fairly significant macroeconomic shock.

2. **SMSF property rent relief**
   A significant number of SMSFs hold investment properties, both commercial and residential. Rent relief may relieve some tenants who are suffering under the financial strain of reduced business operations or closure or perhaps even reduced working hours for tenants leasing residential property. In the instance of leasing a property to a related party, an SMSF risks being seen to provide financial assistance if rents aren't at market rates, it also runs the risk of income being treated as non-arm's length income and taxed at the top marginal rate. Occupancy rate may also drop if businesses are forced to shut down.

3. **Over inflated in-house assets**
   The in-house asset rules require trustees to put in place a plan to dispose of in-house assets within the year of exceeding the 5% limit. During the GFC the ATO took a practical approach to this measure and required trustees to formulate their plan but not act on it if the markets corrected themselves and the in-house assets returned to less than 5% by the end of the next year.

All of these matters are worthy of your attention. It's no time for making short term decisions with long term consequences, so we're here to make sure you can make the most informed decisions.

Don't hesitate to contact your Client Manager to discuss. We're operational and here to support you.