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YOUR QUESTIONS JOHN WASILIEV

Lump sum taxable for non-dependant members too

I liked the article about tax on investments sold to pay death benefits from a self-managed super fund and tax on death benefits paid to non-dependants (*Weekend AFR* October 24-25). It would seem the options are to sell all investments at the first sign of illness so there is only cash in the fund when we die. Or we might withdraw a tax-free lump sum during the pension phase, which would be passed on as cash. But would it make a difference if non-dependant beneficiaries are also members of the fund? Are there tax advantages in having them as contributing members, to allow investment assets to be passed on and stay in the fund? Or must they be realised and withdrawn?

The strategy of drawing a tax-free amount during the pension phase – assuming you are over 60 – and giving it to non-dependants prior to your death would achieve the objective of passing on super benefits tax free, says Ed Bernard, technical adviser with super administrator Super Guardian.

Unfortunately, having non-dependants as fund members would not allow the assets to simply be passed on to beneficiaries. A death benefit would still need to be paid as a lump sum to non-dependants, meaning assets would need to leave the fund and the "taxable" portion of the benefit would remain taxable to the non-dependant. Of course, if they were members they could contribute these amounts back into the fund, subject to their contribution limits.

Arrangements such as promissory notes have been used by trustees of SMSFs. A promissory note is a promise to pay. Examples are IOUs or post-dated cheques. This involves a trustee giving the promissory note representing the death benefit to a member. The member endorses it back to the fund as a contribution, removing the need to sell assets that may incur capital gains tax.

The relevant death benefit tax and contribution limits would still apply, but it means specific assets need not be sold. However, this is frowned on by the Australian Taxation Office, as outlined in a Taxpayer Alert 2009-10. It cautions against promissory notes being used "in a non-commercial and contrived manner to artificially avoid liquidity problems, change the timing of transactions or to obtain taxation advantages".

Before implementing this strategy it would be wise to get professional advice.

Ask us

Get your superannuation questions answered by the experts. Send any query, big or small, to:

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I am unsure of the rules about a lump sum from an account-based pension. I understand it is necessary to pay the pension prior to taking the lump sum. For example, let's assume the pension assets were $1 million on July 1, 2009 and the pension set at $20,000 (the minimum 2 per cent that applies to a 60-year-old for 2009-10). I want to take a $100,000 lump sum next March. How much pension would have to be paid to allow this to happen? Would I have to convert the whole pension, and restart a new one with the balance of the pension assets that would require a new pension calculation?

A benefit of super changes from July 2007, says Graeme Colley, national technical manager with ING Australia, was the introduction of account-based pensions. The simple rules require a minimum, age-based payment.

When paying an account-based pension it is possible to make lump-sum withdrawals, described as commutations, from the account providing the pension.

Such commutations can be made simply by notifying the fund that you wish to withdraw an amount as a lump sum. There is also a requirement to pay minimum income equal to the annual pension payment, pro-rated to the time of commutation. If we assume you commenced a pension from July 2009 with an account balance of $1 million, the minimum annual pension payable would be $20,000 (2 per cent of $1 million).

If you wished to partially commute the pension at the end of March 2010 you would be required to have received at least a minimum amount equal to the pension, pro-rated on a daily basis to March 31, 2010. As there are 274 days (inclusive) from July to March, the pro-rata minimum amount would be $15,013. That is $20,000 multiplied by 274 days divided by 365 days. This means there is no requirement to commute the whole pension and start anew with the balance.

I'm 60 and have an endowment personal super plan with AMP, into which I have been making monthly payments since 1969. The plan ends this month with a payout of $262,000 into my SMSF. Could I withdraw this tax free, as I wish to pay off my mortgage?

Assuming the policy was held by your fund, says Peter Burgess, superannuation manager with Kingston Capital, you could only withdraw the payout proceeds if you satisfied a condition of release, such as retirement from the workforce. As you are 60, you would satisfy the retirement condition of release if you have permanently retired or an arrangement under which you were gainfully employed had ceased on or after you turned 60. As you have reached 60, lump-sum withdrawals are tax free.