

Superannuation & Natural Disasters

The recent bushfires across Australia have impacted many thousands of individuals and small businesses and prompted an outpouring of generosity at levels never before seen in this country. We've since had multiple inquiries from clients whose SMSF has been negatively affected or who'd like to use their SMSF monies to help others.

In this article we cover the most common questions, aimed not just at the recent bushfires but any national disaster across the country.

EARLY ACCESS TO SUPER

As a general rule, preserved superannuation benefits may only be accessed in lump sum form once members turn 65 or reach their preservation age and retire (or satisfy some other condition of release such as permanent incapacity, terminal illness etc). However, in times of financial distress, there are some circumstances under which members may be able to bypass these rules and access their super "early".

My client has lost their home/business/job. Can they draw a lump sum from their super to help them out financially?

At least part of a member's preserved superannuation monies may be available if they are suffering from "severe financial hardship" or qualify on "compassionate grounds". Unfortunately, these rules only give early access to superannuation under very limited circumstances that are sadly unlikely to provide any immediate help to people affected by the bushfires.

SEVERE FINANCIAL HARDSHIP

For superannuation purposes, "severe financial hardship" is a specifically defined term and the conditions to be satisfied depend on the member's age [SIS Reg 6.01(5)].

Members can access at least part of their superannuation as a lump sum if they are:

- currently in receipt of certain Government income support payments and have been for at least the last 26 weeks continuously, and
- able to satisfy the trustee of their fund that they are unable to meet their "reasonable and immediate family living expenses".

It is up to the trustee of the fund to determine the amount which can be paid, taking into account the member's financial resources and needs, up to a maximum of \$10,000 per annum (before tax). Only one payment is permitted in any 12 month period.

For members who have reached their preservation age plus 39 weeks, there are additional paths. Under the financial hardship rules, they can access their entire benefit as a lump sum or an account based pension if they:

- are not currently employed for 10 or more hours per week, and
- have received certain Government income support payments for a total of least 39 weeks since reaching preservation age (this does not need to have been continuous).



Of course simply reaching preservation age is an important milestone for accessing superannuation. Members of this age (regardless of their financial position, work intentions) are able to commence a transition to retirement income stream (TRIS) allowing them to withdraw up to 10% of their balance as a pension payment each year. Lump sums are not permitted (unless the member has sufficient unrestricted benefits eg they satisfied a condition of release in the past). Should the member's financial position recover and they no longer require access to monies from super, the TRIS could be stopped and the balance returned to accumulation phase if desired.



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Depending on their work history and future intentions, members of preservation age may even meet one of the retirement definitions and have full access to their superannuation as a lump sum or account based pension.

The most common Government income support payment that qualifies under the severe financial hardship rules is Newstart Allowance but others are also relevant – for example, sickness allowance, parenting allowance or the Farm Household Allowance [SIS Reg 6.01(2) def'n of "Commonwealth income support payment", Farm Household Support Act s.91(3)]. Certain special payments that the Government might make in the event of an emergency may also qualify but if they are only made for a very short time, they won't be enough (in isolation) to meet the requirements outlined above.

For members of non-SMSFs, the trustee of the fund will determine if the member has satisfied the necessary conditions. As a minimum, they may ask the member to obtain a letter from the Department of Human Services confirming the receipt of income support payments (some non-SMSFs can access this information directly).

For members of SMSFs, again it is the trustee of the fund who is to determine a member's eligibility and as a minimum, a letter from the Department of Human Services confirming receipt of income support payments for the requisite period will be required. For members under preservation age, trustees should also have sufficient documentation on file to satisfy the fund's auditor (and the ATO) of the member's financial circumstances.

COMPASSIONATE GROUNDS

Where members don't have the financial resources to meet certain types of expenses, they may be able to take money out of their superannuation to cover these costs. The particular types of expenses allowed include those:

- to cover medical treatment for a chronic or life threatening illness but only if that treatment is not readily available through the public health system,
- to pay for modifications to their home or vehicle to accommodate a severe disability,
- to cover the palliative care or funeral costs of a dependant, and
- to prevent foreclosure on their home mortgage if

their lender has threatened to repossess or sell their home.

Only unpaid expenses are eligible. If members have already paid the expense (eg using their credit card or with the help of family), then those costs will not be eligible.

The ATO is responsible for approving all claims for accessing super on compassionate grounds. If approved, they will tell the fund of the member's eligibility and members can then apply for benefits from the fund. Members of SMSFs must not draw any money from the fund until the ATO authorises the payment.

Again, the ability to access super on compassionate grounds is unlikely to provide any immediate assistance to those affected by the bushfires.

Normal superannuation tax is payable when benefits are accessed under the severe financial hardship rules or compassionate grounds. Family tax benefits or other concessions may be impacted as could any child support payments.

For clients with SMSFs, it is very important they aren't tempted to withdraw money from the fund before they are legally entitled to. If they were to do so, the consequences could be severe. They will be taxed on the amount taken at their marginal tax rate (instead of the concessional rate usually applied to superannuation monies), they could be fined and/or imprisoned and the fund could be made non-complying (potentially losing almost half its assets in tax) [ITAA 1997 s.304-10, SIS s.166, SIS s.196(3), SIS s.202, ITAA 1997 s.295-325].

LOSS OF SMSF DOCUMENTS

In times of fire, flood, cyclone etc, an SMSF trustee sometimes loses critical fund records.

What if the original of the fund's trust deed/change of trustee deed has been lost?

If an original of the deed cannot be found, a deed of variation and ratification can usually be prepared using details obtained from any copies of the deed held by the fund accountant/administrator/auditor.

What if other documents prepared on establishment of the fund have been lost?

If copies of these documents cannot be found on the files of the fund accountant/administrator/auditor, we

would usually suggest replacements are prepared of the trustees' Consent to Act and Trustee Declaration, together with a statutory declaration acknowledging the loss of the originals.

What if pension commencement documents have been lost?

If copies of these documents cannot be found on the files of the fund accountant/administrator/auditor, we would usually suggest the trustee prepares minutes to confirm the terms of the pension particularly any reversionary beneficiary.

What if the fund's accounting/financial records have been lost?

It is usually possible to recreate records using the files of the fund accountant, administrator, auditor, financial adviser, and/or the ATO sufficient to prepare the current year financial statements/returns. The fund's auditor may qualify the audit report and/or lodge an Auditor Contravention Report due to loss of prior year records but the ATO is unlikely to take any action given the circumstances [SIS s.35AE, SIS s.35B].

SMSF OWNED ASSETS

One of the risks of investing in property is the asset's vulnerability to damage, with the potential to impact both rental income and capital returns.

My client's SMSF owns property which has been damaged or destroyed. What do I need to watch out for?

- Firstly, it will be important for the trustees to identify exactly what the SMSF owned and what the trustee is responsible for repairing/replacing. For example, the property itself may have been owned by the fund but there may have been other assets used in connection with the property which are owned by/the responsibility of the tenant. This will usually be evident from the lease and the original purchase documentation. The fund's auditor should have a copy of these even if the originals have been lost. It would be difficult to justify having the SMSF pay for repairs to anything that is legally the responsibility of the tenant (see our comments below on helping others with SMSF money). In contrast, the SMSF is of course **obliged** to make good any assets it is responsible for if this is what the lease requires.

- Where the asset was insured, any insurance proceeds received will need to be paid to the owner of the asset. The tax treatment of any insurance proceeds will depend upon what the proceeds are replacing. For example:
 - If covering loss of rent, the proceeds are generally ordinary assessable income of the fund.
 - If in respect of depreciable assets, an amount may be assessable/deductible depending on the written down value of the asset (ie a balancing adjustment).
 - If in respect of capital items (ie CGT assets), the CGT provisions will generally determine the amount of any cost base adjustments, and the capital gain or loss incurred.
- Where the property has been damaged to such an extent that the tenant is no longer able to use all or part of it, it is likely there will need to be an adjustment made to the rent payable. The fund's lease agreement may specifically detail what is to happen in these situations. Alternatively, the local estate agent may be able to provide information on the approach taken by other landlords in similar situations. The trustee will need to make sure the approach they take is commercial and documented, particularly if the tenant is a related party of the fund.



In our view, related party tenants should not continue to pay full rent to the fund on a property where there is material damage to the capability they were renting. For example, if the landlord was responsible for fencing and this has all been destroyed, the farmer may be unable to re-stock. If the tenant paid normal rent despite the landlord (the SMSF) effectively failing to provide the asset in a fit state for use, the rent paid could be considered non-arm's length income and taxed at 45% (instead of the concessional 15% or nil rate) as the fund's income would be higher than it would have been if the parties had been acting at arm's length [ITAA 1997 s.295-550].

- If the SMSF wants to engage a related party to undertake repairs or the building of a replacement asset:

- Whilst it is common place for builders to supply the goods and materials used in the provision of a building service, in an SMSF context, this would breach the acquisition of asset rules [SIS s.66]. This means the related entity must be engaged to provide services only with the fund sourcing the materials directly from third party suppliers or the fund will need to enter into an agency agreement with the related party.
- The arrangement between the SMSF and the related entity must be conducted on arm's length terms [SIS s.109, ITAA 1997 s.295-550]. This means a contract must be entered into and the contract price must be the same as it would be between two arm's length parties. The trustee will need to be able to substantiate that the price paid is the same as what would have been charged to third party customers.

The contract terms must also be arm's length. This means all terms and conditions (eg timing and amount of progress payments, potential action for non-payment etc) must be the same as for third party customers.

- The fund is unable to borrow to finance repairs (unless the asset was purchased under an LRBA) or replacement of the asset [SIS s.67].
- The damage/destruction of a fund asset would usually be a trigger for obtaining a new market valuation of the asset for use in the fund's financial statements.

Is the situation different if the asset was owned by a bare trust under a limited recourse borrowing arrangement (LRBA)?

Where the asset is owned via an LRBA, there are additional considerations:

- The fund is able to borrow for repairs but not improvements to the asset [SIS s.67A(1)(a)(i), SMSFR 2012/1]. Improvements would need to be sourced from fund monies. For example, if a fire destroyed a three bedroom house (but not the land) owned by a LRBA, the fund could borrow to rebuild the house. However, if the house was extended to four bedrooms when it was rebuilt, this is likely to be considered an improvement with the additional cost needing to be sourced from fund monies.
- However, any improvements must not fundamentally change the character of the asset

such that the asset becomes a different asset whilst the LRBA is in place. For example, a fund owned a house and land via a LRBA and the house was destroyed. If the house was replaced with three strata title units, this would be a fundamental change to the character of the asset. This would only be permitted if the debt was repaid and the land transferred to the SMSF before the change took place.

- If the entire asset has been destroyed (eg an item of machinery destroyed by fire), insurance proceeds/fund monies could be used to replace the asset within the fund but it cannot be replaced within the LRBA.

My client's SMSF owned property is undamaged but the tenant is currently unable to pay the rent. What do I need to watch out for?

Where tenants are unable to meet their obligations under their lease arrangement with the fund (eg because their business profits have been impacted or they have lost their job), the trustee has a number of options.

They could choose to enforce the terms of the lease arrangement and follow the process in the lease agreement to recover any shortfall.

More commonly though, a landlord will agree to a payment plan, rental reduction, rent free period etc particularly where there is a location-wide impact. Trustees may decide that this approach will be cheaper in the long-term than incurring legal costs, finding a brand new tenant etc.

Where the tenant is a related party, it will be essential for trustees to ensure the approach they take is commercial and able to be substantiated [SIS s.109]. As noted above, the local estate agent may be able to provide information on the current market conditions, approach taken by other landlords etc.

HELPING OTHERS USING SMSF MONIES

For those clients who've not been impacted and would like to help others less fortunate, can their SMSF play a role? Unfortunately, the answer is usually "no".

All superannuation funds are required to comply with the sole purpose test [SIS s.62]. That is, the fund needs to be maintained only for the purpose of providing benefits to members on their retirement, or for their dependants, in the case of members who die before

retirement. Sadly, there is little opportunity for altruism in the sole purpose test.

Can an SMSF make a charitable donation?

In our view, an SMSF making a charitable donation would breach the sole purpose test as it would be difficult to argue that there was a retirement purpose behind the transaction.

You may then wonder how public offer funds are able to do so. For them, the argument is slightly different.

Making a (often publicised) donation to charity, sponsoring a sporting team or offering incentives to particular groups raises awareness of the fund's brand, encouraging new members which in turn reduces the administration costs for all members. The amount of the donation is usually at such a low level relative to the total assets of the fund that member returns are not impacted. A similar approach was taken by AustralianSuper recently with Qantas' offer of bonus frequent flyer points for new fund members.

Of course, those SMSF members whose benefits are unrestricted non-preserved (eg reached age 65, over preservation age and met a retirement definition, or satisfied some other condition of release allowing access to their benefits) could draw on those benefits and make a personal donation with the proceeds.

On a similar note, on the death of a member, can their benefits be paid to a charity?

Not directly. Superannuation benefits may only be paid to the member's dependants or their legal personal representative (ie their estate) [SIS Reg 6.22]. Where benefits are paid to the member's estate, they could then be paid to charity in accordance with the member's will.

My client's SMSF owns residential property. Can they lease the property to those who've lost their homes at a nominal rate?

It depends.

If the property is located in an area where there is a shortage of rental properties, there is likely to be greater demand which could put upwards pressure on prices. For the SMSF to then lease their property at a nominal rate suggests there is a non-retirement purpose behind the transaction.

However, if the property is currently untenanted and

the trustees do not believe they will be able to secure long-term tenants on favourable terms now given the damage to infrastructure in the area etc, then they may in fact be making a tactical decision which will lead to higher retirement benefits in the longer term. For example, they may consider having a tenant in the property at a reduced rate is better than no rent at all, and that they'll then have the opportunity to lock in a higher rate when conditions improve. They could even potentially argue that no rent is reasonable if there is significant value in having "someone" in the property at a time when the area is less stable than normal.

In this case, the rent would not be considered *nominal*, but in fact simply a reduced rate to reflect the current circumstances. It would be important in this situation to have those considerations documented by the trustee.

The acid test will always be - is this simply a generous act or can it be supported as the prudent management of the fund's assets in order to maximise retirement benefits? Imagine it was someone else's money/assets you were dealing with - would you do it or would you feel that was something you could only really justify if it was your own money?

SUMMARY

Where superannuation is concerned, particularly SMSFs, it is always important to double-check the rules before taking action. Often the law simply doesn't allow for the outcome trustees and members desire.

If you have other questions for us to consider, let us know so that we can cover more scenarios in future articles.

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