



NOVEMBER 2014

Welcome

Welcome to the November AIA 'Investor Update'. A good range of articles this month – The NSW Committee reports on their new initiative – a Workshop on Investment Planning. Note the Switzer invitation to their webinar. We also have an article about LRBAs in SMSFs and the myths about SMSFs property investments. Note also the article about the new banking capital requirements and the potential effect on term deposits. .

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AIA trials Hands-on Workshop on Investment Planning

By Brian Spies and Richard Cowan, NSW committee.

On 7th November, the AIA ran a 1-day seminar in Sydney, with an ambitious goal: *Create your personal investment plan: A hands-on workshop*. This was the first time the AIA had attempted such a program, and its success was largely due to the outstanding presenters Doug Turek, Tony Rumble and Colin Nicholson, and detailed preparatory work by the NSW committee.

(Cont'd)

Upcoming Events

Frankston South Discussion Group

3rd December 2014 1.00pm

Brisbane Information Meeting

3rd December 2014 7.15pm

Blackburn VIC Discussion Group

3rd December 2014 7.15pm

Canberra Discussion Group

8th December 2014 7.30pm

Sydney North Shore Information Meeting

10th December 2014 7.30pm

Gold Coast Information Meeting

16th December 2014 9.30am

Brisbane Investment Management Discussion Group

16th December 2014 6.30pm

AIA trials Hands-on Workshop on Investment Planning (Cont'd)

Feedback from the 66 members and family who attended the investment planning workshop was uniformly positive. Two-thirds of attendees said they did not have a comprehensive financial plan. Some said that this was the first time they had worked out their annual expenditure and were surprised at how much they spent. Some decided to immediately change their asset allocation and strategic approach to investing. Many left the workshop with more questions than they had when they arrived, but with a greater understanding of what they needed to do.

In preparation for the workshop, participants were sent a 4-page workbook to compile basic financial information, such as current and projected annual expenditure, investment net worth, wealth and investment structure indicators, risk tolerance and life goals. Armed with this information, the presenters led participants through six interactive sessions – life goals and investment needs, strategic asset allocation, growth assets, debt and defensive assets, portfolio management and revising and improving the investment plan. Another workbook, aligned with the six sessions, was started during the day and completed at home.

The basic question in financial planning is "Will my investment assets and income sources generate sufficient income to fund my desired level of expenditure over my lifetime?" If not, either more savings are needed, or expenses need to be lowered and expectations adjusted. Additional issues to consider include various types of risk, personality and preferred investment style, and preparation for contingencies such as health expenses, family assistance and changing government legislation.

The workshop proved to be an excellent starting point to consider these issues. The AIA Board is considering running the course at next year's national conference, so please talk to your local coordinator if you have interest in learning more. The two workbooks can be downloaded from the members-area of the AIA web site [LINK].

Brian Spies and Richard Cowan, NSW committee.

Invitation to webinar from the Switzer Super Report

AIA members are invited to join Peter Switzer and Paul Rickard in a live and interactive webinar where they discuss the economy, financial markets, and all things investing. [Click here to register!](#)

The webinar will be held Friday the 5th of December at 12.30pm AEDT. If you can't make it at that time, register and you'll be able to view the webinar at a later time.

If you haven't used the *Switzer Super Report* before, you'll also receive a complimentary three week subscription to the report. If you're only interested in the webinar, you can simply unsubscribe from the report.

"Don't Let The Truth Get In The Way Of A Good Story!!!" The REAL stats on LRBAs in SMSFs!

By Shane Ellis

What a croc! That is right, I said it and meant it, What a heap of big cow poo. The repeated unsubstantiated comments and untruths about SMSFs and real property really are just **CRAP!**

Just like this one: *"Self-managed super funds are gearing into property more heavily amid regulator concerns that debt is fuelling growth in house prices and creating risk for the financial system."*

Geez media, please **get it right!!!**

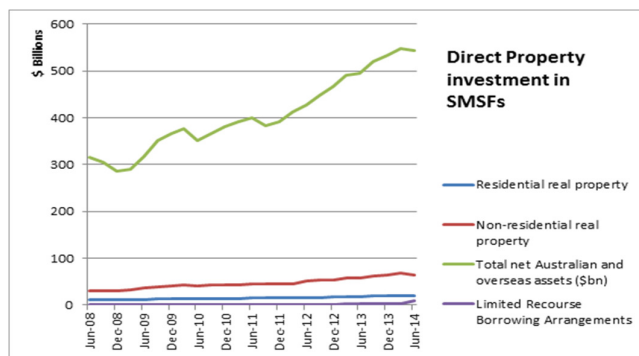
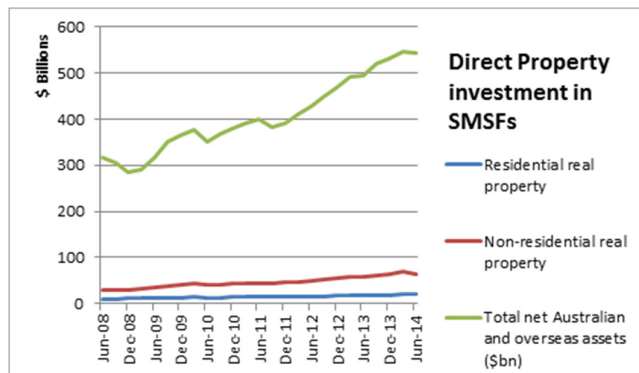
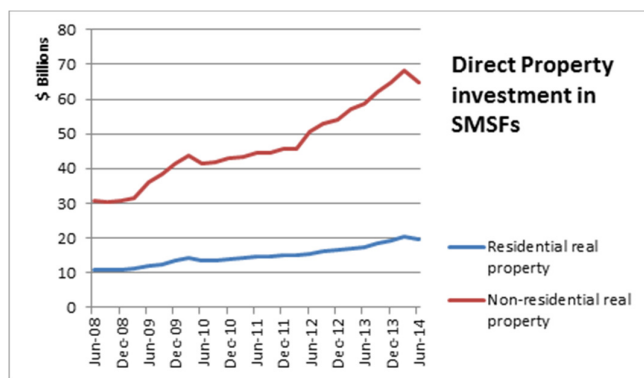
...And readers please understand the truth is based on statistics not just what sells papers, has people listening and watching radio and TV...or what comes through online.

The graphs below were compiled by the good folk at the Superannuation Professionals Association of Australia (SPAA) based on the ATO stats for the June quarter which were released on the 9th of September 2014. The estimate SPAA came up with was that the amount of gearing by SMSFs was in the vicinity of \$8-\$10 Billion which has been confirmed by the ATO stats being in the lower end of that estimate.

Have a look at the graphs below which show SMSF direct property investment, comparing it to total SMSF investments, and then showing the amount that is linked

to SMSF limited recourse borrowing arrangements (loans to buy property by SMSFs). Please pay close attention to the purple worm in the third graph because it looks pretty dead to me compared with the overall SMSF investment grubs. The purple line happens to represent the amount of SMSF limited recourse borrowing arrangements, and the worm only just got its head off the canvas in about June 2014. If I was relying on that grub to fuel speculation that SMSFs were doing anything in a big way then I may be hard pressed to have people agree with me.

Startling, absolutely startling. I hope you readers can sleep after so much stimulation. Just like the purple worm is. ZZZZZZZZ!!!



The Superannuation Professionals Association of Australia is acknowledged for the supply of the charts above.

The ATO is acknowledged as the source of the statistics.

Here is a link to the ATO's media release explaining the difference in the LRBA stats due to more detailed collection of information. The revised figures are about the same as what we found when doing work with the larger banks.

<https://www.ato.gov.au/Media-centre/Quarterly-SMSF-statistical-report-released/>
<https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report---June-2014/>

If we can assist you with any SMSF documents or documents designed to protect your assets and estate, please contact us here at SMSF LAW EQUITYPROTECT.

Shane Ellis is the Managing Director of Equityprotect & SMSF Law

SMSFD 2014/1: latest from the ATO on commuting a TRIS

By Bryce Figot, Director, bfigot@dbalawyers.com.au, DBA Lawyers

The ATO has recently released self managed superannuation fund determination SMSFD 2014/1. SMSFD 2014/1 builds on taxation ruling TR 2013/5 and SMSFD 2013/2 and provides some important insights regarding the ATO's views on commuting transition to retirement income streams ('TRIS'). This article discusses some key points arising from the determination.

What is a 'commutation'?

Although not expressly defined in the determination, from certain comments in the determination, it's clear that the ATO view a commutation as being where an SMSF trustee's liability to make pension (eg, TRIS) payments is exchanged or substituted for a liability to pay a lump sum.

I stress an important point at this stage, which applies not just to TRISs but to all pensions: The lump sum that arises upon commutation does not have to be cashed out of the superannuation system. The lump sum can be rolled over. More specifically, *subject to the specific terms of the particular SMSF's deed*, it could be rolled over to another fund (SMSF or an APRA-regulated fund) or it could be internally rolled over within the same SMSF. I note that there are still a number of SMSF governing rules (typically contained in the SMSF deed) that do not permit internal roll overs. Accordingly

reviewing deeds — and if necessary updating them — is a must.

Key point: partial commutations count towards satisfying pension minimums

The critical aspect of SMSFD 2014/1 is that if a TRIS is partially commuted and the resulting lump sum is cashed out of the superannuation system, the lump sum counts towards the required TRIS minimum payments. Naturally, this generally can't occur because, if a TRIS is partially commuted, the preservation rules prevent the resulting lump sum from being cashed out of the superannuation system. However, to the extent that the TRIS is comprised of unrestricted non-preserved benefits, this is able to occur.

Although there are not many who fall into this category (ie, who are young enough to bother with a TRIS yet have unrestricted non-preserved benefits), this is important for who are in this category. This is because if such a person is under 60 and the benefit is comprised of the taxable component, the person may well want to make use of reg 995-1.03 of the *Income Tax Assessment Regulations 1997* (Cth). Regulation 995-1.03 provides that a superannuation pensioner may in certain circumstances elect before receiving a pension benefit that the benefit is not to constitute a pension payment in the pensioner's hands for income tax purposes. Naturally, if a benefit does not constitute a pension payment in the pensioner's hands for income tax purposes, it will constitute a lump sum.

Lump sums generally attract far more concessional income tax treatment in the hands of recipients than pension payments. For example, when the recipient is aged between preservation age and 60, up to the recipient's low rate cap amount (currently \$185,000), the taxable component of the lump sum is received income tax free. After that, the taxable component of the lump sum is subject to a maximum 15% income tax plus applicable levies. This can be contrasted to pension payments. The taxable component of pension payments received in equivalent circumstances is taxed at up to 30% plus applicable levies.

Not exceeding cap

SMSFD 2014/1 also provides somewhat of a pleasant surprise. Although a lump sum cashed out of the superannuation system due to a TRIS partial commutation counts towards satisfying the minimum pension requirements, it does not count towards the 10% maximum. SMSFD 2014/1 illustrates this — and other important points — with the following example:

Sheldon ... is receiving ... a transition to retirement income stream ...

On 1 July 2013, the account balance of Sheldon's transition to retirement income stream was \$300,000. The minimum annual amount required to be paid ... was \$12,000.

On 1 May 2014 Sheldon requested, in accordance with the governing rules of the fund, to partially commute ... to the extent of \$20,000 and have paid to him the \$20,000 as a result ... the \$20,000 was permitted to be paid to Sheldon as an unrestricted non-preserved benefit because the amount of Sheldon's unrestricted non-preserved benefits when the commutation took effect was \$25,000

The \$20,000 partial commutation payment was paid accordingly to Sheldon on 3 May 2014 as an unrestricted non-preserved benefit.

The partial commutation payment counted towards the minimum annual amount required to be paid from the pension account ... As \$20,000 exceeded the minimum annual amount ... the trustee did not need to pay any further amount ...

Subsequently in the 2013-14 financial year, Sheldon advised the trustee that he still wished to be paid \$15,000 as an income payment from the income stream before 30 June 2014. That payment was made on 3 June 2014.

... the \$20,000 payment does not count towards the maximum annual amount allowed to be paid from the pension account ... Even though a total of \$35,000 was paid to Sheldon in the 2013-14 financial year, the trustee did not exceed the maximum annual amount for the income stream for that year of \$30,000 (being 10% of \$300,000).

In specie payments

The ATO have previously expressed the view that a pension payment must be a payment of money and cannot be a non-money (ie, *in specie*) asset transfer. In SMSFD 2014/1 — consistent with SMSFD 2013/2 — they state that a lump sum that results from the partial commutation of a pension can be *in specie*. This is the case even though the partial commutation counts towards the required pension minimums.

An important tax trap

Imagine an SMSF trustee that is using its assets to fund a pension. Of course typically subdivision 295-F of the

Income Tax Assessment Act 1997 (Cth) would operate to exempt any income generated by those assets from being assessable income. That is, under what is colloquially called the pension exemption, income generated by pension assets is tax free. Naturally, 'income' in this context includes net capital gains.

Now consider where an asset is rolled over to another fund. This raises the question of whether any income tax liability arises. On its face it may well because an asset is being transferred to an existing trust (ie, CGT event E2 is occurring).

Some argue that no income tax liability arises because — if the members of both funds are the same — there is no change in beneficial ownership. However, based on *Kafataris v DFCT* [2008] FCA 1454 this argument is doomed to fail.

Others argue that the pension exemption (or s 118-320) would operate to exempt or disregard any net capital gain or capital gain.

However, SMSFD 2014/1 reminds us that this may well not be the case. The determination states that the payment of a lump sum that results from commutation occurs *after* the cessation of the TRIS. Accordingly, there might not be a current pension liability at the moment when the CGT event occurs. This is particularly important for SMSF trustees that are not using the actuarial method to calculate the pension exemption, but rather are using the segregation method.

Accordingly, care should be taken when rolling assets from one fund to another as it may well give rise to a CGT-related income tax liability.

(Naturally, stamp duty and GST should also be considered.)

Conclusion

SMSFD 2014/1 provides much in the way of helpful insights and guidance.

Note: DBA Lawyers hold SMSF CPD training at venues all around Australia and online. For more details or to register, visit www.dbanetwork.com.au or call Marie on 03 9092 9400.

Changes To The Centrelink Treatment Of Account Based Pensions

Max Newnham

There have been many superannuation fund members starting account based pensions over the past six

months to try and avoid the changes to the income test for the Age pension. Although there are some benefits under the existing income rules, as a member gets older they could be disadvantaged by the current rules.

From January 1, 2015 anyone commencing an account based pension will have the deeming rules applied to the value of their superannuation to assess how much income is counted under the income test.

To have the existing rules apply, where the amount counted under the income test is the net value of the pension received after deducting a purchase price; a person must be in receipt of the income benefit from Centrelink and also be receiving an account based pension at December 31, 2014.

When an account based pension is paid at the minimum pension rate the amount counted by Centrelink under the existing rules can be zero. This occurs when the purchase price exceeds the pension being taken.

Once a person needs more income from their superannuation, and therefore must increase their account based pension, the amount counted by Centrelink can in fact be greater than would be counted under the deeming rules.

An example of this would be a lady who commenced an account based pension at age 65 with \$300,000 in her account and managed to maintain this balance while receiving a pension. At age 85 she must take a minimum pension of \$27,000 and, after deducting her purchase price of \$13,876, would have \$13,124 counted under the income test.

If the deeming rates were applied to her \$300,000 superannuation balance the amount counted under the Centrelink income test would be only \$9,306. Thankfully this is one area where superannuation members can have their cake and eat it too. When a member needs or is forced to increase their account based pension, to the point where it is decreasing the amount of the Age pension, they can cease their existing pension and commence a new one that will have the deeming rules applied to it.

In addition to the changes to the Age pension there also changes being made to how people qualify for the Commonwealth Seniors Health Card. From January 1, 2014 anyone applying for a CSHC will have the deeming rate applied to the value of their superannuation pension account.

Currently the income test is based on a person's taxable income and, because account based pensions for someone over 60 are tax-free, many people receiving account based pensions over the income limit of \$82,400 are still eligible for the CSHC. For a couple to exceed the CSHC under the deeming rules, with only account based pensions as income, they would need to have super balances of more than \$2,388,400.

Both of the changes to eligibility for the Age pension and the CSHC apply to new applicants from January 1, 2014 and as long as an account based pension is not ceased and a new one commenced the current entitlements will be preserved

Is this the end of the traditional term deposit?

by Justin McCarthy – FIIG

In December 2013, the Australian Prudential Regulation Authority (APRA) released a revised liquidity standard (APS 210) for all Australian Authorised Deposit-taking Institutions (ADIs). This standard encapsulated APRA's views of the Basel III regulatory changes for global banks.

A centrepiece of Basel III and indeed APS 210 is the liquidity coverage ratio (LCR). While other countries have transitional arrangements over a number of years for adoption of the LCR, APRA requires the larger Australian ADIs to comply with it from 1 January 2015.

The LCR aims to ensure that an ADI can meet its liquidity requirements in a severe stress or 'bank run' scenario. The regulation requires an ADI to hold sufficient unencumbered high quality liquid assets (HQLA) that can be converted into cash within a day to meet all of the ADI's liquidity needs for a 30-day stress scenario. The ratio of HQLA to the ADI's expected net cash outflows during this period must exceed 100%.

The three key features (and implications for depositors) of the LCR are as follows:

1. 30 day horizon

The LCR looks at a 30-day liquidity period and any product or deposit with a 31+ day break or notice period intact will not be included in the calculation of liquidity required. ADIs will be required to hold low yielding HQLA for any deposit (or at-call money) which can be repaid or matures within 30 days. This makes these deposits 'expensive' for the ADI as it has to tie up a portion of its funds in low yielding HQLA.

Conversely, a deposit that has a 31+ day break or notice period requires no HQLA backing. As such, ADIs will place a higher value on the latter and will pay higher rates to attract those funds. Traditional at-call and short-dated term deposits, particularly from financial institutions, will receive the opposite treatment with rates expected to be significantly lower come 1 January 2015. Corporates will receive slightly better treatment especially where money on deposit can be proven to be 'operational'.

Come 1 January 2015, the ability to break term deposits will become significantly harder with Product Disclosure Statements and terms and conditions expected to change to prevent the breaking of term deposits, with very few exceptions, the main one being personal hardship.

2. Depositor classification and 'run off' assumptions

There are vastly different 'run off' assumptions for various categories of depositors which will have a significant impact on the rates the ADIs will offer these different categories.

At one extreme are the 'sticky' retail deposits that APRA assumes will withdraw just 5% of funds in a crisis scenario. At the other end are 'hot' wholesale deposits from financial institutions that are assumed to see 100% of funds withdrawn at the first sign of a crisis.

It is important to note that for the purpose of the LCR calculation, this represents a differential of 20 times between the highest and lower risk deposit categories. Again, the implications are clear. Mum and dad 'retail' deposits will continue to be in high demand and hence command higher rates. This typically covers deposits up to the \$250,000 government guarantee amount. Self Managed Superannuation Funds up to this limit also attract positive treatment under APS 210.

However, the larger implications are for wholesale deposits and at-call money from larger institutions, particularly those classified as financial institutions. It is here where the traditional deposit product offering looks to be a dying breed, to be replaced by 31+ day break or notice period deposit products.

Corporations that can demonstrate a long term operational relationship will receive a 40% run-off assumption placing them in the middle of sticky retail and hot wholesale money. The focus here will be for corporate and potentially some financial institutions to prove the operational nature of portions of their funds on deposit and to argue for higher rates.

Another clear implication is that all wholesale depositors will have an incentive to do an accurate assessment of their real requirement for very liquid funds such as at-call or short dated term deposits, given the much lower rates expected on these come next year. This low returning portion of an investor's portfolio should be minimised and as much as possible locked away for a minimum of 31 days to attract a better rate from the new breed of deposit products.

3. The LCR does not apply to credit unions, building societies and mutual banks, nor branches of foreign banks

Compliance with the 100% LCR is only required from what APRA terms the 'scenario analysis' ADIs. This essentially refers to the major and regional Australian banks and locally incorporated foreign subsidiary banks (such as HSBC Bank Australia Limited and Rabobank Australia Limited).

Branches of foreign banks that operate in Australia (such as Bank of China Limited) are only required to meet 40% of the LCR.

Credit unions, building societies and other mutual banks (technically termed 'minimum liquidity holding' or MLH ADIs) are not required to comply with the specific LCR.

As such, we expect the deposit rates from the branches of foreign banks and the MLH ADIs to be more competitive at certain points in time, especially for corporate and wholesale deposits. However, this will still be a function of demand and supply with many MLH ADIs currently very liquid and not in need of extra funding from the wholesale sector.

FIIG will monitor the rates offered by the 60-odd ADIs we raise funding for and advise investors of any opportunities from the branches of foreign banks or MLH ADIs.

What to watch for

The impending changes have already been occurring in the market, with many ADIs releasing 31+ day break or notice period products over recent months. We expect this to gather pace throughout December and early 2015.

Investors should consider the following list when assessing term deposit investments now and into 2015:

- Make an accurate and realistic assessment of absolute liquidity needs and minimise the amount placed at-call or in short dated term deposits if the rates on offer are materially below those available with 31+ day break or notice clauses
- Where possible, maximise the amount with 31+ day break or notice clause. Possibly combine this with other sources of liquidity such as an allocation to high quality, liquid bonds that can be sold at short notice if emergency liquidity is required
- Maximise the amount on deposit through personal/retail or SMSF accounts and minimise the amount through deemed corporate or financial institution accounts. Likewise maximise the amount that can be classified as 'operational'
- As with any regulatory change or new product development, be on the lookout for special rates that may be offered in the early stages to attract investors. Typically, the early adopters receive the best rates and this product is here to stay. It is not a fad.
- Don't discount the branches of foreign banks or MLH ADIs who from time to time may offer competitive rates for the traditional deposit products, given the LCR does not fully apply to those ADIs. There are now over 10 credit unions and building societies that are rated investment grade and considered very safe places to invest deposit or at-call money.
- The ease and low cost of breaking term deposits that has prevailed for many years is expected to come to an abrupt halt come 1 January 2015, so be sure to have other sources of liquidity if this is a possibility.
- Be aware that ADIs will monitor the behaviour of depositors and over time (later in 2015 and beyond) will reward deposits that remain in place and penalise those that are seen to be 'hot' money. Where the difference in rate is small, it may pay to remain loyal in the long run

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