SD 2004/1 - Superannuation: can a self managed superannuation fund provide a defined benefit pension?

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This document has changed over time. This is a consolidated version of the ruling which was published on *12 July 2006*

Superannuation Determination

Superannuation: can a self managed superannuation fund provide a defined benefit pension?

Preamble

Superannuation Determinations do not have the force of law. Each decision made by the Australian Taxation Office is made on the merits of the individual case having regard to any relevant Rulings and Determinations.

*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

1. A self managed superannuation fund (SMSF) may provide a new defined benefit pension if:[1]

- the SMSF was established before 12 May 2004; and
- the governing rules of the SMSF have not been amended on or after 12 May 2004 to provide for the payment of the pension.

2. An SMSF may continue to pay a defined benefit pension where the term of the pension has commenced or where the entitlement to the pension has been established before 12 May 2004, even if the first payment is not made until on or after 12 May 2004.

3. Further, an amendment to the governing rules relating to the provision of new pensions does not prevent a trustee from paying existing entitlements.

4. An SMSF cannot provide a new defined benefit pension if:

- the SMSF was established on or after 12 May 2004; or
- the governing rules of the SMSF are amended on or after 12 May 2004 to provide for payment of the pension.

5. In particular, an SMSF cannot provide a defined benefit pension, even if its governing rules allow for the payment of defined benefit pensions, if they do not set out the terms and conditions of the defined benefit pension proposed to be paid. In that case, a resolution made on or after 12 May 2004, establishing the terms and conditions of the pension, would be regarded as an amendment to provide for the payment of the pension.

[1] [Deleted].

6. However, there is an exception relating to a transitional period ending on 31 December 2005. Under this exception, a regulated superannuation fund that has less than 50 members, including an SMSF, may provide a defined benefit pension to a person only if:

- the person was a member of the fund on 11 May 2004;
- at any time before 1 January 2006, the person retires on or after attaining age 55 or attains age 65 (even if this occurred before 12 May 2004);
- the person becomes entitled to be paid a defined benefit pension after 11 May 2004 and before 1 January 2006; and
- the first pension payment is made within 12 months after the day when the person became entitled to the defined benefit pension.

Explanation

7. A transitional exception relates to individuals who were fund members on 11 May 2004 and who, before 1 January 2006, attain 65 years or retire on or after attaining 55 years. This exception is summarised at paragraph 6. The transitional exception applies until 31 December 2005 regardless of whether the governing rules are amended on or after 12 May 2004 to provide for payment of the pension. The explanation which follows should be read subject to this exception.[2]

8. Division 9.2B of the Superannuation Industry (Supervision) Regulations 1994 (the SIS Regulations) was inserted by the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2) which were gazetted as Statutory Rules 2004 No. 84 and commenced on 12 May 2004.

9. The purpose of the changes was to prohibit the provision of defined benefit pensions by funds with less than 50 members without affecting those funds already paying a defined benefit pension, and while continuing to allow 'the flexibility to offer to their members account-based pensions such as allocated pensions and the new market-linked income stream'.[3]

10. Subregulation 9.04I(1) in Division 9.2B provides that a regulated fund that has fewer than 50 members (which includes an SMSF)[4] must not provide a defined benefit pension.

11. A defined benefit pension means a pension under section 10 of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) other than an allocated pension or a pension wholly determined by reference to particular life assurance policies.[5]

12. The intent of this provision is to 'restrict the provision of defined benefit pensions to funds that are of a sufficient size to satisfactorily manage the investment and mortality risks of providing those pensions'.[6]

13. Paragraph (a) of subregulation 9.04F(1) prevents any SMSF established on or after 12 May 2004 from providing a defined benefit pension.

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[2] The exception was introduced by the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 8), which were gazetted on 25 June 2004 as Statutory Rules 2004 No. 155.
[3] Media release C038/04 by the Minister for Revenue and Assistant Treasurer.
[4] Under section 17A of the SIS Act, an SMSF must have fewer than five members.
[5] Regulation 9.04E of the SIS Regulations.
[6] Explanatory Statement to the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2).

14. Paragraph (b) of subregulation 9.04F(1) prevents any SMSF established before 12 May 2004 from paying a defined benefit pension if the governing rules of the fund are amended on or after 12 May 2004 to provide for the payment of a defined benefit pension.

15. Where an SMSF had begun to pay a defined benefit pension before 12 May 2004 in accordance with its governing rules the fund can continue to pay that pension.

16. The governing rules of a fund are very broadly defined in subsection 10(1) of the SIS Act to mean:

(a) any rules contained in a trust instrument, other document or legislation, or combination of them; or

(b) any unwritten rules;

governing the establishment or operation of the fund.

17. If a document or unwritten rule of a regulated superannuation fund is amended, or a new document or unwritten rule is created, on or after 12 May 2004 to provide for payment of a defined benefit pension, Division 9.2B applies. This includes but is not limited to changes to the fund's trust deed and may therefore also include a resolution as to the terms and conditions on which a defined benefit pension is to be provided.

18. The intention of the regulations is evident from the Explanatory Statement which states in relation to Division 9.2B:

> The new division will not prevent a defined benefit pension from being paid by an existing superannuation fund where the governing rules of that fund set out the terms and conditions of the pension prior to the commencement of these regulations. If, however, the governing rules of an existing superannuation fund are amended to specify a term or condition of the pension, prior to the commencement of that pension, then the new division would apply.[7]

19. Accordingly, the Division is intended to apply if the terms and conditions on which a defined benefit pension is to be paid are established on or after 12 May 2004. This is also confirmed by the Explanatory Statement to the transitional regulation, which refers to the regulations inserting Division 9.2B as prohibiting 'regulated superannuation funds with fewer than fifty members from putting new defined benefit pension arrangements in place'.[8]

20. The governing rules may include a broad provision to the effect that the fund may pay a pension, without specifying the terms and conditions under which the pension may be paid. In that case, having regard to the Explanatory Statement, it is considered that, if a resolution establishing the terms and conditions on which a defined benefit pension is to be paid is made on or after 12 May 2004, the governing rules of the fund are amended to provide for the payment of a defined benefit fund in terms of paragraph (b) of subregulation 9.04F(1). Payment of the pension would be prohibited.

21. It has been suggested that there is no amendment to the governing rules to provide for the payment of a defined benefit pension, in terms of the regulation, where the trust deed would have permitted the payment of a defined benefit pension but the trustee resolves on or after 12 May 2004 to pay a particular pension on terms set out in the resolution. However, since most superannuation fund trust deeds contain such provisions, on this view the amendments would have no practical effect and would not achieve their purpose of prohibiting the payment of new defined benefit pensions by SMSFs.

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[7] Explanatory Statement to the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2).
[8] Explanatory Statement to the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 8).

22. Further, the transitional rules would not have been required on this view. The introduction of the transitional rules, which would not be required if defined benefit pensions would be permissible in any case during the transitional period, provides a clear indication that the Parliament intended that the provisions should be construed such that they are effective in prohibiting the establishment of new defined benefit pension entitlements.

23. If the governing rules were altered in a way that would result in a commutation and rollover of an existing pension, a new defined benefit pension could not be provided by the fund. An amendment to the governing rules that does not result in a commutation and rollover of an existing pension will not restrict the continued payment of an existing entitlement to a defined benefit pension.

24. It is necessary to consider, therefore, on a case by case basis, whether an alteration to the governing rules would establish a new entitlement in relation to an existing pension. If so, the governing rules would be regarded as amended to provide for the pension with the new entitlement. Payment of the pension with the new entitlement would be prohibited.

25. An amendment to the governing rules of the fund (on or after 12 May 2004) only affects the ability of a fund to provide for the payment of a defined benefit pension where the amendment relates to the provision of such a pension. An amendment allowing the fund to, for example, accept super co-contributions, would not affect the fund's ability to provide a defined benefit pension if the fund was established before 12 May 2004 and its governing rules set out the terms and conditions of the pension before that date.

26. A particular person or class of persons may be exempted from compliance with the provisions of operating standards.[9] A requirement imposed by Division 9.2B is an operating standard for the purposes of the SIS Act.[10] Accordingly, a trustee may be exempted from compliance with provisions of the Division.

27. The Explanatory Statement[11] indicates it is envisaged exemptions would only be granted in limited circumstances and only if the trustee and members are at arm's length and adequate arrangements are in place to fund all future pensions. While applications for exemption would be considered on their individual merits, these circumstances are unlikely to apply to SMSFs, as the trustee and members are not at arm's length.

Example 1

28. *Jimmy Mason retires at the age of 65 and wants to receive a defined benefit pension from the Mason Superannuation Fund. The governing rules of this SMSF allow the trustee to pay any type of pension allowed under the SIS Act. Before 12 May 2004, the trustee received an actuarial report and resolved to establish a pension with the particular features described in the report. The Mason Superannuation Fund can pay this pension (even if the first payment has not been made before 12 May 2004).*

Example 2

29. *Sarah Mason is also a member of the Mason Superannuation Fund on 11 May 2004. She retires at the age of 65 on 1 June 2005. The trustee receives an actuarial report, and considers a proposed resolution setting out the terms and conditions of a new defined benefit pension for Sarah. If Sarah becomes entitled to be paid the*

[9] Section 328 of the SIS Act.
[10] Regulation 9.04H of the SIS Regulations.
[11] Explanatory Statement to the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2).

pension before 1 January 2006 and the first payment is made within 12 months of Sarah becoming entitled to receive the pension, the fund can provide this new defined benefit pension, even though the governing rules would be amended on or after 12 May 2004 to provide for payment of the defined benefit pension.

Example 3

30. *John Mason also wants to receive a new defined benefit pension from the Mason Superannuation Fund. The governing rules allow the trustee to pay any type of pension allowed under the SIS Act. They also mention the practical necessity of consulting with an actuary to determine the amount to be set aside to fund the pension and the relevant terms and conditions of the pension. On 15 January 2006, following receipt of an actuarial report, a proposed resolution to pay a defined benefit pension to John is considered. The Mason Superannuation Fund is unable to provide the defined benefit pension as the governing rules would be amended to provide for payment of the defined benefit pension on or after 12 May 2004 if the resolution were passed.*

Example 4

31. *Jimmy Mason has been receiving a defined benefit pension from the Mason Superannuation Fund since before 12 May 2004. The trustee seeks an actuarial report on 30 June 2010. The actuarial report advises the current pension cannot continue to be paid, based on significant investment losses suffered since the last actuarial report. The fund is unable to provide a new defined benefit pension for Jimmy as a resolution to do so on new terms and conditions would involve an amendment to the governing rules to provide for the new pension.*

Commissioner of Taxation
8 December 2004

Previous draft:

SD 2004/D1

Legislative references:

- SIS Act 10
- SIS Act 10(1)
- SIS Act 17A
- SIS Act 328
- SIS Regulations Div 9.2B
- SIS Regulations 9.04E
- SIS Regulations 9.04F(1)(a)
- SIS Regulations 9.04F(1)(b)
- SIS Regulations 9.04H
- SIS Regulations 9.04I(1)
- Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2)
- Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 8)

Other references:

- Explanatory Statement to the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 2)
- Explanatory Statement to the Superannuation Industry (Supervision) Amendment Regulations 2004 (No. 8)

ATO references

NO: 2004/9162
ISSN: 1449-8685