SMSFD 2011/1 - Self Managed Superannuation Funds: for the purposes of the Superannuation Industry (Supervision) Regulations 1994, is a benefit payable with a cheque or promissory note 'cashed' at the time the cheque or note is received by the member or beneficiary?

Self Managed Superannuation Funds Determination

Self Managed Superannuation Funds: for the purposes of the Superannuation Industry (Supervision) Regulations 1994, is a benefit payable with a cheque or promissory note 'cashed' at the time the cheque or note is received by the member or beneficiary?

Preamble

This publication represents the Commissioner's view about the way in which provisions of the *Superannuation Industry (Supervision) Act 1993*, or regulations under that Act, apply to superannuation funds that the Commissioner regulates: principally self managed superannuation funds.

Self Managed Superannuation Funds Determinations (whether draft or final) are not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to you than this determination indicates, the fact that you acted in accordance with this determination would be a relevant factor in your favour in the Commissioner's exercise of any discretion as to what action to take in response to a breach of that law. The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.

Ruling

1. Yes, provided that:
   - at that time, money is payable immediately and available for payment;
   - the trustee takes all reasonable steps to ensure that the money is paid promptly;
   - the money is paid; and
   - the requirements of the Superannuation Industry (Supervision) Regulations 1994 (SISR)[1] are otherwise satisfied.

[1] All legislative references in this Determination are to the SISR unless otherwise indicated.

Funds to which this Determination applies

2. This Determination applies to Self Managed Superannuation Funds[2] (SMSFs) and former SMSFs.[3] References in the Determination to SMSFs include former SMSFs unless otherwise indicated.

Date of effect

3. This Determination applies to years of income commencing both before and after its date of issue. However, the Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

Commissioner of Taxation
19 January 2011

[2] As defined in section 17A of the *Superannuation Industry (Supervision) Act 1993* (SISA).
[3] A former SMSF is a fund that has ceased being a SMSF and has not appointed a registrable superannuation entity (RSE) licensee as trustee: see subsection 10(4) of the SISA.

Appendix 1 – Examples

This Appendix is provided as information to help you understand how the Commissioner's view has been reached.

4. These examples concern the payment of benefits for the purposes of the SISR. The principles described in these examples are applicable to the payment of pensions and lump sums and the purchase of annuities.

5. No inferences should be drawn about the application of other legislation administered by the Commissioner such as income tax legislation.

Example 1 – Payment using a cheque

6. Jenny is a member of the Blue SMSF. As at 30 June, financial year 1, the Blue SMSF is required to make a benefit payment to Jenny of $15,000.

7. The trustee writes a cheque for $15,000. Jenny receives the cheque on 30 June, financial year 1, but does not present it for payment until 5 July, financial year 2. The cheque is subsequently honoured.

8. The benefit was cashed on 30 June, financial year 1 when Jenny received the cheque. Objectively, the trustee intended to transfer funds from the SMSF to Jenny at that time by issuing the cheque and money was paid promptly.

9. If the cheque was not honoured because there were insufficient funds held in the account of the SMSF, the benefit would not be cashed on 30 June, financial year 1.

10. Alternatively, the SMSF may have had sufficient funds, but proceeds from the cheque may not have been transferred to Jenny because of a failure in the bank's systems. In such a case, the benefit would be cashed on 30 June, financial year 1, provided that all reasonable steps are taken to ensure that the funds are transferred to Jenny once the bank's systems resume normal operation.

Example 2 – Payment using a cheque: immediate payment not objectively intended

11. Alana is a member and trustee of the Pink SMSF. As at 30 June, financial year 1, the Pink SMSF is required to make a benefit payment to Alana of $5,000.

12. The SMSF does not have sufficient available funds to make this payment to Alana at that time. However, a term deposit held by the SMSF is expected to provide the necessary funds on 30 September, financial year 2.

13. The SMSF writes a cheque for Alana for $5,000. Alana receives the cheque on 30 June, financial year 1, but does not present it to her financial institution for payment until 1 October, financial year 2. The cheque is subsequently honoured.

14. The lack of available funds as at 30 June, financial year 1 indicates that Alana, as trustee of the Pink SMSF, did not objectively intend to immediately transfer funds from the SMSF at the time the cheque was issued. Therefore, Alana's benefit was not cashed on 30 June, financial year 1.

15. Alternatively, the SMSF may have had sufficient funds available, but Alana delayed presenting the cheque to her financial institution as she did not require the funds immediately. The delayed presentation of the cheque indicates that there was not an objective intention to immediately transfer funds from the SMSF. Therefore, Alana's benefit would not be cashed on 30 June, financial year 1.

Example 3 – Payment using a post dated promissory note

16. Sarah is a member of the Green SMSF. As at 30 June, financial year 1, the SMSF is required to make a benefit payment to Sarah of $10,000.

17. The trustee writes a promissory note with a face value of $10,000. Sarah receives the note on 30 June, financial year 1. The note is due for payment on or after 30 June, financial year 3. On 30 June, financial year 3, the note matures and Sarah is paid $10,000.

18. Sarah's benefit was not cashed on 30 June, financial year 1. The terms of the note make it clear that the trustee did not have an objective intention to transfer funds from the SMSF when Sarah received the note.

Appendix 2 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached.

Background

19. The general rules regarding the payment of benefits are set out in Division 6.2. In particular, subparagraph 6.17(2)(a)(i) provides that a member's benefit in a fund may be paid by being cashed in accordance with Division 6.3.

20. The time at which benefits are paid by cashing is relevant to the operation of the payment standards. In particular, the standards for annuities and pensions prescribe minimum amounts (and in some cases, maximum amounts)[4] which must be paid in each year.[5]

Explanation

21. For the purposes of Division 6.3, 'cashing' involves a member's 'benefits in a fund' being 'paid'.[6] This indicates that cashing involves an SMSF making a payment which reduces the member's benefits in the fund.

22. The detailed payment standards referred to in paragraph 20 of this Determination confirm that cashing involves an actual distribution of benefits from the fund. Those standards would be effectively bypassed if benefit payments in a particular year included promises or undertakings to distribute benefits in later years.

Characterising what is provided

23. In order to determine whether a benefit has been cashed, it is necessary to characterise what has been provided to the member or beneficiary, by reference to the objective purpose of the transaction.

24. A cheque or promissory note issued by the trustee of a fund is not a benefit in the fund, transferred from the SMSF in discharge of the trustee's liability to pay benefits. While such instruments may evidence a process for the payment of money, they are not money themselves.[7] The true character of the benefit is derived from the subsequent payment of money from the fund in satisfaction of the right evidenced by the cheque or note.

25. Benefits cannot be cashed with a cheque or note that is not honoured with an actual payment of money, since in such a case no payment occurs,[8] and no benefits leave the fund. Similarly, no cashing occurs where a cheque or note issued by the trustee is merely indorsed back to the trustee as a purported contribution. In such cases, there is no actual payment of benefits from the fund to the member or beneficiary.

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[4] See subregulation 1.06(4).
[5] For example, subregulation 1.06(1) and 1.06(9A) require payment to be made at least annually, and the total of the payments in each year must at least equal the amount worked out under Schedule 7.
[6] Subparagraph 6.17(2)(a)(i).
[7] *Sidney Raper Pty Ltd v. Commonwealth Trading Bank of Australia* [1975] NSWLR 227 at 233.
[8] A negotiable instrument only operates as a 'conditional payment' of the underlying liability. The debt revives if the security is not realised, in which case there is no payment at all; see *City Link Melbourne Ltd v. FC of T* 2004 ATC 4945 at 4955; *Currie v. Misa* (1875) LR 10 Ex 153 at 163-164; *Mackenzie v. Rees & Thomas Brown and Sons Ltd* (1941) 65 CLR 1 at 6.

Time of cashing

26. Payment using a negotiable instrument is made when the instrument is received by the payee unless it is subsequently dishonoured.[9] However, in order for such a transaction to amount to cashing for the purposes of the SISR it must objectively represent a payment of 'benefits in a fund'.

27. Where the instrument is honoured, the benefit will be cashed at the time it is received by the member or beneficiary, provided that the trustee's objective intention is to immediately transfer funds from the SMSF to the member or beneficiary. This will only be the case where:

- when the instrument is received, the money is payable immediately and available for payment; and
- the trustee takes all reasonable steps to ensure that the money is paid promptly.

Money payable immediately and available for payment

28. An unconditional right to *immediate* payment is consistent with an objective intention to immediately transfer funds from the SMSF to the member or beneficiary. Although the right is not itself a benefit in the fund, it may be evidence that such a benefit is presently available to the member or beneficiary and, as such, is objectively regarded as having been paid.

29. In contrast, an instrument which is post-dated, interest bearing or discounted does not contemplate an immediate transfer of funds from the SMSF to the member or beneficiary. By its very nature, such an instrument evidences an objective intention to transfer such funds in the future. Accordingly, benefits could not be cashed pursuant to such an instrument before they are actually paid to the member or beneficiary; see Example 3 of this Determination.

30. Similarly, an objective intention to immediately transfer funds will not exist where there are insufficient liquid assets available to the trustee to make an immediate payment of money.[10] Even if an unconditional right to immediate payment is provided, the inability of the member or beneficiary to obtain immediate access to money indicates that immediate payment is not intended; see Example 2 of this Determination.

All reasonable steps taken to ensure prompt payment

31. A benefit will only be considered to be cashed at the time a member or beneficiary receives a cheque or note where the trustee takes all reasonable steps to ensure that payment is made promptly.

32. Unless this occurs, the trustee will be unable to demonstrate an objective intention to immediately transfer funds from the SMSF to the member or beneficiary. Where payment does not occur promptly, the use of the instrument may instead be an objective indication that prompt payment was not intended.

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[9] See for example, *Tilley v. Official Receiver In Bankruptcy* [1960] HCA 86.

[10] When formulating and giving effect to an investment strategy, trustees must have regard to the liquidity of the fund's investments, its expected cash flow requirements and the ability of the entity to discharge its existing and prospective liabilities. See paragraph 52(2)(f) of the SISA.

33. What constitutes prompt payment in this context is a question of fact, to be determined in the circumstances of each case. A benefit will be regarded as having been cashed upon the receipt of an unconditional right to receive money if the actual payment of money is made within a time which is reasonable, having regard to ordinary commercial practice; generally within a few business days.

34. In limited circumstances, an objective intention to immediately transfer funds from the SMSF to the member or beneficiary may be found to exist without prompt payment. This would only occur if the trustee could establish that prompt payment was prevented by actions or circumstances which the trustee could not reasonably have been expected to control; see Example 1 of this Determination.

35. Accordingly, a benefit would not fail to be cashed merely because payment is prevented or delayed by the independent actions of a third party. However, in such cases it is expected that the trustee take all reasonable actions to make the payment as soon as practicable.

36. In contrast, a person holding the office of trustee is considered to have control over their own actions in other capacities.[11] Accordingly, a person will fail to cash a benefit in their capacity as trustee where they fail to promptly present a cheque or note for payment in their capacity as a member: see Example 2 of this Determination.

[11] While there is a legal distinction between the capacities of trustee and member, a trustee may be taken to consent to their own actions in whichever capacity they act: *In Re Wilmer's Trusts; Wingfield v. Moore* [1910] 2 Ch 111.

References

Previous draft:

SMSFD 2010/D1

Subject references:

- cheques
- promissory notes
- self managed superannuation funds
- superannuation benefits

Legislative references:

- SISA 1993
- SISA 1993 10(4)
- SISA 1993 17A
- SISA 1993 52(2)(f)
- SISR 1994
- SISR 1994 1.06(1)
- SISR 1994 1.06(4)
- SISR 1994 1.06(9A)
- SISR 1994 Div 6.2
- SISR 1994 6.17(2)(a)(i)
- SISR 1994 Div 6.3
- SISR 1994 Sch 7

Case references:

- City Link Melbourne Ltd v. FC of T [2004] FCAFC 272; 2004 ATC 4945; (2004) 57 ATR 316
- Currie v. Misa (1875) LR 10 Ex 153
- Mackenzie v. Rees & Thomas Brown and Sons Ltd (1941) 65 CLR 1
- Sidney Raper Pty Ltd v. Commonwealth Trading Bank of Australia [1975] NSWLR 227
- Tilley v. Official Receiver In Bankruptcy [1960] HCA 86
- Re Wilmer's Trusts; Wingfield v. Moore [1910] 2 Ch 111

ATO references

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