



Australian Government

Australian Taxation Office

**The use of reserves by
Self Managed Super Funds
May 2018**

Overview – What are we discussing?

- The use of reserves by self-managed superannuation funds
- What is a reserve?
- What has caught our attention?
- What are our concerns?
- What types of reserves are we concerned with?
- What limited circumstances do we accept?
- What are we doing?
- What should trustees be doing?
- Scenarios – Our compliance approach

The use of reserves by SMSFs

- SMSF Regulator's Bulletin 2018/1 *The use of reserves by self-managed superannuation funds* published on 15 March 2018
- SMSF Regulator's Bulletins are a new advice product designed for SMSFs
- Data taken from the 2016 SMSF Annual Return indicates that there are approximately 2,500 SMSFs with reserves; however the figure may be higher

What is a reserve?

Common understanding of a reserve

- An account within a superannuation fund that holds amounts that have not been allocated to a particular member.

What is a reserve under superannuation law?

- Sub-section 115(1) of the Superannuation Industry (Supervision) Act 1993:
 - *the trustee of a superannuation entity may maintain a reserve for a particular purpose, unless the governing rules of the entity prohibit the maintenance of a reserve for that purpose.*
- Consistent with APRA's Prudential Practice Guide SPG 222 Management of reserves

What is a reserve under income tax law?

- Need to consider the application of a number of provisions including concessional contributions

What has caught our attention?

- We expect that the use of reserves by SMSFs will be in limited circumstances and only for specific and legitimate purposes.
- There are differences between APRA regulated funds and SMSFs when it comes to the need to maintain reserves.
- We have concerns with the use of reserves following the introduction of the Government's Superannuation Reform measures announced in the 2016–17 Budget.
- The use of reserves by SMSFs outside limited and legitimate circumstances may suggest that they are being used as part of a broader strategy to circumvent the certain restrictions.

What are our concerns?

- Does the reserve have a purpose? (Section 115 of the SIS Act - maintaining reserves)
- Does the fund have a reserve management strategy? (Paragraph 52B(2)(g) of the SIS Act - covenants)
- Does it meet the sole purpose test? (Section 62 of the SIS Act - sole purpose test)
- Is there a reason for the ATO to consider Part IVA of the ITAA 1936?
Considerations include whether the reserve enables:
 - Additional non-concessional contributions
 - Additional concessional contributions
 - A greater allocation to the retirement phase
 - Access to the segregated method to calculate exempt pension income

Types of reserves are we concerned with?

- Administration reserves
- Investment reserves
- Operational risk reserves
- Self-insurance reserves
- Reserves supporting an account-based pension
- Reserves used in arrangements for insurance cover

In what limited circumstances do we accept that an SMSF may have a reserve, or similar account?

- Reserves previously established to support:
 - anti-detriment payments (the related deduction is being phased out from 1 July 2017)
 - grandfathered non-account based pensions
- Unallocated contributions – suspense account

What are we doing?

- We will be scrutinising reserves which we consider to be outside of the limited and legitimate circumstances
- We will not review arrangements entered into by SMSFs before 1 July 2017 provided that:
 - the reserve was permitted by section 115 of the SISA and the governing rules of the SMSF,
AND
 - the facts and circumstances do not indicate that the use of the reserve by the trustee was a means of circumventing the restrictions imposed by the Government's Superannuation Reform measures announced in the 2016-17 Budget.
- We will continue to monitor the use of reserves by SMSFs.

Poll Question

What is the percentage of the reserve account that can be allocated (in a fair and reasonable manner) before it counts towards the concessional contributions cap?

1. Nil
2. Under 5%
3. 10%
4. There is no limit

What should trustees be doing?

- Reduce the balance of established reserves
- Things to remember when reducing reserves:
 - Amounts allocated from a reserve before or after 1 July 2017 will generally be a concessional contribution unless otherwise excluded
 - Allocations from reserves cannot be made to an account-based pension account
 - Ensure that allocations are permitted by the SMSF's trust deed.
- Seek independent professional advice or approach us for advice

Poll Question

An SMSF maintains an investment reserve. The trustees should:

1. Continue to allocate investment earnings to the reserve.
2. Immediately reduce the balance to nil.
3. Gradually allocate the reserve balance on a fair and reasonable manner and at less than 5% of member's total interest in the fund if they wish to avoid allocation being a concessional contribution.
4. Reclassify the reserve as a pension reserve.

Scenario 1 – Our compliance approach

ABC Superannuation Fund

- The SMSF has 2 members with one member receiving a complying life expectancy pension.
- The life expectancy pension was commuted prior to 1 July 2017, leaving a balance remaining in the reserve which was previously supporting the pension. As the pension had ceased, this amount constituted an unallocated reserve.
- The trustees were allocating from the reserve prior to 1 July 2017 in a fair and reasonable manner to every member and continue to do so past this date.
- The facts indicate the trustees are taking steps to reduce the reserve amount and we will not apply compliance resources.
- When allocating, the trustees should ensure:
 - Allocations are made in a fair and reasonable manner,
 - The amount of annual allocations is less than 5% of the member's total superannuation interest in the SMSF, or recorded as a concessional contribution for that member.
 - Allocations are not made to an account-based pension.

Scenario 2 – Our compliance approach

XYZ Superannuation Fund

- The SMSF trustees maintained an investment reserve prior to 1 July 2017.
- The trustees continue to maintain this reserve.
- The trustees are not taking steps to reduce the reserve amount and this is likely to attract our scrutiny.



Questions?



Thank you

Thank you for your time today.

To stay up-to-date with the latest updates and information for SMSF professionals and trustees, please subscribe to SMSF News (QC 19484) at ato.gov.au.