Controlling commutation of a child pension

Trustees must now pay attention to ownership details

Husband (H) and wife (W) are members of a self-managed superannuation fund, and as part of their estate planning, they want to direct the trustee of the fund to set up child pensions for their eligible children if either of H or W die early.

As their children are likely to qualify for the child pension well into their twenties while they continue their studies, H and W see the prospect of their children wanting a lump sum for a number of possible reasons.

The parents aren't averse to a child getting access to a lump sum but only if it's for an appropriate reason: investing, not lifestyle.

They therefore don't want to ban commutation outright in the pension terms, but want to ensure that their children cannot commute the pension without the consent of the survivor of H and W.

Is such a condition possible without jeopardising the compliance and validity of the child pension?

Both the SIS Act and *the Income Tax Assessment Act 1997* adopt the SIS Regulations definition of a pension provided in regulation 1.06 of the SISR. It is therefore central that a death benefit pension meets all the requirements set out in that definition to ensure the payments are not in breach of the SIS Act and also to ensure the payments receive concessional tax treatment under the tax laws as a 'superannuation income stream' as referred to in *the Income Tax Assessment Act 1997* (Cth) and *Income Tax Assessment Regulations 1997* (Cth).

The SISR definition states that a benefit is taken to be a pension if the rules applying to the pension meet the standards of sub-regulation 1.06 (9A). Our interpretation of the sub-regulation (9A) is that it sets out the minimum standards the rules of the pension must meet in order for the pension to be deemed a complying pension under the SISR. A pension with additional rules in place may still qualify as a complying pension, however the additional rules must not impede compliance with the minimum standards as set out in the SISR.

The terms of the pension (other than those relating to commutation) must meet the general standards of a beneficiary pension, namely: payment is made at least annually and total payments made each year are more than the statutory minimum under Schedule 7 of the SISR.

A key SISR requirement relating to commutation of a child beneficiary pension is that the pension must only be paid to eligible persons under regulation 6.21, therefore implying that the pension must be commuted upon the beneficiary ceasing to meet the eligibility requirement.

Under regulation 6.21 of the SISR, a child is only eligible to receive a beneficiary pension in the following circumstances:

(a) while they are under the age of 18,
(b) while they are aged 18 or more but less than 25 years and are financially dependent on the member, and/or
(c) while they are aged 18 or more but have a disability of a kind described in s8(1) of the *Disability Services Act 1986* (Cth).

The SISR definition does not prohibit the trustee and the member agreeing, in the form of a pension agreement, to only commute the pension with a third party's consent, so long as the prescribed requirements in the SISR definition are preserved and take precedence over the power of the consent.

In order to ensure compliance with the minimum standards, the pension terms must contain an overriding provision for the trustee to commute the child beneficiary pension if the beneficiary is no longer eligible for the pension without needing to first seek your consent. This would effectively mean it would not be an effective strategy to prevent commutation of a child beneficiary pension to an adult child beneficiary who has attained the age of 18 if the child is not financially dependent at that time.

If, however the child is financially dependent after attaining the age of 18, the consent power may be used to prevent commutation of the pension until the child is no longer dependent or attains the age of 25, whichever is earlier.

Practically, the trustee must assess whether or not the beneficiary continues to be eligible (i.e. financially dependent) to receive the pension on and from the date the beneficiary attains the age of 18. This assessment is a question of fact. Once the beneficiary is not financially dependent and does not have any disability, the pension should be commuted without needing to seek any consent.

If the pension agreement is drafted in a way that does not ensure the SISR requirements taking precedence over any consent power, the pension will not meet the SISR definition of a superannuation income stream for tax law purposes. The pension in such event will also result in breach of the mandatory death benefit cashing out requirement under the SIS Act.

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