Last minute withdrawals before time is called

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Is it possible to make a last minute withdrawal before you die and the payment, if made after you have died, still be treated as being tax free? Well Yes – according to a recent private binding ruling from the Commissioner (PBR 1051988780639). But first some imaginary background to set the scene…

Tarquin has three independent adult children. His wife of many years, Flavia, having died some time ago. Tarquin has is receiving a pension from this self-managed superannuation fund and is currently drawing down $60,000 per year. His pension balance is about $1,500,000. When he first commenced the pension, the tax-free percentage of each pension payment was set at 10% with the taxable balance being 90%. Having 90% of his $60,000 annual pension payment is not an issue for Tarquin as he is over 60 years of age and each pension payment is tax free in his hands – even the taxable portion.

Tarquin has been actively involved in the management of his SMSF for many years. He is a director of the corporate trustee (and has already applied for this Director Identification Number). His co-director is his brother, Gaius Julius. Tarquin has in place a Binding Death Benefit Nomination providing that on his death that his benefit is to be divided equally between his three children.

Tarquin is aware that super benefit has a taxable portion of 90% and so, consequently, on his death the pension will be commuted, the pension balance will revert to accumulation phase and then be paid as a lump sum to these three children. If the pension balance was $1,500,000 then on his death each child would receive $500,000 which would consist of $50,000 tax free component and $450,000 taxable component. On this basis each child may have to pay tax of up to $67,500 on their share: that is 15% of $450,000 being the taxable component. In total up to $202,500 may be paid in tax.

Could Tarquin somehow have an arrangement already in place which will operate to withdraw his entire super balance shortly before his death and be payable to him? If so, then the $1,500,000 balance could be paid to him and he would pay no tax at all on the $1,500,000 (as the taxable portion – still 90% of the payment – is not taxable in his hands).

Probably Yes and would it be effective – again probably Yes.

Tarquin would have to prepare and sign (but not date) a full cashing request in respect of his pension and the payment as a lump sum of the pension account balance to him. When the time was appropriate Tarquin could date (or have his duly authorised agent date) and serve the full cashing request on the trustee. Tarquin together with his brother, Gaius Julius, the directors of the corporate trustee, would then acknowledge receipt of the full cashing out request, note that Tarquin had a unilateral right to cash out his super which right has been exercised and authorise administrative processing of the full cashing out request. Importantly, once the full cashing out request has been received by the Trustee, there is no further condition which must be satisfied to make the full cashing out request valid. Once Tarquin has exercised his cashing out right, the relationship between Tarquin and this SMSF has changed. Before the relationship was beneficiary-trustee and now the relationship is creditor-debtor.

Once the creditor-debtor relationship has been established, the payment of the benefit to Tarquin will be a superannuation member benefit rather than a superannuation death benefit. This will be the case even if Tarquin dies after the full cashing out request has been received by the Trustee and before the benefit has been paid.

In this event, the Trustee would transfer $1,500,000 to Tarquin's bank account without any deduction on account of tax. The $1,500,000 in the bank account would form part of Tarquin's estate and then be allocated as specified in his Will. As his Will specifies the estate to be paid equally to this three children, they will each receive $500,000. This $500,000 is tax free in their hands.

The critical issue is whether Tarquin has an unconditional right to fully cash out his pension and whether he effectively exercised that right before he died. Having served the cashing out request on the Trustee before he died clearly shows the exercise of this right. Upon service of the full cashing request, Tarquin has the legal right to the immediate payment of his pension balance. The fact that that Trustee only discharges that legal right after Tarquin's death is irrelevant. The fact that the Trustee is aware of Tarquin's death is also irrelevant. The fact that fund assets may have to be redeemed (whether before or after Tarquin's death) to permit the bank transfer is also irrelevant.

Again the critical issue is whether Tarquin had an unconditional right to fully cash out his pension and whether he effectively exercised that right before his death. If yes to both – then the payment to Tarquin's bank account of the $1,500,000 will be a superannuation member benefit for Tarquin, no tax is required to be deducted from that payment by the Trustee and the payment will be not taxable.

For more information on any aspect covered in this article, please call SUPERCentral on 02 8296 6266 or email info@supercentral.com.au.