SMSFD 2010/D1 - Self Managed Superannuation Funds: for the purposes of the Superannuation Industry (Supervision) Regulations 1994, can a benefit payable with a cheque or promissory note be 'cashed' at the time the cheque or note is issued?

This document has been finalised by SMSFD 2011/1.

Draft Self Managed Superannuation Funds Determination

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

Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary 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 the final version of this determination indicates, the fact that you acted in accordance with the final version of 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:

- the money is payable immediately;
- 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. It is proposed that when the final Determination is issued, the Determination will apply 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
28 July 2010

[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 preliminary 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 to Jenny for $15,000, dated 30 June, financial year 1. Jenny presents the cheque for payment on 5 July, financial year 2. The cheque is subsequently honoured.

8. The benefit was cashed on 30 June, financial year 1 when the cheque was given to Jenny. 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 where presentation is delayed

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. On 30 June, financial year 1, the SMSF issues a cheque to Alana for $5,000. The cheque is dated 30 June, financial year 1. However, Alana does not present the cheque to her financial institution for payment until 1 October, financial year 2. The cheque is subsequently honoured.

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

Example 3 – Payment using a post dated promissory note

15. 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.

16. The trustee issues a promissory note to Sarah with a face value of $10,000. 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.

17. 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 to Sarah at the time the note was issued.

18. The SMSF does not pay the benefit in the form of an asset merely because it has promised to pay an amount of money to Sarah in the future. The true character of the benefit is derived from the subsequent payment of money on 30 June, financial year 3.

Appendix 2 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary 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.

Explanation

20. For the purposes of Division 6.3, 'cashing' involves a 'member's benefit in a fund' being 'paid'.[4] This indicates that cashing involves an SMSF making a payment which reduces the member's benefits in the fund.

21. The detailed payment standards for pensions and annuities in the SISR confirm that cashing involves an actual distribution of benefits from the fund. These standards prescribe minimum amounts (and in some cases, maximum amounts)[5] which must be paid in each year.[6] Those regulations would effectively be bypassed if promises or undertakings to distribute benefits in later years were themselves regarded as payments.

Characterising what is provided

22. 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.

23. A cheque or promissory note issued by the trustee of a fund is not a benefit of 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.

24. Accordingly, no cashing will occur where a cheque or note issued by the trustee is not honoured by the actual payment of money to the member or beneficiary. In such a case, no payment occurs,[8] and the benefits of the member or beneficiary remain in the fund.

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[4] Subparagraph 6.17(2)(a)(i).

[5] See subregulation 1.06(4).

[6] For example, subregulation 1.06(1) and 1.06(9A), requires 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.

[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

25. Where the instrument is honoured, an SMSF is considered to cash a benefit at the time of issuing the instrument provided that:

- the money is payable immediately; and
- the trustee takes all reasonable steps to ensure that the money is paid promptly.

Payable immediately

26. 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 beneficiary and, as such, is objectively regarded as having been paid.

27. 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 make a payment in the future. Benefits will not be cashed pursuant to such an instrument until they are actually paid to the member or beneficiary; see Example 3 of this draft Determination.

Paid promptly

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

29. Where this occurs, the trustee will demonstrate an objective intention to immediately transfer funds from the SMSF to the member or beneficiary. In such circumstances, the benefits are objectively regarded as having been paid to the member or beneficiary when the cheque or note was issued.

30. 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 granting 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.

31. Where payment does not occur promptly, the use of the instrument may be an objective indication that prompt payment was not intended. This conclusion would be considered to follow unless the trustee can establish that prompt payment was prevented by circumstances they could not reasonably be expected to control. Cashing is not prevented by such circumstances, since the trustee's objective intention may still be to immediately pay money from the fund.

32. However, a person holding the office of trustee is considered to have control over their own actions in other capacities (for example, as a member of the SMSF).[9] Consideration will be given to the absence of an arm's length separation between SMSF trustees and members; see Example 2 of this draft Determination. No cashing will occur at the time of issuing a cheque or note if a person acting as trustee causes or allows a significant delay in the transfer of funds from the SMSF to the member or beneficiary.

[9] While the capacities of trustee and member are legally distinct, a person 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.

Appendix 3 – Your comments

33. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

34. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **27 August 2010**

Contact officer: **Nadia Alfonsi**

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References

Previous draft:

Not previously issued as a draft

Subject references:

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

Legislative references:

- SISA 1993
- SISA 1993 10(4)
- SISA 1993 17A
- SISR 1994
- SISR 1994 1.06(1)
- SISR 1994 1.06(4)
- SISR 1994 1.06(9A)
- SISR 1994 6.17(2)(a)(i)
- SISR 1994 Div 6.2
- 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
- Re Wilmer's Trusts; Wingfield v. Moore [1910] 2 Ch 111

ATO references

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