Technical Bulletin

Accessing Superannuation Benefits

SMSF trustees cannot release a member's preserved or restricted non-preserved benefits until the member satisfies a 'condition of release'. Once the trustee is satisfied that a condition of release has been met, they need to confirm whether any cashing restrictions apply to determine how much of the member's interest can be released and in what form i.e. a lump sum or an income stream (pension).

This bulletin helps to identify the most common conditions of release an SMSF may come across as well as some of the more quirky conditions, and identifies any cashing restrictions that might apply.

Preserved benefits

All contributions and earnings added to a member's accumulation phase interest are preserved and cannot be accessed until a member satisfies a condition of release.

If a condition of release is satisfied and no cashing restrictions apply, the value of the member's interest at that point in time will be classified as unrestricted non-preserved benefits. Unrestricted non-preserved benefits can be accessed by the member at any stage, however, the taxation implications will be determined by the age of the members and in some instances the condition that has been met.

Attaining Preservation age

A member's preservation age depends on the birth date of the person.

Date of birth	Preservation age
Before 1 July 1960	55
1 July 1960–30 June 1961	56
1 July 1961–30 June 1962	57
1 July 1962–30 June 1963	58
1 July 1963–30 June 1964	59
After 30 June 1964	60

A member of an SMSF who has reached preservation age can access preserved and restricted non-preserved benefits in the fund without satisfying the retirement definition, discussed below.

Under this condition of release, there is a cashing restriction which allows a member access to their benefits as a non-commutable pension, meaning they can draw down income but are unable to exchange their right to that income with the ability to take lump sum withdrawals. This pension is most commonly referred to as a transition to retirement pension.

Having attained preservation age, once a further condition of release with a nil cashing restriction is met, as identified below, the non-commutable restriction is removed and the member has access to all of their benefits.

Retirement

Retirement has nil cashing restrictions resulting in a member's total benefit in an SMSF at the time when the condition is satisfied becoming unrestricted non-preserved. The choice to retire is only possible after a member has reached their preservation age. Two definitions of retirement apply depending on the member's age:

- member has reached preservation age but not age 60
- member has reached age 60 but not age 65

Preservation age but under age 60

A member is retired if an arrangement under which they were gainfully employed has ended and the trustee is satisfied that the person never intends to become gainfully employed for 10 hours or more per week at any time in the future.

Aged 60 or more but under age 65

A member aged 60 or over can also satisfy the above definition however they also have an alternative retirement definition available. If an arrangement under which a member was gainfully employed ends on or after their 60th birthday, then regardless of any future work intentions they can declare retirement and access their benefits.

Attaining age 65

Once a member of an SMSF reaches age 65 they may access their benefits regardless of their employment status. Turning 65 is a nil cashing restriction.

Health based conditions of release

Whilst the first group of conditions are based exclusively on age and work status, superannuation is also accessible subject to a person's health. Ranging from temporary illness right through to the death of a member, there are opportunities to access benefits based on physical and mental health.

Temporary incapacity

Temporary incapacity, in relation to a member who has ceased to be gainfully employed, means ill health (whether physical or mental) that caused the member to cease to be gainfully employed but does not constitute permanent incapacity, as discussed below.

A cashing restriction applies so that the member's benefits in the SMSF may only be paid as a non-commutable income stream to replace the income received before the incapacity and can only be paid for the period of that incapacity.

It is not necessary for the member's employment to fully cease. Benefits may be paid where a member makes a partial return to gainful employment while incapacitated, provided the member's remuneration plus the temporary incapacity benefits do not exceed the member's remuneration at the time the member became ill.

Funding temporary incapacity benefits is generally via insurance proceeds as a member cannot access their minimum benefits to pay a temporary incapacity income stream. The only way a temporary incapacity benefit can be paid from a member's balance is if the amounts are not member-financed contributions or mandated employer-financed contributions or the earnings on either. This would mean salary sacrifice amounts over and above Superannuation Guarantee could be paid out under temporary incapacity.

Permanent incapacity

The permanent incapacity condition of release is met if the trustee is reasonably satisfied that the member is unlikely, because of injury or ill health, to engage in gainful employment for which the member is reasonably qualified by education, training or experience.

If this condition is met, there is NIL cashing restriction.

Whilst not incorporated in the condition of release, it is recommended that Trustees obtain certification from 2 medical practitioners that the member is unlikely to engage in future employment due to their condition. If they don't the member will not be entitled to tax concessions on any payment made under the terms of a disability superannuation benefit, as discussed below.

Terminal medical condition

Terminal medical condition was introduced as a condition of release as at 1 July 2008, there is nil cashing restriction. This allows a member suffering from a terminal medical condition to access their entire benefit.

A "terminal medical condition" exists in relation to a person at a particular time if:

a) two registered medical practitioners have certified, jointly or separately, that the person suffers from an illness, or has incurred an injury, that is likely to result in the death of the person within a period (the certification period) that ends not more than 24 months after the date of the certification

b) at least one of the registered medical practitioners is a specialist practising in an area related to the illness or injury suffered by the person

c) for each of the certificates, the certification period has not ended.

If a member satisfies the terminal medical condition, the benefits which have accrued up to that point in time become unrestricted non-preserved benefits and can be accessed at any time. Any additional benefits accrued by the member during the certification period are also unrestricted non-preserved benefits, which makes it an exception to the standard rules. The member's benefit remains unrestricted non-preserved even if it is not accessed by the member during the certification period (within the 24 month period).

Outside the 24 month period any benefits accrued are preserved benefits and another condition of release would need to be satisfied in order to access these benefits. This can include re-certification from the 2 medical practitioners.

Amounts taken within the 24 month window are non-assessable amounts. Drawings taken outside the period are treated as normal superannuation lump sums and are taxed subject to the member's age.

Death

When a member of an SMSF dies, the member's benefits must be paid either to beneficiaries and/or the deceased member's estate via their Legal Personal Representative. There is NIL cashing restriction on death and the benefit must be paid as soon as practicably possible. **Death is the only compulsory cashing requirement.**

Other conditions of release

There are other, less common, conditions of release that can apply within an SMSF.

Compassionate Grounds, which is outlined in SIS Regulation 6.19A does make provisions for payment in certain circumstances which must be approved by the Regulator (ATO). Grounds include to prevent foreclosure on a mortgage, payment of certain medical expenses, payment of funeral expenses and also for modifications for palliative care. As these payments are approved by the ATO, the amount drawn will be provided for and tax is likely to apply unless other tax concessions exist i.e. the member is over 60.

Financial hardship is a condition where the member is unable to meet immediate living expenses, the trustee must be provided with evidence that the member has been in receipt of Commonwealth income support for a continuous 26 week period and the maximum amount that can be paid in a 12 month window is $10,000. Different rules apply once a member attains preservation age.

The release of benefits as a result of excess contributions, the first home super saver schemes and Division 293 tax are all captured under the provisions relating to conditions of release. In all instances a member cannot access their superannuation until the ATO has issued the appropriate release authority outlining how much needs to be released.

Benefit payments and taxation

In relation to SMSFs, a superannuation benefit to a member can be either a superannuation lump sum or a superannuation income stream benefit (pension). Some conditions require lump sums and others allow for pensions only whilst some, retirement, turning 65 and permanent incapacity provide a choice.

The tax treatment of superannuation paid to a member, excluding death benefits, varies according to:

- the age of the member
- whether the benefit is a superannuation lump sum or a superannuation income stream

The tax rates on member superannuation lump sums are as follows:

Tax rates on member superannuation lump sums *Add Medicare Levy		
Age	Tax free component	Taxable component
60 and over	0%	0%
Preservation age but under age 60	0%	up to low rate cap 0%
		over low rate cap 15%*
Under preservatoin age	0%	20%*

Member aged 60 or over

If the member is 60 years or older when they receive a superannuation benefit, the benefit is not assessable income and not exempt income (tax free).

This applies to both superannuation lump sums and superannuation income streams.

In this case, the SMSF trustee does not need to provide a PAYG payment summary to the member.

Member over preservation age but under age 60

The **tax free component** of a benefit, whether a lump sum or an income stream, paid to a member who has reached preservation age and is below age 60, is not assessable income and not exempt income.

The taxable component of a lump sum is assessable income. However, an offset applies on lump sums so that the maximum amount of tax payable does not exceed the applicable lump sum tax rates.

SMSF trustee/s need to withhold tax using the lump sum tax rates and issue a PAYG payment summary to the member.

If a member is receiving a pension then they must pay marginal tax but are entitled to a 15% rebate.

Low rate cap

The taxable component of a superannuation lump sum is taxed at zero percent (0%) up to the low rate cap ($205,000 in 2018/19 and $210,000 in 2019/20). The balance is taxed at 15% plus Medicare.
The low rate cap applicable to a member in a particular year is reduced by amounts previously received in the same or previous years. This allows a person to take advantage of the indexation amounts.

Member below preservation age

The tax free component of a benefit (whether a lump sum or an income stream) paid to a member under preservation age is not assessable income and not exempt income.

The taxable component of a lump sum is assessable income, with the member entitled to a tax offset so that the tax payable on the element taxed in the fund of the lump sum is not greater than 20% plus Medicare.

For pensions received under preservation age there is no rebate unless the benefit is a disability superannuation benefit (or a death benefit).

DISABILITY SUPERANNUATION BENEFIT

As stated above, if a member meets the condition of release linked to permanent incapacity the trustee must be satisfied the member is unlikely to ever be gainfully employed. To get tax relief the member must satisfy the definition of a disability superannuation benefit.

A disability superannuation benefit is a benefit:

- that is paid to a person because he or she suffers from ill health (whether physical or mental), and
- where two legally qualified medical practitioners have certified that because of the ill health, it is unlikely that the person can ever be gainfully employed in a capacity for which he or she is reasonably qualified because of education, experience or training.

Taxation of disability superannuation benefits

If a member is entitled to a disability superannuation benefit they may be paid as either an income stream benefit or a lump sum benefit. An income stream is entitled to a 15% rebate. If the benefit is paid a lump sum, the member is entitled to a modified tax free amount, as calculated below. This is the only event where a member's tax free component can be modified.

Tax free component of disability superannuation benefit

The tax free component of a disability lump sum benefit is calculated as the sum of the tax free component worked out under the normal proportioning rule and the amount worked out under the following formula:

$$\text{Amount of benefit} \quad \times \quad \frac{\text{Days to retirement}}{\text{Services days} + \text{Days to retirement}}$$

where:

- Days to retirement is the number of days from the day on which the member stopped being capable of being gainfully employed to his or her last retirement day, usually age 65.
- Service days are the number of days in the service period for the lump sum.

The effect is that the tax free component of the benefit is increased to reflect the period where the member could have expected to be gainfully employed if the disability had not occurred. The tax free component cannot exceed the amount of the benefit.

Taxable component of disability superannuation benefit

The taxable component is calculated by subtracting the total tax free component from the total amount of the superannuation benefit.

Example

Kate's date of birth is 1 July 1971. Her employment commenced on 1 July 1996. As a result of a serious work injury, Kate stops being capable of being gainfully employed on 3 September 2018. Her last retirement day would have been the day she turned 65, which is 1 July 2036. On 1 March 2019, Kate receives a disability lump sum benefit of $160,000 from her superannuation fund. The total value of Kate's superannuation interest is $400,000 just before the lump sum benefit is paid. The superannuation interest includes a tax free component of $100,000 and a taxable component of $300,000.

Step 1 - Calculate the tax-free proportions of the superannuation interest just before the benefit is paid:

$$\frac{\text{Tax free component}}{\text{Value of the interest}} = \frac{\$100{,}000}{\$400{,}000} = 25\%$$

Apply the proportion to calculate the tax free component of the lump sum benefit as if it was a normal lump sum benefit:

$160,000 x 25% = $40,000

Step 2 - Calculate the additional tax free component of the superannuation benefit using the formula below:

$$\text{Amount of benefit} \times \frac{\text{Days to retirement}}{\text{Services days + Days to retirement}}$$

Where:

- Amount of the benefit is $160,000.
- Days to retirement is 6,512 days (from 3/9/2018 to 1/7/2036).
- Services days is 8,099 days (from 1/7/1996 to 3/9/2018).

The amount is therefore $71,311 ($160,000 x 6512/14611).

Step 3 - Calculate the total tax free and taxable components of the disability superannuation benefit as follows:

The tax free component is the sum of the amounts worked out via Step 1 and Step 2:

$40,000 + $71,311 = $111,311

The taxable component is the remaining amount of the benefit:

$160,000 - $111,311 = $48,689

CONCLUSION: TAX SAVING

By satisfying the condition of “Disability Superannuation Benefit” the member has created the following tax saving:

Original Taxable Component = $120,000 ($160,000 - $40,000)

Original Tax @ 20% = $24,000

Tax on Disability Superannuation Benefit:

$48,689 @ 20% = $9,737

Tax Saving = $14,263 plus Medicare.

Paying benefits while members are alive

Paying benefits from a superannuation fund can be a complex process, commencing with whether the member is entitled to a benefit and what type of benefit they are entitled to. Once it is determined whether a benefit can be paid it is critical to know whether any tax concessions apply and whether any modifications are required to the preservation or taxation components.

All of these issues are complex enough without contemplating insurance benefits and ultimately death benefits. In our next technical bulletin we will consider the issues associated with paying insurance based benefits and death benefits.

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