SuperGuardian

Guide to Pensions in SMSFs

When a member meets a condition of release, they become eligible to commence a pension using some or all of their superannuation balance. The pension establishes an income stream for the member, with a minimum payment requirement each financial year.

Prior to the commencement of any income stream, the fund's trust deed must be reviewed to ensure that it allows the commencement of the type of pension requested by the member. Some older deeds may not provide for recent changes to legislation and may prohibit types of income streams that are otherwise now permissible by legislation. If necessary, trustees can amend the trust deed of the fund to allow for all permitted pension types to be paid from their super fund.

Commencing a Pension and Conditions of Release

Superannuation cannot be accessed until a member has met a condition of release and then certain cashing restrictions may apply. There are a number of conditions that can be met and many are linked to major life events. Once a member meets certain conditions of release they are entitled to establish a pension and begin withdrawing their funds. These conditions include:

- Attaining preservation age (Transition to retirement)
- Retirement (after attaining preservation age)
- Ceasing gainful employment after attaining age 60
- Reaching age 65
- Permanent incapacity
- Death (certain beneficiaries entitled to receive pension on death of member)

If a member meets one of these conditions but does not want to start a pension they can retain their superannuation in the accumulation phase. However, as a super fund must meet the sole purpose test at all times to receive concessional tax treatment, the trustees must consider the purpose of their fund.

Conditions of Release	Cashing Restrictions
Retirement (preservation age - age 60)	Member who was gainfully employed (more than ten hours per week of paid employment) has now stopped working and does not intend to return to work in the future.
Retirement (age 60 or older)	Member has ceased working under an existing employment arrangement (more than ten hours per week paid employment).
Attaining age 65	Regardless of work status, members aged 65 or older can access superannuation benefits without restriction.
Permanent incapacity	Member has stopped working and is unlikely to return to work because of ill health.
Death	Upon death of a member, superannuation benefits can be released.

Preservation age

Preservation age is a key factor in satisfying several of the conditions of release. The preservation age of a member is determined by their date of birth, summarised in the below table.

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

Types of pensions

There are several types of pensions that may be paid from an SMSF. The conditions around each pension type do vary, so it is important to ensure that clear records are prepared and retained for the establishment of each pension. The most common pensions held in SMSFs are:

- Account Based Pension (ABP);
- Transition to Retirement Income Stream (TRIS or TTR) In Accumulation Phase; and
- Transition to Retirement Income Stream (TRIS or TTR) in Retirement Phase.

Account Based Pension (ABP)

ABPs are very popular for SMSF members as they are both simple to calculate and understand. There is a requirement to withdraw a minimum amount which is based on the age of the member and their account balance at commencement, and then on 1 July of each year. However, there are no restrictions on the maximum that can be withdrawn or the timing of the payments. Members are able to dictate how much they receive from the fund and how often, providing they draw at least the minimum amount per annum.

One of the largest benefits of an ABP is that they receive tax exemptions, discussed later on. ABPs are subject to the Transfer Balance Cap (TBC) and the tax concessions are restricted to an individual's personal TBC (PTBC). The TBC is effectively a limit on how much superannuation can be placed in 'retirement phase' and be eligible for tax free earnings.

Transition to Retirement Income Streams (TRIS)

A TRIS can be commenced when a member attains their preservation age.
For a comprehensive overview of TRIS' please refer to our Guide to Transition to Retirement Pensions in SMSFs.

Annual minimum payment requirements

The following table outlines the current minimum annual payment requirement for both ABPs and TRIS'. The percentage applied is dependent on the member's age at 1 July or for newly established pensions, at commencement date. Please note that a 50% reduction in the minimum rate applies (as shown) to the 2020,2021 and 2022 financial years due to the impact of the COVID-19 pandemic.

Age of Member	Reduced Minimum 2019/20, 2020/21, 2021/22 and 2022/23 Financial Years	Minimum 2023/24 Financial Year onwards
Under 65	2.00%	4.00%
65-74	2.50%	5.00%
75-79	3.00%	6.00%
80-84	3.50%	7.00%
85-89	4.50%	9.00%
90-94	5.50%	11.0%
95 and over	7.00%	14.0%

As stated above, the annual payment percentage is applied to the member's pension account balance at 1 July or for newly established pensions, at commencement date. However, where the pension commences after 1 July, the minimum payment for the first year is calculated proportionately to the number of days remaining in the financial year. The minimum is rounded to the nearest $10.

Additionally, where the pension commences on or after 1 June in a financial year, no minimum payment is required to be made for that financial year.

It is vital to ensure the fund has sufficient liquidity to meet the calculated annual withdrawal requirements.

Commutations

A partial commutation does not count towards the member's minimum annual pension requirement. As a result, an individual must ensure that the minimum pension is paid prior to the commutation or that there is sufficient balance remaining after the commutation to satisfy the minimum pension requirement.

If a pension is fully commuted an individual must ensure that a prorated minimum annual pension payment is paid prior to the commutation. This is determined by the number of days in the pension payable period divided by the number of days in the financial year, the pension payable period includes the day of the commutation. This is not required if the ABP ceases due to the death of the member and there is no reversionary beneficiary.

Tax Implications - Fund level

Earnings, including capital gains, from assets supporting retirement phase pensions are exempt from tax, whereas earnings from assets supporting accounts in accumulation phase are subject to tax up to 15%, including TRIS in accumulation.

Non-arm's length income is taxed at 45% regardless of whether the fund is in accumulation or retirement phase.

If there is a pension/s in retirement phase and accumulation balances within the fund, it's not as straightforward. There are two options for SMSFs running both retirement phase pensions and accumulation accounts for members. The application of these will depend on the member's 'Total Super Balance' (TSB) at the preceding 30 June, being the balance of all superannuation benefits, not only in the SMSF, but also all other superannuation funds. This includes monies held in both pension and accumulation phase.

Option One: Segregated Accounts

Segregation refers to the ownership of specific assets either supporting the retirement phase or supporting the accumulation phase. If all members of an SMSF have a TSB below $1.6 million segregation can be applied.

As separate portfolios/assets are being held it is possible to clearly attribute any earnings to the specific phase it supports. Whilst under this method it is simple to identify which earnings are tax free, there is additional work involved by the trustee in properly administering the fund.

Realised capital losses in a segregated account are disregarded.

Where one or more members have a TSB over $1.6 million, and any member with $1.6m is in receipt of a retirement phase income stream from any source, segregation is not allowable for tax purposes and the SMSF must adopt the proportionate method. NOTE: as at time of writing this applies to SMSFs where 100% of the assets are supporting retirement phase income stream but one of the member's has a TSB over $1.6m when combined with other funds.

Option Two: Proportionate Method

Where a fund is not segregated (either by choice of trustees, or due to the TSB restriction above) it is classed as being 'pooled' for tax purposes. This refers to the fund assets being in a single pool, and ownership by the retirement or accumulation phase is not identifiable.

Realised capital losses can be carried forward under the proportionate method, to the extent that they are not used. Under this method, the fund will need to obtain an actuarial certificate each financial year to determine the proportion of the fund's income that is applicable to the accumulation phase vs the retirement phase.

This reduces the complexity of operations for trustees, as only once investment portfolio is held, and simplifies the administration. As a result of this the proportionate method is widely adopted as the preferred option of calculating tax.

Tax Implications - Member Level

Super benefits via a pension to a member aged 60 or are generally tax free and there is no need to withhold tax or have the pension shown on the member's personal income tax return.

For a member under the age of 60, the taxable and tax-free components determined at establishment of the pension will be used to determine how much is assessable and how much tax needs to be withheld, at marginal rates. A 15% tax offset is available on the taxable component which needs to be shown on the member's personal income tax return. It is important to confirm whether or not a member under age 60 wants to claim the tax free threshold.

Key benefits of setting up a pension

Tax free environment

When a member is contributing to super, their balance is referred to as being in accumulation phase. All contributions are allocated to the accumulation phase account, along with any earnings.

This money remains preserved until the member satisfies a condition of release. During this phase, concessional contributions and assessable earnings are taxed at 15%. Capital Gains Tax may also be incurred during this time and will be taxed subject to how long the asset has been held.

Where a member establishes a pension, their balance moves from the accumulation phase to retirement phase. For balances in the retirement phase the fund is entitled to a tax exemption. That is, there is no tax payable for associated earnings or capital gains relating to the retirement phase balance.

The amount that a member can move into the retirement phase is capped at their Personal Transfer Balance Cap (PTBC) across all of their superannuation accounts, this includes defined benefit pensions.

From 1 July 2017 to 30 June 2021, all individuals with a retirement phase pension had a PTBC of $1.6 million.

From 1 July 2021 to 30 June 2023, all individuals with a retirement phase pension have a PTBC ranging between $1.6 and $1.7 million.

From 1 July 2023, PTBCs will range from $1.6 million to $1.9 million.

This is due to proportional indexation being applied. If an individual met or exceeded their PTBC then they do not benefit from proportional indexation.

For an individual that commences their first retirement phase income stream on or after 1 July 2023 their PTBC will be $1.9 million.

Refer to our fact sheet Indexing the Personal Transfer Balance Cap for more information about indexation and the TBC rules.

Once a balance has shifted into the retirement phase it can no longer be contributed to, further contributions will be added to the accumulation phase account. Many members often hold a balance in the accumulation phase and another balance in the retirement phase, which is acceptable. This is most common for persons who have a total superannuation balance above the cap referred to above.

Tax free income stream

Of particular interest are the personal tax benefits. Where a member is below age 60, pension payments are assessable and reported in their personal tax return. Whilst tax concessions do apply a tax liability may be incurred.

For members aged 60 or older these pension payments are non-assessable.

Therefore, members aged 60 or older no longer need to report their payments and can withdraw their superannuation (within their prescribed limits) tax free.

Control

Provided that the payment requirements have been met each financial year, the member has autonomy over the amount and timing of pension payments.

Refund of franking credits

Franking credits (also known as imputation credits) represent the tax paid by Australian companies and are attached to franked dividends. These franking credits are usually used to offset tax liabilities the fund may incur from other assessable income, or concessional contributions. As there is no tax payable attributed to balances in retirement phase, the franking credits exceed the tax liability. This excess of franking credits results in a refund from the ATO upon lodging the annual tax return.

Frequently Asked Questions

How many pensions can I start?

There are no restrictions on the number of pensions a member can start, subject to the member's PTBC. A member can commence as many pensions as needed to suit their own personal situation. Each pension is a unique account called an 'interest'.

From an administrative perspective it is much simpler to have one pension account. However, there are reasons it can be worthwhile to have multiple pensions, such as:

1. *Preserving tax components – The tax components are fixed at the commencement of a pension under the proportioning rule. Therefore, having multiple pensions commenced at different times will have different tax components. If you intend to withdraw more than the minimum required, you can choose to take the amount above the minimum from the least tax effective pension (the pension with the largest taxable component). For members below age 60 you would want to take the amount above the minimum from the pension with the smallest taxable component.*

2. *Streaming death benefits - Having multiple pensions allows for a death benefit to be streamed to the beneficiaries in the most tax effective manner. A death benefit to a spouse is tax free whereas to an adult child, the taxable component is subject to tax. In a blended family there may be instances where the member wants to ensure an amount goes to their spouse and also amounts to any adult children. Given the difference in how payments are taxed to these two classes of beneficiaries, they can structure the payment of the death benefit so that the least tax effective pension(s) are paid as a death benefit pension or lump sum to the spouse whilst most tax effective pension(s) are ceased and paid out as lump sums to the adult children.*

Can I continue to make contributions to super after commencing a pension?

Once a pension has been established, that interest cannot be added to by way of contributions. However, this does not deny a member of the ability of making future contributions to an accumulation account. The normal rules and limits for superannuation contributions will apply.

Can I consolidate my member balance?

A member can at any time nominate to combine their account balances. This can include consolidating accumulation phase and retirement phase accounts or consolidating multiple pension accounts. This is subject to the member's PTBC. SMSF members should consider their situation carefully before consolidating accounts, as tax free components are recalculated each time a new pension commences. Depending on beneficiary nominations, estate planning and personal circumstances, there may be instances where consolidation is not appropriate.

What happens to my pension if I die?

It is important to consider your nominated beneficiaries when commencing a pension and to ensure that your nomination remains current and valid.

SMSFs have the ability to pay a reversionary pension, if their trust deed allows. When commencing a pension, members can nominate an eligible reversionary beneficiary. With this nomination in place, upon death, the pension will continue to be paid to the reversionary beneficiary regardless of their age. Alternatively, on death, the trustee can make a decision to pay a pension to an eligible beneficiary or a lump sum. Death benefit pensions will count towards the Transfer Balance Cap of the nominated beneficiary. The application of this amount against the beneficiary's cap is subject to whether the pension automatically reverts or whether the trustees decide to pay a new pension. Reversionary pensions are applied to the beneficiary's Transfer Balance Cap 12 months from the date of death, allowing time for estate plans to be amended appropriately. Discretionary pensions are applied immediately from commencement.

Centrelink Issues

Some SMSF members qualify for Centrelink benefits. We recommend you obtain the appropriate advice before commencing or consolidating pensions to see how it may impact existing Centrelink benefits being received.

What does SuperGuardian do to start my pension?

SuperGuardian recommend speaking to a financial adviser before establishing a pension. For complex financial or family structures (blended families), it is recommended to consult an estate planning lawyer also.

The steps SuperGuardian undertake in establishing a pension include;

1. Review of the trust deed to ensure it allows for the pension desired by the member;
2. Preparation of compliance documentation and minutes of meetings;
3. Documenting trustee review of the investment strategy – Trustees need to consider risk/return, diversification, liquidity and the ability to meet pension liabilities;
4. Preparation of documents for segregated funds (to specify assets supporting the accumulation vs retirement phase accounts). This must be done prior to commencing the pension.
5. Registration of PAYG and assisting with ongoing compliance where pension members are below age 60, as tax may need to be deducted by the fund prior to the payment of the pension.
6. Assisting with the Pension Schedule for Centrelink/DVA purposes if the member is in receipt of, or considering applying for Centrelink benefits.
7. A review of the nominated beneficiaries and, where instructed, noting of a reversionary pension recipient.
8. Preparation and lodgment of Transfer Balance Account reporting requirements.

Our pension administration

By utilising the daily online information platform provided by SuperGuardian, pension minimum and maximum payment requirements are available in real-time. This also includes details of payments taken during the current financial year, and historically for previous years.

After completion of the SMSF annual return, SuperGuardian provide minimum and maximum payment calculations for the new financial year, so that members can have clarity around payment and withholding obligations.

Summary

Before commencing a pension, it is important to consider the member's whole circumstances in an SMSF and the ability of the fund to meet pension payment requirements. It is recommended to speak with a financial adviser or estate planning lawyer, if applicable.

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