SuperGuardian

Guide to Transition to Retirement 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.

There are several conditions of release that can be satisfied to commence an income stream. This guide focuses solely on the condition of release of a member attaining preservation age. This restricted condition of release allows people who have reached preservation age to access a portion of their superannuation benefits without having to retire.

Preservation age

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

Pension requirements

A Transition to Retirement Income Stream (TRIS) can be commenced when a member attains their preservation age and must meet the following requirements:

- Not be commuted unless a condition of release with no cashing restrictions has been met, or the commuted value is rolled back to an accumulation interest;
- Meet minimum pension standards;
- Payments not to exceed a maximum of 10% of the account balance at the start of each financial year.

Immediately prior to commencing the pension, you must establish the value of the member's interest in

the fund taking into account the valuation guidelines for SMSFs. The key components of the member's interest that must be determined are:

- Preservation components; and
- Taxable and tax-free components.

A pension may be commenced with the member's full balance or a specified amount.

TRIS in Accumulation Phase

Where a member has not satisfied a full condition of release (eg retirement or reaching age 65), the TRIS will remain in accumulation phase. This means that for taxation purposes, the TRIS incurs tax up to 15% on assessable earnings and capital gains, noting that non-arm's length income is taxed at 45%.

Key elements of a TRIS in Accumulation Phase:

- They do not count towards the member's Personal Transfer Balance Cap (PTBC) and they can be established for any amount, noting that the payment requirements are tied to the balance of the TRIS.
- Have minimum and maximum limits calculated based on the account balance and member age at commencement and 1 July thereafter. The maximum payment amount is 10% of the account balance at commencement or 1 July.

TRIS in Retirement Phase

A TRIS in accumulation phase converts to being in retirement phase when the member meets one of the following full conditions of release:

- Turn 65
- Retirement (inclusive of ceasing gainful employment post age 60)
- Permanent incapacity, or
- Has a terminal medical condition
- Upon death if the pension is reversionary

The Transfer Balance Cap (TBC) is a limit on how much superannuation can be in 'retirement phase' and have tax free earnings. Refer to our fact sheet Indexing the Personal Transfer Balance Cap for more information about indexation and the TBC rules.

The date at which the shift to retirement phase occurs is crucial as this is the date at which the TBC applies to the TRIS. If the retirement phase balance exceeds the individual's personal TBC, a commutation should occur immediately prior to the condition being met to reduce the balance accordingly.

As the shift to retirement phase is only automatic when a member turns 65 it is important to document the condition of release that has been met and the relevant date.

Once this shift occurs the TRIS is now referred to as being 'in Retirement Phase' (sometimes called a 'Retirement Phase Pension'). This means that the TRIS can now benefit from the same tax exemptions as an Account-based Pension (ABP).

It is important to note that the 10% maximum payment restriction is also lifted at this time. A TRIS in retirement phase enjoys the same maximum as an ABP, being the full account balance.

Annual Payment Requirements

The following table outlines the current minimum annual payment requirements for 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%	7.0%
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.

How are the payments allocated from the member's preservation components?

Generally, when each TRIS payment is made, you must adjust the preservation components for the TRIS.

The payments from the TRIS must be deducted from the preservation components in the following order:

- From any unrestricted non-preserved benefits; then
- From any restricted non-preserved benefits; finally
- From any preserved benefits.

Once a member has satisfied a condition of release with a nil cashing restriction (such as attaining age 65), all of the member benefits within the TRIS become unrestricted non preserved benefits.

Commutations

Until a condition of release with a nil cashing restriction has been met, a maximum of 10% can be withdrawn as a pension payment (calculated at commencement date or 1 July for each subsequent year). There are also restrictions on the ability to commute a TRIS.

When only preserved or restricted non preserved benefits are held a TRIS can be commuted to a lump sum in the following limited circumstances:

- If the member chooses to roll back the benefits to their accumulation interest
- To give effect to a family law payment split
- To give effect to a Division 293 Tax release authority for excess contributions

Where a TRIS contains unrestricted non-preserved benefits the member can at any time partially commute unrestricted non-preserved benefits as a lump sum. 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 TRIS 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 TRIS 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 a **TRIS in accumulation phase** are subject to tax up to 15%.

Earnings, including capital gains, from assets supporting a TRIS in retirement phase are exempt from tax.

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

If there is a **TRIS 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.

Option One: Segregated Accounts cont.

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 paid via a TRIS to a member aged 60 or over are tax free and there is no need to withhold tax or have the TRIS 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 TRIS will be used to determine how much is assessable and how much tax needs to be withheld, at marginal tax 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.

Record Keeping

It's important to maintain appropriate records including being able to show:

- The value of the TRIS at commencement, when it enters retirement phase and at 1 July of each year
- The Preservation and Tax Components at commencement
- The TRIS' share of the fund's earnings each year (allocated to the member's preserved component)
- The member has drawn between the minimum and maximum
- Any preservation balance adjustments when payments are made
- The date the TRIS enters retirement phase

Note that any new contributions cannot be added to an existing TRIS and must be kept separate.

Summary of Advantages and Disadvantages of TRIS

Advantages

- Partial access to funds prior to meeting full condition of release.
- Ability to reduce working hours and use a TRIS to supplement income.
- Ability to work full time and make contributions via salary sacrifice into super which may save personal income tax (TRIS used to replace the salary).
- If over age 60 the TRIS payments are tax free to the member so becomes significantly more tax effective.
- TRIS in accumulation phase does not count towards the TBC.
- If contributing more than the amount being withdrawn via the TRIS, then the member balance is still growing for retirement.
- Can assist in the use of recontribution strategies, albeit subject to withdrawal and contribution limitations.

Disadvantages

- Drawing down on TRIS prior to retirement may mean less funds available at retirement.
- If under age 60 the TRIS payments are taxable to the member. The taxable component is taxed at the marginal rate less a 15% tax offset.
- Using salary sacrifice strategies may not provide any tax benefit to low income earners and may result in more tax for high income earners i.e. Division 293 tax of 15% if your combined income and contributions exceed the threshold of $250,000, or tax on excess concessional contributions.
- TRIS in Retirement Phase counts towards the TBC so needs to be kept under the cap.
- The withdrawal of funds via a TRIS may impact social security benefits.
- Exempt current pension income deduction not available for a TRIS in accumulation phase.

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. *<u>Preserving tax components</u> – 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).* F*or 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. 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. Alternativey, 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.

How will this impact Centrelink entitlements?

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 happens if I don't take enough or draw out too much pension?

Underpayments (under the minimum requirement)

Failure to withdraw the minimum amount by 30 June will mean that the income stream is taken to have ceased at the start of that financial year for income tax purposes. Any payments taken during the year will be super lump sums for both income tax and SIS Regulation purposes.

There are circumstances where the Commissioner of Taxation will allow an income stream to continue where the minimum requirement has not been met. According to the ATO, all of the following conditions need to be satisfied:

1. The trustee failed to pay the minimum pension amount in that income year because of either:
   a. an honest mistake made by the trustee resulting in a small underpayment of the minimum payment amount for a super income stream (1/12th of the minimum required).
   b. matters outside the control of the trustee.
2. If the income stream was in the retirement phase, the entitlement to the ECPI exemption would have continued but for the trustee failing to pay the minimum payment amount.
3. Upon the trustee becoming aware that the minimum payment amount was not met for an income year, the trustee makes a catch-up payment as soon as practicable in the following (current) income year; or treats a payment (intended prior year payment) made in the current income year, as being made in that prior income year. As soon as practicable is considered to be within 28 days of becoming aware of the underpayment.
4. Had the trustee made the catch-up payment in the prior income year, the minimum pension standards would have been met.
5. The trustee treats the catch-up payment, for all other purposes, as if it were made in the prior income year.

Note: the above exception can only be utilised once for the fund. A subsequent underpayment would need to be addressed by writing to the ATO to consider the circumstances.

Overpayments (over the 10% maximum limit)

There is a 10% limit on the amount that can be withdrawn from a TRIS in accumulation phase. There is also no requirement to round the maximum amount to the nearest $10. The maximum is calculated from the date of commencement for a new pension (not pro-rated) or from 1 July for each subsequent year. Exceeding the 10% maximum amount by 30 June will mean that the income stream is taken to have ceased at the start of that financial year for income tax purposes. Any payments taken during the year will be super lump sums for both income tax and SIS Regulations purposes. If a member has only restricted non-preserved benefits or preserved benefits, this will be a breach of the super laws. The fund can be made non-complying and penalties can occur. Any lump sums are also included in the member's assessable income and taxed at marginal rates without any tax offsets. The payments are considered a breach of the SIS payment standards and are considered to be early access to the member's super benefits.

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 also recommended to consult an estate planning lawyer.

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, the ability to meet pension liabilities and insurance requirements;
4. Preparation of any 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 assistance 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. Assistance 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.

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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Strategies to use TRIS

Under Age 60

Case Study – Under age 60 and utilising existing account balance to start TRIS

In this example the member can salary sacrifice more pre-tax income to super and use up the concessional contributions cap of $27,500. They can then supplement their after tax income with TRIS payments to keep their after tax income unchanged.

There is limited benefit in personal income due to the salary sacrifice to super but it is compensated by the pension withdrawal and 15% pension tax offset. Overall there is a marginal increase to the fund balance due to the net contribution being slightly higher than the pension withdrawn. This is limited benefit here when considering the costs to implement the strategy. Over time the annual net benefit could be worthwhile.

In this example, we assume the member is under 60 years of age and has a member balance of $250,000 that is entirely taxable. They can salary sacrifice $17,000 to reach the concessional contributions cap for the 2022/23 financial year. Taking $13,832 means they will end up with the same after tax income they would have if they did not utilise this strategy.

The following table shows the net benefit to the fund of a member under age 60 commencing a TRIS:

	Current Position	TRIS Strategy
Original Salary	100,000	100,000
Super Guarantee Contribution	10,500	10,500
Salary Sacrifice Contribution	-	17,000
Gross Taxable Salary	100,000	83,000
TRIS Pension Taxable	-	13,832
TRIS Pension Tax Free	-	-
Total Gross Income	100,000	96,832
Total Taxable Income	100,000	96,832
PAYG Payable	22,967	21,937
Medicare Levy	2,000	1,937
15% Pension Tax Offset	-	2,075
Net Tax	24,967	21,799
After Tax Income	75,033	75,033
Additional After Tax Contributions		17,000
Less : Tax in Fund		2,550
Net Contribution		14,450
Less Pension withdrawal		13,832
Net Benefit to Fund		618

**The TRIS pension withdrawal amount is set at the amount required to achieve the same after tax income for the member.*

Strategies to use TRIS cont.

Over Age 60

Case Study – Over age 60 and pension payments not taxable

In this example, as per the prior example the member can salary sacrifice more pre-tax income to super and use up the concessional contributions cap of $27,500. They can then supplement their after tax income with TRIS payments to keep their after tax income unchanged.

We assume the member is 60 years or over and has a member balance of $250,000 that is entirely taxable. They can salary sacrifice $17,000 to reach the concessional contributions cap and commence a TRIS with their 100% taxable balance. If they commence a TRIS from 1 July 2022 they will have a minimum of $5,000 to take and a maximum of $25,000 for the year. Taking $11,200 means they will end up with a very close after tax income to what they would have if they did not utilise this strategy.

The following table shows the net benefit to the fund of a member over age 60 commencing a TRIS with a taxable balance of $250,000:

	Current Position	TRIS Strategy
Original Salary	100,000	100,000
Super Guarantee Contribution	10,500	10,500
Salary Sacrifice Contribution	-	17,000
Gross Taxable Salary	100,000	83,000
TRIS Pension Taxable	-	
TRIS Pension Tax Free		11,200
Total Gross Income	100,000	83,000
Total Taxable Income	100,000	83,000
PAYG Payable	22,967	17,442
Medicare Levy	2,000	1,660
15% Pension Tax Offset	-	-
Net Tax	24,967	19,102
After Tax Income	75,033	75,098
Additional Contributions		17,000
Less : Tax in Fund		2,550
Net Contribution		14,450
Less Pension withdrawal		11,200
Net Benefit to Fund		3,250

**The TRIS pension withdrawal amount is set at the amount required to meet the minimum and achieve a very close after tax income to what they would have if they did not utilise the strategy*