CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

SuperGuardian
Superannuation administration made simple!

Pensions and SMSF

Pensions in SMSFs have been referred to as ‘Better than a tax haven!’ How do you better a tax haven? The ATO sends you a refund cheque each year! The tax environment within SMSFs is one of the reasons they are so attractive. This fact sheet will explain the benefits, types of pensions available and who is able to commence a pension.

Pension commencement

There are a number of reasons why you may decide toestablish a pension from your SMSF. Common reasons formembers to move into pension phase include:

- Retirement;
- Transition to retirement;
- Incapacity (Temporary or Permanent); or
- You need cash to meet your living expenses (and areentitled to a pension).

The most common reason not to start a pension is thatyou do not yet need the cash to meet your living expenses and want to retain the capital and earnings in superannuation.

What is a pension?

When a member is contributing to super, this is called‘Accumulation’ phase. All contributions and earnings in thefund are allocated to the member’s account. This money then remains preserved until the member satisfies a condition of release. During this phase, the earnings on the assets of theaccumulation account are taxed at 15%.

If the member decides to establish a pension with their account, the balance is now referred to as “in pension phase”. This means that no further contributions can be made to increase the amount of the pension. During this phase, the earnings on the assets of the pension account are tax exempt (up to an asset value of $1.6 million).

Many SMSF members often have an accumulation balance (to contribute to) and a pension balance (to withdraw from at the same time which is also acceptable.

Benefits of setting up a pension

Tax free environment

Whilst in accumulation phase, the fund will pay 15% tax on all concessional contributions and taxable income within the fund. The key benefit for a member moving into full pension phase is that the portion of the fund supporting the pension also moves into a tax-exempt environment. This means that there is nil tax to pay on any income or capital gains from these assets.

However, from 1 July 2017 legislation was introduced which restricts the amount that can be held in a tax-exempt environment to $1.6 million per member, which is known as the Transfer Balance Cap. The Transfer Balance Cap takes into account ALL types of pension

Refund of franking credits

Imputation credits (also known as franking credits) represent the tax paid by Australian companies and are attached to franked dividends. These credits are usually used to offset any tax liabilities the fund has, however for a fund in pension phase, the income is no longer taxable. As there is no tax liability, when the fund lodges its taxation return at the end of the financial year, the franking credits are refunded to the SMSF’s nominated bank account.

Tax free income stream

For members receiving pension payments from the age of 60 onwards, there is no requirement to report the pension in your personal tax return. This means that all withdrawals within the prescribed limits from your self managed super fund are tax free!

Control

As long as the minimum pension withdrawal requirements are met annually, the member can control how much they withdraw and the timing of those payments.

Condition of release & payment restrictions

A condition of release is a nominated event that the member must satisfy to be able to withdraw benefits from their superannuation. Once the member has satisfied a condition of release the member has the option to commence an income stream.

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.

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Condition Of Release	Cashing Restrictions
Retirement (preservation age–age 60)	Member who was gainfully employed (more than ten hours per week 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.
Temporary incapacity	In limited circumstances, member who has temporarily stopped working due to ill physical or mental health has restricted access to superannuation benefits.
Severe financial hardship	Member is unable to meet reasonable family expenses and has been receiving government income support can gain restricted access to superannuation benefits.
Compassionate grounds	Must be approved by APRA.
Terminal illness & injury	Illness must be certified by two medical professionals, that it will result in the member's death within the next 24 months.
Death	Upon death of a member, superannuation benefits can be released.

Types of pensions

There are several types of pensions that may be paid from an SMSF. The more common pensions include:

- Account Based Pension (ABP);
- Transition to Retirement Income Stream (TRIS or TTR)

Account based pension

Account Based Pensions (ABP's) are very popular for SMSF members as they are simple to both 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 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.

Transition to retirement pension

Members that have reached preservation age, but are not yet able to satisfy a condition of release, can commence a transition to retirement income stream (TRIS). These pensions are also easy to understand. They are essentially the same as an account based pension, however the member is limited to withdrawing a maximum of 10% of their pension account balance each year.

TRIS don't enjoy the same tax free environment as a ABP, as they pay 15% tax.

Members receiving a TRIS are able to convert to an ABP as soon as a condition of release is satisfied, lifting the 10% maximum restriction and also enable the fund to operate in a tax-exempt environment.

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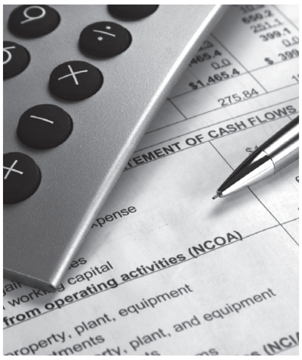
When Can I start a pension?

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

Annual minimum pension requirements: (ABP & TRIS)

The following table outlines the current minimum annual drawdown requirement for both Account Based Pensions and Transition to Retirement Income Streams. The member's age at 1 July each year (or at pension commencement) will determine the minimum percentage of their member balance to be drawn for that financial year.

Age of Member	Minimum
Under 65	4%
65 – 74	5%
75 – 79	6%
80 – 84	7%
85 – 89	9%
90 – 94	11%
95	14%
95+	14%



Can I continue to make contributions to super?

It is true that member balances in pension phase cannot be added to. However, this does not mean that members can no longer contribute to super. Contributions will simply be allocated to a new member account in accumulation phase. The normal rules and limits for superannuation contributions will continue to apply.

How is tax calculated if my fund is part pension & part accumulation?

There are two options for SMSFs running both pension and accumulation accounts for members. The application of these will depend on the member's 'total super balance'. This is the balance of all superannuation benefits, not only in the SMSF, but also all other superannuation structures. This includes moniesheld in both pension and accumulation phase.

Option One: Segregated Accounts

Segregation refers to the ownership of specific assets either supporting the pension phase or supporting the accumulation phase. Therefore, as separate portfolios 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.

From 1 July 2017 eligibility to utilize this method changed. The ability to segregate for tax purposes is now dependent on whether all members in the fund hold no more than $1.6 million in the superannuation environment (not just the SMSF). If one member holds more than this amount, segregation for tax purposes is not allowed

Option Two: Proportionate Method

If a fund is not segregated it is classed as being pooled for taxpurposes and tax is calculated using the proportionate method. This means that all the assets in the fund jointly support both the pension and the accumulation balances in the fund. 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 will not be subject to tax. Due to the ease of administration, this is a much more popular option.

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.

From 1 July 2017 if a member has nominated a reversionary beneficiary and the fund is paying a Transition to Retirement Income Stream, the ability for the pension to automatically revert also depends on the recipient. The recipient will now be required to meet a condition of release to convert the TRIS to a full account based pension or else the original pension will cease. The beneficiary will then need to commence a brand-new pension. The implications of having to commence a new pension will mean that the pension will count towards the beneficiary's Transfer Balance Cap at the date of death instead of twelve months after the date of death, which is the case for eligible reversionary pensions.

How many pensions can I start?

There are no restrictions on the number of pensions a member can start. A member can commence as many pensions as needed to suit their own personal situation.

Can I consolidate my member balance?

A member can at any time nominate to combine their separate balances. This can include consolidating accumulation and pension accounts or consolidating multiple pension accounts.

This process is commonly known as a 'pension stop and restart' because it generally involves stopping the existing pension, then immediately transferring balances and commencing a new pension.

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.

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 is going to affect any existing Centrelink benefits being received.

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What does SuperGuardian do to start my pension?

SuperGuardian holds a limited AFSL and is able to provide you with strategic advice in relation to the establishment of a pension if you do not have your own financial adviser to do so. If you have a complex family structure (blended family) or a complex financial structure, we recommend that you consult with an estate planning lawyer also.

The steps we then undertake 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. If the account is to be segregated, we specify separate assets to support the pension with the segregation done prior to commencement of the pension;
5. The fund needs to register for PAYG purposes if the member is under the age of 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.

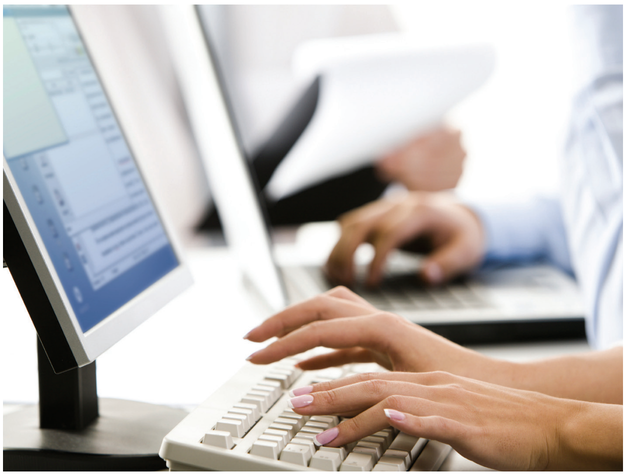
Our pension administration

By utilizing the daily online information platform provided by SuperGuardian, you can check the minimum and maximum pension requirements for an applicable year and be advised of what you have taken year-to-date and how much more you must withdraw to ensure your minimum pension obligations are met.

At the beginning of each financial year, you can log onto SG's secure website to obtain indicative minimum and maximum pension calculations for the new financial year, to allow any adjustments to be made with respect to your pension payments. After completion of the SMSFs annual return, we provide finalised pension calculations for the new financial year.

Summary

You should always obtain financial advice before undertaking any strategy. The information above should be considered general in nature and does not take into account your personal circumstances.



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