SuperGuardian Information

Reversionary Pensions

A member's estate planning objectives should be taken into account when commencing any new pension.

When a super fund member passes away, if they have a pension account with a reversionary beneficiary nomination, the pension can continue to be paid to the reversionary beneficiary. This can have important consequences so should be thoroughly considered when commencing a pension.

The trust deed also needs to allow a reversionary nomination to be made.

Who can be a reversionary beneficiary?

A person should only be nominated as a reversionary beneficiary if they are expected to be a SIS dependant at the date of death of the member, and therefore able to receive the death benefits by way of a pension.

Under the Superannuation Industry (Supervision) Act 1993, a dependant must be one of the following:

1. Be a spouse of the member
2. Be a child of the member:
    - Who is less than 18 years of age; OR
    - 18 or more years of age and less than 25 years of age AND financially dependent on the member; OR have a disability (as defined in the Disability Services Act 1986)

3. Be in an interdependency relationship with the member:
- They have a close personal relationship
- They live together
- One of each of them provides the other with financial support AND
- One of each of them provides the other domestic support and personal care

Important Differences between commencing a new Death Benefit Pension and a Reversionary Pension

1. Minimum Payment Required

A minimum pension payment is not required for an account based pension in the year of death. A payment will be required once a new pension is commenced, based on the recipient's age and the member balance.

A reversionary pension will require the minimum pension to be paid in the year of death. This is based on the deceased member's balance and age. From 1 July of the following year it will be determined by the pension account balance and reversionary beneficiary's age.

2. Transfer Balance Cap

The transfer balance cap applies from 1 July 2017 and is effectively a lifetime limit of the amount of super that a member can place into retirement phase with concessional tax treatment. The limit is currently $1,600,000.

A new account based pension will count towards the recipient's transfer balance cap when the pension commences. The credit amount is the market value of the pension at the time of commencement.

A reversionary pension will count towards the recipient's transfer balance cap 12 months after the date of death of the member. The credit amount is the market value of the pension at the deceased member's date of death.

The timing difference here can have important implications as a reversionary nomination can give the recipient 12 months to deal with any transfer balance cap issues and commute any exiting pension balances they may already have required to comply with the cap.

3. Other Considerations

Commencing a new death benefit pension will require pension commutation documentation, new pension documentation and potentially statement of advice fees to arrange.
By having a pension automatically revert, there is no need for formal documentation however a minute or resolution to note the decision should be done and the reversionary beneficiary has immediate access to pension payments.

4. Transition to Retirement Pensions

It is also important to note that due to the super reforms, from 1 July 2017, if a transition to retirement income stream (TRIS) reverts to a reversionary beneficiary, the beneficiary will need to satisfy a condition of release to continue the pension. It will need to be able to convert to a full account based pension; or it must stop and restart as a new pension.

This has important implications due to the transfer balance cap discussed above. If an entirely new death benefit pension is commenced, it will count towards the transfer balance cap at the date of death. A reversionary pension will count towards the recipients transfer balance cap 12 months after the date of death which provides greater flexibility.

In light of the above considerations estate planning advice should be sought to ensure that any reversionary beneficiary nomination fits in with the member's desired objectives. For any nomination to be effective, the trust deed and pension commencement documents need to allow for it.

RECONTRIBUTION STRATEGY

A recontribution strategy involves withdrawing superannuation benefits and recontributing back into super. The main reason to do this is to effectively minimise tax for your beneficiaries when you pass away.

By withdrawing taxable benefits from your account and making non-concessional contributions to super you can increase the tax free component of your entitlements and therefore pass on tax savings to your beneficiaries.

For this to be possible, you need to be able to do the following:

1. Meet a condition of release – you need to be entitled to withdraw funds from super.

2. Be able to make non-concessional contributions – you need to be in a position to be able to put the funds back into super. You will need to consider the contribution caps and bring forward rules, your total superannuation balance and whether you meet the work test (if over 65 years of age).

It is most beneficial where your superannuation benefits are likely to be paid to non-tax dependants such as adult children.

The below table from the ATO illustrates how super lump sums are taxed when paid to non-dependants versus dependants.

Income component derived in the income year	Age when payment is received.	Amount subject to tax	Maximum rate of tax (excluding Medicare levy)
Death benefit lump sum benefit paid to non-dependents - taxable component - taxed element	Any	Whole Amount	15%
Death benefit lump sum benefit paid to non-dependents- taxable component - untaxed element	Any	Whole Amount	30%
Death benefit lump sum benefit paid to dependents- taxable component - taxed and untaxed elements	Any	None	Nil

The tax free component is not taxed when paid out to a non-dependant so increasing the proportion of your member balance and ultimate death benefit is of great value to your beneficiaries.The tax free component is not taxed when paid out to a non-dependant so increasing the proportion of your member balance and ultimate death.

So how does this work?

1. Superannuation components

Your balance within superannuation is made up of taxable and tax free components. The tax free component is generally made up of non-concessional contributions and any tax free amounts rolled in from other super funds. The taxable component is the total value of the super interest less the tax free component. It is essentially comprised of your concessional contributions and earnings on superannuation investments not supporting pension accounts.

2. Withdrawals from super

The withdrawal from a member's account may take the form of a lump sum from an accumulation balance, a pension withdrawal from a pension balance or a partial commutation from a pension balance.

The ability to utilise this strategy is contingent on being able to meet a condition of release to withdraw funds from super. Unrestricted non-preserved benefits can be withdrawn at any time. For preserved benefits however, a condition of release needs to be met and this may include reaching preservation age and retiring, reaching preservation age and commencing a transition to retirement income stream, ceasing an employment arrangement after turning 60 years of age; or reaching 65 years age. For a member that has reached their preservation age but is not yet 60 years of age, the taxable component of any pension withdrawal would be subject to personal income tax. Therefore it is generally more beneficial for someone over 60 years of age to use this strategy as there are no adverse personal taxation consequences.

The proportioning rule in super means that any superannuation benefit is taken to be paid in the same proportion as the taxable and tax free components of the member's interest in the super fund. Therefore a member is not able to select which components a withdrawal is allocated from. For example if 20% is tax free and 80% is taxable, then any lump sum will be allocated in the same proportions.

3. Non-concessional contributions

The second integral part of being able to utilise this strategy is the ability to recontribute the funds withdrawn. The non-concessional cap is currently $100,000 (for the 2018/19 financial year).

If you are under 65 years of age you may be able to contribute 3 times the annual non-concessional contribution cap in a single year under the bring forward rules. However if you have a total superannuation balance exceeding the general transfer balance cap (currently $1.6m for the 2018/19 financial year) then you are not able to make non-concessional contributions at all. Your total superannuation balance at the end of the previous financial year will determine your non-concessional contribution cap and whether a 2 year or 3 year bring forward period applies under the rules.

The table below from the ATO illustrates the availability of the bring forward rule in relation to a members total superannuation balance.

Total superannuation balance	Contribution and bring forward available
Less than $1.4 million	Access to $300,000 cap (over three years)
Greater than or equal to $1.4 million and less than $1.5 million	Access to $200,000 cap (over two years)
Greater than or equal to $1.5 million and less than $1.6 million	Access to $100,000 cap (no bring-forward period general non-concessional cap applies)
Greater than or equal to $1.6 million	Nil

Another factor to consider is whether the fund can accept a contribution. If you are 65 years of age but not yet 75 years of age, you must have satisfied the work test and have been gainfully employed for at least 40 hours within 30 consecutive days prior to making a contribution. (Note, that from 1 July 2019 there may be a 1 year exemption available to over 65s – this is yet to be legislated). After 75 years of age, non-concessional contributions are not permitted.

Whilst a recontribution strategy is generally one of the more simple super strategies, there is still a lot to consider so it's important to seek financial advice prior to making any decisions. Here is an example of how this can work in a scenario:

• Joe is 62 years of age and retired.
• His nominated beneficiary on his binding death benefit nomination form is an adult son. His son will therefore pay tax on the taxable component of any lump sum death benefit.
• As Joe is retired his balance is unrestricted non-preserved and he can withdraw funds. He is over 60 years of age, so a pension payment or partial commutation is tax free to him personally.
• He has not previously triggered the bring forward rules in the last 2 financial years and his total superannuation balance is under $1.4m. Therefore he can access the full contribution cap of $300,000 over 3 years.

If there were sufficient liquid assets available, Joe could undertake the recontribution strategy by withdrawing $300,000 as a partial commutation from the pension account. He could then recontribute the funds the next day and commence a second account based pension in the fund.

BEFORE Current Components			$300k Allocation	
Taxable	$400,000	66.67%	$200,000	66.67%
Tax Free	$200,000	33.33%	$100,000	33.33%
Total	$600,000	100.00%	$300,000	100.00%

AFTER New Components			New 2nd Pension		Overall	
Taxable	$200,000	66.67%	-	0.00%	$200,000	33.33%
Tax Free	$100,000	33.33%	$300,000	100.00%	$400,000	66.67%
Total	$300,000	100.00%	$300,000	100.00%	$600,000	100.00%

If he were to pass away today, based on the current components, the taxable component would be subject to withholding tax at 15% plus 2% Medicare levy, totalling $68,000.

However if he undertook the strategy and commenced the second pension prior to passing, the components would change per above. The revised taxable component could be reduced to $200,000 and subject to withholding tax at 15% plus 2% Medicare levy, resulting in a 50% reduction in withholding tax.

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