Xpress Super Information

Pensions in SMSFs

Establishing a pension inside an SMSF can have wide-spread tax advantages. This is one of the main attractions for members to consider establishing a pension, second only to the need to fund ongoing cash flow requirements. Below lays out some of the eligibility criteria for and benefits of establishing a pension, and the different types of pensions available.

What is a pension?

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. These payments may incur personal tax consequences for persons under age 60, but are tax free to those aged 60 or older.

**Discussed later in further detail*

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. There are a number of conditions that can be met and many are linked to major life events. Once a member meets a Condition of Release they are entitled to establish a pension and begin withdrawing their funds. Some of these conditions include:

- Temporary or permanent incapacity (physical or mental)
- Transitioning to retirement (after attaining preservation age^)
- Retirement (after attaining preservation age)
- Ceasing employment after attaining age 60
- Reaching age 65

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.

^Preservation Age is discussed later

Condition 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.
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 the ATO.
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.

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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.

Where a member establishes a pension, their balance moves from the accumulation phase to retirement phase (sometimes referred to as pension phase). For balances in the retirement phase the ATO grant 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 a lifetime limit of $1.6 million~ across all of their superannuation accounts, this includes defined benefit pensions. 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 $1.6 million cap referred to above.

~For more on the Transfer Balance Cap of $1.6 million refer to our SMSF Rules on our website.

Tax free income stream

Of particular interest for self-funded retirees is the personal tax benefits. Where a member is below age 60 pension payments are usually reported in their personal tax return, resulting in a personal tax liability. For members aged 60 or older these pension payments are tax free.

This arises because the requirement to report pension payments in their personal tax return ceases on their 60th birthday. Members aged 60 or older no longer need to report these payments personally and can therefore withdraw their superannuation (within their prescribed limits) tax free.

Control

Control over the amount and frequency of payments is of huge benefit to self-funded retirees. 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 for funds 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.

Important Note: Labor have proposed to remove this franking credit refund if elected in this month's election. Instead of being paid a refund by the ATO, the excess franking credits would be 'lost' to the tax system.

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) Not in Retirement Phase; and
- Transition to Retirement Income Stream (TRIS or TTR) in Retirement Phase.

Account Based Pension (ABP)

Account Based Pensions are the most common pension for SMSF members as they are simple to both calculate and understand. ABPs have minimum and maximum payment requirements each financial year. The minimum payment amount is based on the member's age and account balance at 1 July of the financial year, while the maximum is the full account balance. Provided that the annual sum of payments are within these minimum and maximum amounts, a member has control over the timing and size of pension payments they receive.

One of the largest benefits of an ABP is that they receive the tax exemptions discussed earlier. This also means that ABPs are subject to the $1.6 million Transfer Balance Cap, as they are referred to as being in Retirement Phase where these tax exemptions exist.

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Transition to Retirement Income Stream (TRIS) Not in Retirement Phase

A Transition to Retirement Income Stream can be commenced when a member attains their preservation age. Where a member has not satisfied a full condition of release, the TRIS will be referred to as 'Not in Retirement Phase' (sometimes called a
'Non-Retirement Phase Pension'). This means that for taxation purposes, the TRIS is treated as being in accumulation phase and incurs tax at 15% on assessable earnings and capital gains.

As there is no tax exemption, these pensions do not count towards the $1.6 million cap. Therefore a TRIS Not in Retirement Phase could be established for any amount, noting that the payment restrictions are tied to the balance of the TRIS.

Payments from a TRIS Not in Retirement Phase have minimum and maximum limits which are determined on the account balance and member age at 1 July, similar to an ABP. A key difference arises with the maximum payment amount. Unlike an ABP, a TRIS Not in Retirement Phase has a maximum payment amount of 10% of the account balance at 1 July.

Transition to Retirement Income Stream (TRIS) in Retirement Phase

After understanding a TRIS Not in Retirement Phase, it is important to understand how a TRIS can subsequently move into retirement phase and what changes as a result.

A TRIS Not in Retirement Phase automatically converts to being in retirement phase when the member meets a full condition of release. As the shift to retirement phase is automatic it is important to document the condition of release that has been met and the relevant date.

Once this 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 ABP.

The date at which the shift to retirement phase occurs is crucial as this is the date at which the $1.6 million cap applies to the TRIS. If the balance exceeds this cap, a commutation should occur to reduce the balance accordingly.

An important note is 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 minimum payment requirements

The following table outlines the current minimum annual payment requirement for both Account Based Pensions and Transition to Retirement Income Streams (including Not in Retirement Phase and in Retirement Phase). The percentage applied is dependent on the member's age at 1 July or for newly established pensions, at commencement date.

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

Preservation age

Before establishing a pension a member must attain preservation age, as discussed earlier. The preservation age of a member is determined by their date of birth, and 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

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

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

How is tax calculated if my fund holds both a Retirement Phase pension and Accumulation Phase balance?

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', 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 Total Super Balance below $1.6 million segregation can be applied.

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.

Where one or more members have a Total Super Balance over $1.6 million, segregation is not allowable for tax purposes and the SMSF must adopt the proportionate method.

Option Two: Proportionate Method

Where a fund is not segregated (either by choice of trustees, or due to the Total Super Balance 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.

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.

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 even when they have not met a condition of release. Alternatively, on death, the nominated beneficiary can choose to have the pension balance paid out as a lump sum.

Reversionary pensions, on death, will also count towards the $1.6 million Transfer Balance Cap of the nominated beneficiary if paid as a pension. The application of this amount against their cap is not an immediate action, like establishing an ABP or TRIS in Retirement Phase. The reversionary pension is applied to the beneficiary's Transfer Balance Cap 12 months from the date of death, allowing time for estate plans to be amended appropriately.

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 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.

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.

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What does Xpress Super do to start my pension?

Xpress Super recommend speaking to a financial adviser before establishing a pension. In the event a financial adviser is not appointed, Xpress Super is able to provide strategic advice in relation to the establishment of a pension. For complex financial or family structures (blended family), it is recommended to consult an estate planning lawyer also.

The steps Xpress Super 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 assist 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. Assist 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 Xpress Super, 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, Xpress Super provide minimum and maximum payment calculations for the new financial year, so that members can have clarity around payment obligations.

Summary

Before commencing a pension it is important to consider a whole-of-circumstance for each member in an SMSF. It is recommended to speak with a financial adviser or estate planning lawyer, if applicable. Pensions can carry with them highly attractive tax exemptions, but also impose payment requirements each year.

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