Pension payment strategies

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Agenda

- 2018-19 year-end pensions checklist
- Consequences of not meeting the minimum pension standards
- Options and strategies for taking a payment from an SMSF in 2019-20
2018-19 year-end pensions checklist
Account based pensions must meet minimum pension standards by 30 June

- Minimum payment = % based on member age at 1 July x balance

Non-retirement phase TRIS must also meet minimum pension requirements

- E.g. Anna had $125,000 in a non-retirement phase TRIS at 1 July 2018 and was aged 61, she
  - Minimum pension = 0.04 x 125,000 = 5,000

Pensions commenced during 2018-19 must pay a pro-rated minimum amount

- If Anna’s pension had commenced 30 September 2018 on her 62nd birthday then she would have a minimum pension requirement of $3,750
  - $125,000 x 0.04 x 274 / 365 = 3,753 rounded to nearest 10 dollars

Each individual income stream must meet the minimums

- A payment that is sufficient in total but is paid from just one income stream does not meet the pension standards
2018-19 year-end pensions checklist

- Make sure minimum pension standards have been met
- Where someone passed away check in on their pensions
- Lodge required transfer balance account reports
- Get the timing of last minute pension payments right

- Remember that from 1 July 2017:
  - Partial commutations do NOT count towards minimum pension payments
  - You can no longer elect to treat pension payments as lump sums for tax purposes = no access to low rate cap for income stream payments
  - Lump sum payments do NOT not count towards minimum pension payments = if you claimed a TBA debit for a payment from a retirement phase income stream it will be a lump sum not a pension payment
  - A pension payment must be paid prior to completing a full commutation of an income stream

- Remember that a partial commutation does not trigger a re-calculation of the minimum pension payment
  - You still need to pay the full annual minimum payment based on the 1 July calculation even if partial commutations are made
  - Pro-rata amount is only calculated for a full commutation
Minimum payments are not required...

- On the death of a member where the income stream is not automatically reversionary
- For pensions which commenced in June
- For allocated pensions commenced prior to 1 July 2007 still operating under the former rules (min and max drawdown limits)
- …unless the member has previously decided to operate the allocated pension under the minimum pension standards by informing the trustee of their desire to change payment rules for the pension
- For a market linked pension payments must be made based on pension factors in SISR 1994 Schedule 6 +/- 10%, if commenced on or after 20 Sept 2007 generally must also meet the minimum pension standards
- For a defined benefit pension e.g. lifetime and term pensions, the trustee must make the payment as defined in the terms of the pension, and indexation may not occur on 1 July e.g. anniversary

Accurium has a calculator on the Tech Hub that can help you check minimum requirements
What events to report

- Lump sum payments from a retirement phase income stream
- Commutations of a retirement phase income stream, including compliance with a commutation authority
- Commencement of a new retirement phase income stream or death benefit income stream
- When a TRIS converts to be in the retirement phase
- LRBA payments which increased the value of a member’s retirement phase income stream
- Personal injury contributions

What not to report

- Pension payments
- Earnings or losses or the updated balance of a pension
- The death of a member
- When an income stream ceases due to being drawn to $0
- Information that individuals or other funds report to the ATO
Report events on time
- An annual reporting SMSF will have 2018-19 events due at the time when the SMSF’s 2018-19 annual return is due
- A quarterly reporting SMSF should have reported events which occurred in Jul – Sept by 28 Oct 2018, Oct – Dec events by 28 Jan 2019 and Jan to Mar events by 28 April, with Apr to Jun events due 28 July 2019
- Early reporting encouraged where double counting may occur

If a member has exceeded their transfer balance cap the SMSF must report commutations sooner
- 10 business days from end of the month in which voluntary commutation in response to ETB occurred
- 60 days from date of commutation authority
If 2018-19 is the first year the SMSF had a retirement phase income stream then need to determine the frequency of reporting:
- If total super balance of any member at 30 June 2018 was > $1 million the SMSF will be a quarterly reporter.
- Report events which occurred July to March ASAP as now late.
- Once the SMSF’s TBAR frequency is set it does not change and it applies to all current and future members.

Quarterly reporters may not know the accurate ‘value’ of a pension by the reporting due date:
- You still need to report on time!
- ATO say “trustee may choose to use a reasonable estimate of the value to meet TBAR obligations”.
- The ATO expect that as part of choosing to commence a pension the individual will be in possession of a reasonable estimate of the value of that pension and will have ensured that commencing the pension will not result in an excess transfer balance.
- The trustee may choose to correct the value initially reported by cancelling the original report and submitting a new one.

2018-19 year-end pensions checklist:
- Make sure minimum pension standards have been met.
- Where someone passed away check in on their pensions.
- Lodge required transfer balance account reports.
- Get the timing of last minute pension payments right.
Benefits paid as death benefit income stream must meet pro rata minimum pension payment prior to 30 June

- Pro rata is based on days from commencement of the death benefit income stream and minimum % on beneficiary’s age
- E.g. Sam passed away on 4 Aug 2018. His wife Serena joined the SMSF and commenced a death benefit income stream with $834,000 on 16 Aug. Serena was aged 78 and so a payment of $43,730 must be paid prior to year-end

\[
834,000 \times 0.06 \times \frac{319}{365} = 43,734, \text{ rounded to nearest$10}
\]

Benefits paid as automatically reversionary income streams must meet annual minimum pension requirements

- Sum of payments made prior to and after the pensioner passes away count towards meeting the minimum pension
- Don’t re-calculate minimum requirement
- E.g. If Sam’s pension was automatically reversionary the minimum would be based on his age and balance at 1 July 2018 and this was $60,900

By 4 Aug Sam had already paid $40,000 in pension payments. Serena must make a pension payment of $20,900 by year-end
If a member passed away in 2018-19 with an automatically reversionary income stream

- The income stream reverts to beneficiary on date of death and that is the date of the reportable event for TBAR
- E.g. if SMSF is a quarterly reporter and member passed away 23 April 2019 then beneficiary must report value of reversionary income stream at date of death by 28 July 2019
- Credit does not apply to the beneficiary’s TBA for 12 months but must still report the event based on date of death

2018-19 year-end pensions checklist

- Make sure minimum pension standards have been met
- Where someone passed away check in on their pensions
- Lodge required transfer balance account reports
- Get the timing of last minute pension payments right
30 June 2019 is a Sunday this year
- To count towards the 2018-19 minimum pension standards a payment must occur before midnight 30 June 2019
- ATO website states ‘trustees are expected to ensure that all pension payments are made prior to 30 June’

A pension payment must be ‘cashed’
- Payment is cashed when the member receives an amount and the member’s benefits in the SMSF are reduced
- A transfer of fund assets does not count as a pension payment, it is done by way of a commutation and lump sum payment
- A journal entry with a catch up payment made the following year does NOT count as a pension payment

2018-19 year-end pensions checklist
- Make sure minimum pension standards have been met
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- When a pension payment is counted as being paid
  - EFT: when the funds are credited in the member’s bank account
  - Cheque: the date of the cheque as long as it is presented promptly and is honoured

- Last minute payments:
  - Take care with an EFT payment close to 30 June as payment must hit member’s bank account prior to 1 July 2019 in order to count towards the minimum payments
  - A cheque payment dated 30 June would count towards the minimum payment as long as promptly presented
Consequences of not meeting the minimum pension standards
How the ATO treats a pension that does not meet the minimum standards

- The interest will not be a retirement phase income stream for the year and will cease effective 1 July of the financial year for tax purposes
- Earnings and capital gains will not be eligible for ECPI
- Any payments made will be treated as lump sums for tax and SISR purposes
- The fund must complete a TBAR to report a debit equal to the value of the income stream at 30 June (or at the date of commutation if earlier in the year)
- If the minimum pension rules are complied with in the following year this results in the commencement of a new income stream and the trustee must re-calculate the tax components for that new income stream and complete a TBAR for the pension commencement
Implications for the SMSF

- Higher tax bill
  - Funds using the unsegregated method will have a lower exempt income proportion for the year and if the pension was the only interest in the fund it would go from 100% exempt to 0% exempt
  - Potential serious impact on tax outcome if the fund realised material capital gains in the year
  - If there were assets segregated to the pension interest then may end up with segregated non-retirement phase assets over the year which would require a separate actuarial certificate
  - Payments now treated as lump sums may incur tax for persons under age 60 (can utilise the low rate cap where available)

- Note that if the SMSF had multiple pensions then those pensions which did meet the pension standards will continue to be eligible for ECPI
Implications for the SMSF

- **Additional administration costs**
  - The pension interest will be taken to have mingled with any accumulation interest for the year for tax purposes and the tax component will need to be re-calculated for the new pension commenced at the start of the following year.
  - TBAR will need to be completed for the pension commutation due to not meeting minimums at 30 June and the new pension commencement at 1 July.

- **Possible contraventions**
  - A non-retirement phase TRIS that fails the minimum pension requirements or exceeds the 10% payment limit will have payments treated as lump sums from accumulation but will not have met a nil cashing restriction condition of release.
  - Illegal early release of super benefits.
General powers of administration concession

- May allow the income stream to continue in limited circumstances:
  1. Failed to meet minimums due to
     - honest mistake resulting in small underpayment, or
     - due to matters outside the trustee’s control
  2. Entitlement to ECPI would have continued if the minimums had been met
  3. Upon becoming aware minimums were not met the trustee makes a catch-up payment as soon as practicable in following year (or treats a payment in that year as being made in prior year)
  4. The catch up payment is sufficient such that if it was actually paid in the year the minimums would have been met
  5. The catch up payment is treated for all other purposes as if it were made in the prior year
General powers of administration concession

- If all the conditions are met the income stream is taken to have continued and a new pension is not commenced in the following year
  - Don’t need to re-calculate tax components or do TBAR
  - Can continue to claim ECPI
  - Payments can continue to be treated as pension payments

- GPA concession can be used for account-based pensions or TRIS
  - The concession does not cover a TRIS that breaches the 10% maximum payment limit
  - If multiple pensions in an SMSF do not meet the minimum pension standards the GPA concession will be considered per pension
  - Trustee may self-assess the concession as long as underpayment does not exceed 1/12 of minimum payment, all other conditions are met, and have not previously applied for the exception

- ATO webpage: Minimum pension payment requirements – frequently asked questions
What else can you do...

- If you see in advance that an income stream will not meet the full minimum pension standards but has capacity to make some payments in the year then trustee could
  - Commute in full the income stream part way through the year at a time which means that the pro rata minimum pension payment will be met
- Note partially commuting at 1 July will not help as the minimum payment will already be set based on the initial 1 July balance
  - Partially commuting at 30 June in advance of the following year will assist in reducing the following year’s minimum pension requirements
- Where there are multiple pensions and the pension standards will not be met but some payments can be made, allocate payments so that one pension will meet the standards
  - One pension will retain ECPI vs both pensions not meeting pension standards and losing ECPI
  - Some people prefer to have multiple pensions per member for this reason
Payment strategies for 2019-20
Options for taking a benefit payment

- Pension payment from a retirement phase income stream
  - Must take at least the minimum pension requirement as a pension payment
  - No TBAR required

- Lump sum from a retirement phase income stream
  - Can be in-specie or cash
  - Is a TBAR event and must be reported

- Lump sum from a non-retirement phase account
  - No TBAR required
  - Can be in-specie (except from a non-retirement phase TRIS) or cash
Strategy for source of benefit payments

- If a member desires more than the minimum pension payment in 2019-20
  - Must draw minimum from the pension as a pension payment
  - If the member has an accumulation interest then drawing down on that ahead of the retirement phase income stream will help to increase ECPI
  - If the member draws additional funds from the retirement phase income stream then consider reporting these under TBAR as a lump sum as this will reduce the member’s TBA opening up space in their cap

- If a member desires less than their full minimum pension payment
  - If a member has a large balance and their minimum payments are higher than desired then can commute part of the balance to accumulation phase at 30 June
  - Trade off: reduces following year’s minimum payment but creates an accumulation interest that will reduce ECPI
Strategy for timing of benefit payments

- Maintain as high a proportion in retirement phase as possible to maximise ECPI
  - Draw pension payments and lump sums from retirement phase as late in the financial year as possible
  - Draw payments from accumulation phase as early in the year as possible
  - The timing of payments will be particularly effective for large one-off payments
  - If thinking about starting a retirement phase income stream do as early in the year as possible
  - If taking lump sum payments from a retirement phase SMSF complete the partial commutation and lump sum payment on the same day to avoid a day where the fund has an accumulation account
Tim and Kate have all their superannuation in an SMSF and are retired

1 July 2019 balances of $1,412,090 and $720,300 in retirement phase, Tim also has $103,045 in accumulation phase having been subject to the TBC at 1 July 2017

Draw an additional $65,000 this year, on top of their usual $75,000 in spending, to pay for daughter’s wedding

Payments totalling $140,000 are required

Minimum pensions of 5% = $70,600 for Tim and $36,020 for Kate = total of $106,620

To maximise ECPI in 2019-20:

MUST take $106,620 as pension payment => take as late in the year as possible

Take the remaining $33,380 from Tim’s accumulation balance => take as early in the year as possible

No TBAR required for these payments
Example: alternative strategy for Kate & Tim

- At 25 June 2019 Tim withdraws $100,000 from accumulation and Kate makes a NCC of $100,000 and commences a new account-based pension
  - Complete TBAR for Kate’s pension commencement by 28 July 2019
  - Take $3,085 as lump sum payment from Tim’s accumulation to draw this account to $0 => make this payment first and as early in the year as possible
  - MUST take $111,620 in pension payments (Kate’s new pension has a $5,000 minimum payment)
  - Take remaining $25,295 as pension lump sums => complete TBAR for lump sums within 28 days of the end of the quarter in which the payment occurred
  - Fund will be deemed as segregated after accumulation account emptied => timing of payments does not matter
  - Obtain an actuarial certificate to claim ECPI in period where had accumulation unless balance withdrawn by 1 July 2019
  - Allocate lump sums to members based on who might benefit most from having greater space in their TBC
Starting pensions when have TSB > $1.6m

- Starting a pension with > $1.6m is allowed but...
  - You will raise an excess transfer balance and be required to commute the excess to accumulation phase
  - You will be taxed on the excess in retirement phase at 15% of assumed earnings
  - The minimum pension payment for the year will be based on the higher starting pension balance even if you commute the excess the next day
- Make sure clients are aware of the new TBC rules and only commence pensions up to their TBC
Example:

TRIS leading to excess TBA

- Alison has $1,325,000 at 1 July 2019 in a TRIS set up a number of years ago, she is turning 65 on 14 July
  - Alison retired in 2018 but never reported this to the SMSF, she hasn’t been fully aware of the new TBC rules
  - At retirement she started receiving a $35,000 p.a. lifetime pension from Commonwealth Superannuation Scheme (CSS)

- At 14 July Alison’s TRIS will automatically convert to retirement phase
  - As she is in receipt of a CSS income stream she will already have a TBA based on the special value of her CSS pension of say 35,000 x 16 = $560,000
  - Her TBA will increase by say $1,325,000 leading to an excess transfer balance of $285,000 which would be deemed to earn income which would be taxed at 15%

- If Alison was not aware of the TBC rules then the first she may realise her error would be when she receives an excess transfer balance determination from the ATO
Implications for Alison:
- Must comply with the excess transfer balance determination and commute the excess plus assumed earnings to accumulation phase in the SMSF or withdraw it from the SMSF
- Due to excess earnings she will not be able to keep as much in retirement phase as otherwise would be the case
- SMSF will need to pay tax on the assumed earnings at 15% as determined by the ATO

What Alison needed to do before 14 July 2019:
- Understand that she already had a TBA from the CSS pension and confirm what her current TBA was
- Complete a commutation from the TRIS to accumulation phase of an amount equal to the excess that would otherwise be raised once the TRIS converted to retirement phase and credited to her TBA = $285,000
- SMSF must complete a TBAR for the balance of the TRIS converting to retirement phase at 14 July by 28 October 2019
- As long as partial commutation of TRIS is done before 14 July no TBAR is required as is from non-retirement phase

Example cont:
TRIS leading to excess TBA
A death benefit that triggers an excess TBC

- It will not be uncommon in an SMSF for a member to receive a death benefit that if taken in full would lead to an excess transfer balance

- If the aim is to retain as much as possible in the superannuation environment then
  - Work out the excess that would be created by taking the full death benefit as an income stream based on the member’s current TBA
  - Commute that much from the member’s existing income streams back to accumulation as soon as practicable, then commence the death benefit income stream
  - If full commutation of the member’s current income streams cannot create enough space then some of the death benefit will need to be taken as a lump sum as death benefits cannot be paid to accumulation phase
  - Report for TBAR the commutation of the existing income stream and the new death benefit income stream
  - Make sure a pro-rata minimum pension payment is made prior to the full commutation of existing income streams (if full commutation required)
  - Calculate the new pro-rata minimum payment on the new death benefit income stream
A death benefit that triggers an excess TBC

- Avoid commencing a death benefit income stream with the full death benefit and then immediately paying a lump sum from the pension to remove the excess
  - This has no impact on the member’s TBC but would have an additional TBAR required for the commutation
  - The minimum pension for the year is based on the full death benefit which may be higher than desired
Example:
Death benefit that triggers an excess TBC

- Thomas has $923,000 in an SMSF and receives a death benefit
  - Thomas’ wife passed away with a superannuation interest valued at $834,000, his TBA is currently $1 million
  - He commenced a death benefit income stream with the full $834,000 (creating an excess transfer balance of $234,000) and soon after realises the error and commutes the excess
  - This will require a TBAR for the death benefit pension commencement and the partial commutation
  - The minimum pension payment will be based on the $834,000 commencement value, not $600,000
  - The $234,000 excess will now be outside super as the death benefit cannot be commuted to accumulation
Example cont:

Death benefit that triggers an excess TBC

- **What Thomas could have done**
  - Partially commute $234,000 from his account-based pension to accumulation and report a TBA debit
  - Commenced a death benefit income stream with the full $834,000 and reporting the TBA credit
  - $TBA = 1$mill – $234,000 + $834,000 = $1,600,000
  - The minimum pension payment will be based on the $834,000 commencement value and commencement date
- **Or**
  - Pay $234,000 as a death benefit lump sum, no TBAR
  - Commenced a death benefit income stream with $600,000 and reporting the TBA credit
  - The minimum pension payments will be based on the $600,000 commencement value and commencement date
  - Might be preferred if don’t have much outside super so pay less tax vs 15% in accumulation phase in SMSF
A reversionary death benefit that triggers an excess TBC

- If receive a reversionary pension defer the commutations for near 12 months to maximise ECPI
- If full commutation of an existing pension will be required to accommodate the TBC credit of the reversionary income stream
  - Take this into account when calculating and paying pension payments in the next year, you’ll only need to pay a pro rata payment on the existing income stream
- If the reversionary income stream is valued close to or in excess of $1.6m
  - Some of the reversionary income stream may also need to be commuted => also defer this 12 months
  - Minimum payment in the next year will be calculated on the full balance at 1 July
  - Commutation made to comply with the TBC will not count towards the pension payment as it needs to be a lump sum in order to reduce the member’s TBC
Example:
A reversionary death benefit that triggers an excess TBC

- SMSF member Jake passes away 15 Aug 2019
  - Pam and Jake are married and have $428,000 and $1,598,000 in reversionary retirement phase income streams on 15 Aug
  - Jake has $647,000 in accumulation phase on 15 Aug
  - Pam must report the $1,598,000 death benefit pension as commencing 15 Aug 2019 and report by 28 Oct 2019 (the credit will be applied to her TBA at 15 Aug 2020)
  - Pam’s TBA is currently $500,000 and the family has considerable assets outside super so would like to maximise the amount retained in the SMSF
Example cont:
What Pam could do to avoid an excess transfer balance and maximise ECPI

2019-20
- Pay out the $647,000 death benefit as a lump sum as soon as practicable after 15 Aug 2019, say 30 Aug 2019
- Keep both her existing pension and the reversionary pension in 2019-20 and ensure minimum pension payments are paid to maximise ECPI
- The SMSF is solely in retirement phase from the date the death benefit lump sum was paid => will use the unsegregated method to claim ECPI on income earned from 1 Jul to 30 Aug and segregated method from then to 30 Jun

2020-21
- Commute her entire existing pension on 14 Aug 2020 and report the TBA debit for the full commutation value
- As she will be fully commuting her existing pension she will only make a pro-rata minimum pension payment in 2020-21 based on the pension being in existence for 45 days of the year (unit 14 Aug)
- A full annual minimum payment is required in 2020-21 based on the reversionary pension balance at 1 July 2020
Example cont:
Partial commutation of the reversionary pension

- Next step in 2020-21 is to work out how much of the reversionary pension needs to be commuted on 14 Aug to avoid an excess
  - Potential excess transfer balance = (500,000 – commutation value at 14 Aug 2020) + 1,598,000 – 1,600,000
  - Let’s say we get close to 14 Aug and Pam’s balance is $387,000 then this would mean even after commuting the pension the credit of the reversionary pension will lead to an $111,000 excess
  - Pay out $111,000 on 14 Aug 2020 from the reversionary income stream as a lump sum death benefit and complete a TBAR for the debit
- Report the commutation events early, ASAP, so that the ATO does not mistakenly raise an excess transfer balance
Conclusions

- Ensure minimum pension payments are cashed prior to 30 June 2019
- Double check that pension payments have been made on death benefit income streams
- Plan ahead with reversionary income streams to maximise ECPI
- Avoid excess TBC issues with death benefit income streams, know the member’s current TBA
- Think about the timing and source of benefit payments to improve tax outcomes for clients