



Understanding defined benefit pensions in an SMSF

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Agenda

- ▶ What are defined benefit pensions (DBPs)?
- ▶ Actuarial certificates
- ▶ What happens when the pensioner passes away
- ▶ Distributions from the unallocated reserve
- ▶ Commuting a DBP
- ▶ Common questions

What are defined benefit pensions (DBPs)?

- ▶ Member exchanged a purchase price for a series of regular payments
 - Pension payments pre-defined and must be paid every year
 - Income stream is not linked to investment performance

- ▶ Cannot start a new DBP in an SMSF since 1 January 2006
 - Assets supporting the pension may be exempt from Centrelink Assets Test
 - Subject to an annual solvency test requiring an actuarial certificate

Types of DBPs

Complying pension

- ▶ Two types:
 - Lifetime Pension – SIS Regulations 1.06(2)
 - Life-expectancy (fixed-term) Pension – SIS Regulations 1.06(7)

- ▶ Can be commuted only to start another “complying” pension
 - Market-linked pension (TAP)
 - Retail complying annuity

- ▶ May be eligible for Centrelink Assets Test exemption:
 - 100% exempt if started on or before 19 September 2004
 - 50% exempt if started 20 September 2004 to 31 December 2005

Types of DBPs

Commutable pension

- ▶ Flexi-pension – SIS Regulations 1.06(6)
 - Can be lifetime or fixed-term
- ▶ Can be commuted to an account-based pension
 - strict upper limit on value of commutation
- ▶ Can pay residual capital value on expiry or death of pensioner
 - must be part of the terms set at commencement
- ▶ No Centrelink Assets Test exemption

Key elements of a DBP

- ▶ Terms of the pension set at commencement and cannot be changed
 - Amount, frequency and indexation of payments
 - Type and term of pension
 - Reversion and residual capital value

| | |
|---------------------------------|----------------------------|
| Pensioner name: | Joe Bloggs |
| Birthdate and gender: | 01/07/1935, Male |
| Pension start date: | 01/07/2000 |
| Type of pension: | 1.06(2) |
| Pension rate at 01/07/2015: | \$12,000 p.a. |
| Pension increases: | Nil, fixed pension amount. |
| Payment frequency: | Monthly |
| Term of pension: | Lifetime |
| Residual capital: | Nil |
| Reversion to dependent: | 100% |
| Dependent birthdate and gender: | 01/07/1940, Female |

Differences between complying DBPs and ABPs

- ▶ The pensioner does not have a right to the assets supporting the DBP, only to receive the specified pension payments
- ▶ Minimum pension standards do not apply
- ▶ DBP balance may be Assets Test exempt for Age Pension assessment
- ▶ Income earned on assets supporting DBP is not necessarily 100% tax exempt
- ▶ No death benefit entitlement

Actuarial certificates

- ▶ A legislative requirement
 - Statement of adequacy – Reg 9.31 of SISA 1993
 - Certificate of exempt income – Section 295-390 of ITAA 1997

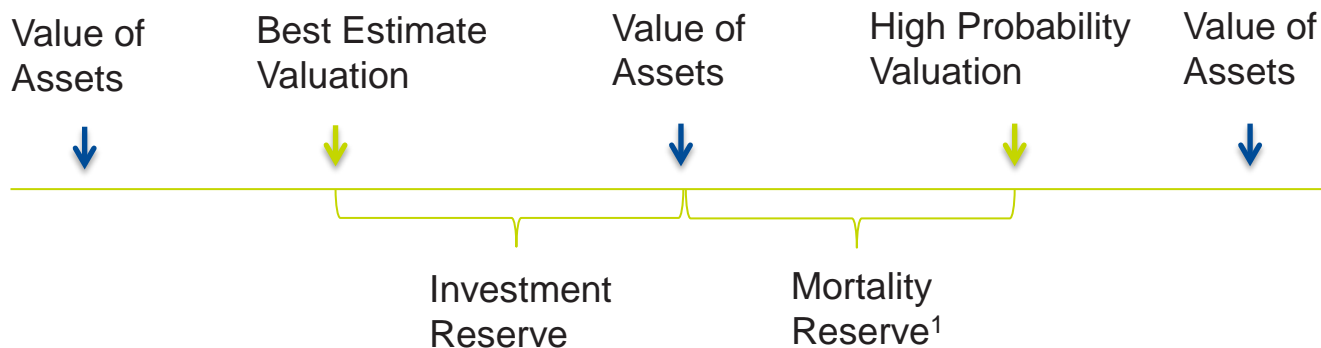
- ▶ If Assets Test exempt
 - Provide a copy of actuarial certificate to Centrelink/DVA
 - Deadline for certification 29 Dec
 - Deadline for submission 19 Jan

- ▶ If a DBP is Assets Test exempt get in your application to Accurium in early
 - Our current turnaround time is 1 business day

Actuarial certificates.. continued

- ▶ The statement of adequacy provides the Actuary's opinion on whether the assets are sufficient to fund future payments based on assumptions:
 - Long term investment strategy
 - Inflation
 - Longevity

- ▶ Actuary's opinion can be:
 - Adequate/positive opinion
 - Inadequate
 - Unsatisfactory



1. Mortality reserve is nil for life-expectancy pensions

Actuarial certificates.. continued

- ▶ The calculation for tax purposes looks at the liabilities over the previous year:
 - Tax exempt % = average pension liabilities / average total liabilities
- ▶ Pension liabilities calculated on best estimate basis
- ▶ An SMSF with a DBP is rarely 100% tax exempt

Treatment when pensioner passes away

| | Lifetime DBP | Life-expectancy DBP |
|------------------|--|---|
| Reversionary | Pension continues to eligible beneficiary ¹ | Pension continues to eligible beneficiary ¹ or estate until expiry |
| | The reversionary beneficiary may retain the Asset Test exemption of the original pension | |
| Non-reversionary | Pension ceases | Pension can continue until expiry |
| | Account balance remains in unallocated reserve | Lump sum payment possible |
| | No death benefit | Maximum lump sum set by RBL valuation |

1.As long reversionary beneficiary is eligible under the regulations to receive a pension. For example, if the reversionary beneficiary is a non-dependent adult child then the reversionary benefit may have to be paid out as a lump sum.

Assets backing the DBPs

- ▶ Effectively forms a sub-fund in the SMSF
 - Unallocated reserve
 - The Trustees pay the defined benefits

- ▶ When will funds remain in the reserve:
 - Death of all beneficiaries of lifetime DBPs
 - Expiry of life-expectancy DBPs
 - Residual capital after commutation of all DBPs

- ▶ The taxation treatment of monies distributed
 - ITAR 292-25.01
 - watch out for excess contributions tax
 - 5% rule

Commuting a complying DBP

- ▶ A complying DBP can be commuted only to commence another complying pension
 - Market-linked pension (TAP)
 - Retail complying annuity

- ▶ Commuting a Lifetime DBP
 - Entire balance can be used

- ▶ Commuting a Life-expectancy DBP
 - Commutation value capped SISR 1994 – Reg 1.08

- ▶ If original pension is Asset test exempt
 - May retain or lose Asset test exemption
 - Complicated

- ▶ Failing to meet the deadlines or actuarial certificate doesn't state a positive opinion
 - commute to a complying retail annuity within 12 weeks to retain ATE

Common questions

- ▶ DBP is inadequate or unsatisfactory – is there anything we can do?
- ▶ The pensioner didn't take the correct pension payment during the financial year
- ▶ A pensioner made a lump sum withdrawal from the reserve
- ▶ Can I change the Fund's investment strategy? How does it impact the results?

Contact us

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