Pension payment strategies

Webinar: Q & A

Below we address questions that were asked by attendees during the live webinar presented on 18 June 2019. You can access the slides to the webinar here.

The responses represent the views of Accurium as at 11 July 2019. Another useful source of information on minimum pension payment requirements is the ATO's frequently asked questions webpage which you can access here.

Q1: (Brady) With a pension that is ceased and recommenced on 1 July, is there a minimum pension amount for the one day on the old pension that ceased?

A1: Technically there may be a 1 day pro-rata minimum pension payment required prior to the full commutation of the income stream, but the consequence of not meeting the minimum pension standards would be for the income stream to cease for tax purposes on 1 July and have a transfer balance account report (TBAR) debit reported using the value on 1 July, which is the desired outcome of the full commutation anyway.

If the trustee is worried about the pension payment implications then they could commute the income stream at end of day 30 June, and then commence the new income stream also at end of day 30 June or on 1 July. However, it has been common practice to 'reboot' a pension on 1 July and in practice we have not heard any issues from people dealing with the Australian Tax Office (ATO) when doing this.

Q2: (Tracey) What is the consequence if a transition to retirement income stream (TRIS) does not pay the minimum pension?

A2: The consequence of a retirement phase TRIS not paying the required minimum pension during a financial year is the same as when the minimum is not met on an account-based pension. The pension account ceases for tax purposes on 1 July of that financial year (or on the commencement date if commenced during the year) and any pension payments made during the year would be treated as lump sums for tax and Superannuation Industry (Supervision) Regulation 1994 (SISR) purposes (some members under age 60 may end up paying tax on the payment). The trustee would need to recalculate tax components and recommence the income stream the following 1 July if the pension standards were again met in the following year.

The consequences can be more problematic if the income stream was a non-retirement phase TRIS (i.e. no nil-cashing restriction has been met) as the lump sum payments are treated as early access to the member's super benefits and a breach of the SISR payment standards.

If the income stream was a retirement phase TRIS the fund would need to submit a TBAR for the balance at 30 June representing the commutation of the income stream due to not meeting the pension standards. Another TBAR would need to be submitted for 1 July if the pension again meets the pension standards in the following year and the pension is recommenced. The retirement phase TRIS would also not be eligible for exempt current pension income (ECPI) in the year the minimum payments were not met.

The ATO has some great information about running a TRIS here.

Q3: (Simon) What are the consequences of exceeding the maximum pension limit for a market-linked pension and how do we rectify this issue?

A3: There is a requirement under SISR 1.06 (8)(b) that the total payment made in a year is determined under Schedule 6, and for pensions commenced after 20 Sept 2007 they must also meet the account-based pension standards. We however do not have specific guidance from the ATO on the consequences to the SMSF for under or overpaying a market-linked income stream.

Generally, we expect that the fund would not eligible to claim ECPI on that income stream in the financial year of the incorrect pension payment. If an overpayment occurred the member may be required to re-pay the excess. However, as a market-linked income stream is non-commutable the income stream may not 'cease' in the same way the ATO treat an account-based pension that does not meet the pension standards.

We suggest speaking with the ATO if you have a fund in this situation and would also be very interested in hearing the outcome of such a discussion.

Q4: (Rick) What is difference in treatment between a lump sum payment and a commutation from a retirement phase income stream?

A4: A commutation refers to the process of converting the income stream to a lump sum. Often this is a partial or full commutation of the income stream where the lump sum is paid into accumulation phase and retained in the SMSF. A lump sum payment from a retirement phase income stream is implemented by way of partial commutation of the income stream where the amount is paid out of the fund and not retained in accumulation phase.

In either scenario the trustee should ensure that the required minimum pension payment is made prior to any full commutation, or in the case of a partial commutation ensure that enough is left in the pension account to ensure the required minimum payment can be met. Both situations will also require a TBAR to be submitted for the amount commuted/lump sum paid.

Q5: (Rick) What limited recourse borrowing arrangement (LRBA) payments need to be reported under TBAR?

A5: The ATO website on Event based reporting for SMSFs states that events which affect a member's transfer balance account must be reported and that this includes:

> details of limited recourse borrowing arrangement (LRBA) payments (including the value and date of each relevant payment) if the LRBA was entered into on or after 1 July 2017 (or a pre-existing LRBA was re-financed on or after 1 July 2017) and the payment results in an increase in the value of the member's interest that supports their retirement phase income stream

Q6: (Fahad) What is the '16' in Alice's example on slide 29 where the Special Value of the lifetime pension is calculated?

A6: This example was in respect to determining the Special Value of Alice's capped defined benefit income stream which counted as a credit to her transfer balance account.

To determine the transfer balance account credit for Alice's lifetime pension we multiply the annualised payment amount by 16.

The value of 16 is a legislated value, further examples are provided on the ATO's webpage Calculating the 'Special Value'.

Q7 (Danny): What happens if a member commences a reversionary pension in April 2019, then passes away in June 2019, does the minimum pension have to be pro-rated?

A7: The pro-rata minimum pension payment required in 2018-19 would be determined based on the age of the pensioner and the balance at commencement in April.

When the pensioner passed away in June the income stream does not cease but automatically reverts to the nominated beneficiary. The required minimum pension payment must still be paid prior to 30 June 2019. Any amounts paid prior to the pensioner passing away will count towards the minimum, if the minimum has not been met at the date of death then the reversionary beneficiary will need to make a payment prior to 30 June to ensure the pension standards are met and the income stream remains eligible for ECPI in the 2018-19 year.

Q8 (Kim): Can you please confirm whether an in-specie transfer of shares from the self-managed superannuation fund (SMSF) to a member cannot be processed and classified as a pension payment?

A8: The in-specie transfer of shares from an SMSF cannot be classified as a pension payment. An in-specie transfer is completed by way of a partial commutation paid out as a lump sum. The ATO have specifically confirmed that from 1 July 2017 you cannot elect for a lump sum paid from a pension account to be treated as a pension payment and count towards the minimum pension standards.

This is confirmed on the ATO webpage here where they answer the question 'Can an in-specie partial commutation count towards the annual minimum pension payment?'.

Q9 (Wenny): With a reversionary pension, will the minimum payment in future years be based on the beneficiary's age?

A9: The minimum pension payment of an account-based pension is calculated based on the current beneficiary's age and pension balance on 1 July of each financial year. This will mean that for a reversionary income stream, in the year after the original beneficiary has passed away (and future years after that) the required minimum pension payment will be calculated based on the reversionary beneficiaries age.

Q10 (Rosalina): Is it okay to count a journal entry as a pension payment for an underpayment of the required minimum pension which is 1/12th of the minimum required pension amount?

A10: If a trustee is relying on the ATO Commissioner's general powers of administration (GPA) concession in order to retain the income stream over the year, then one of the conditions of applying the concession is that the trustee needs to make the catch up payment as soon as practicable in the following financial year that is sufficient to cover the underpayment. That catch up payment needs to be treated for all intents and purposes as if it occurred in the prior year, and this may involve the use of journal entries. That is, the payment will count towards the pension payments made in the prior year not the year it is actually paid.

On its own a journal entry at year end to state that pension payments have been made is not appropriate to meet the minimum pension standards. The use of a journal entry to meet the pension standards would only be appropriate if the member has met all the conditions to self-assess the GPA concession or has received written confirmation from the ATO they are eligible to apply the concession.

Q11 (Grace): Where a minimum pension is not met in Year 1 and the account-based pension rolls back to accumulation phase, do we need to need to go through the process of applying for a new account-based pension on 1 July of the following year? The problem is that most clients don't know they haven't met their minimum until well and truly into the new financial year. What is standard practice to create a new pension effective 1 July?

A11: To recommence an account-based pension in the year after not meeting the minimum pension requirements, and again be eligible for ECPI, the ATO says that if the pension standards are again met in the that year the income stream can be taken to recommence at 1 July of that year. The trustee must re-calculate the tax components of the pension interest and revalue assets at market value to complete a TBAR for the credit of the balance at 1 July (the balance at 30 June will have been reported as a debit due to failing to meet the pension standards).

Tax ruling 2013/5 states at section 101:

> If in the following year the relevant rules are again complied with this in effect results in the commencement of a new superannuation income stream and the proportioning rule must be applied to that new superannuation income stream when it commences.

Q12 (Pravin): What happens where a member passes away with a reversionary clause on their pension, but the spouse has used up their transfer balance cap (TBC)?

A12: The reversionary pension will automatically transfer to the spouse at the date of death. A TBAR will be completed for the beneficiary to give rise to a credit equal to the balance of the pension at the date of death. However, the credit will not apply to the beneficiary's transfer balance account until 12 months' time. This means the beneficiary has a year to act and ensure that their TBC is not exceeded.

If the beneficiary has already used up their TBC then they will need to consider how to reduce their transfer balance account sufficiently so that when the credit is received in 12 months' time it does not lead to an excess. The member could consider a combination of the following options, and reporting the TBAR event prior to when the credit will increase their transfer balance account:

- Commute an existing income stream to accumulation phase
- Commute some, or all, of the reversionary pension to a lump sum (and pay it out of the SMSF)

Q13 (Vas): What is the difference between a retirement phase and non-retirement phase TRIS?

A13: Whether a TRIS is in retirement phase or non-retirement phase depends on if the member has attained age 65 or reported to the trustee they have met a condition of release with a nil-cashing restriction.

When a member has met their preservation age and commenced a TRIS this will be in non-retirement phase. Being in non-retirement phase the TRIS will not be eligible for ECPI but is still an income stream and must meet the pension standards each year. The non-retirement phase TRIS is also subject to commutation restrictions and a maximum payment each year of 10% of the balance.

A TRIS will convert to be in retirement phase either:

- Once the member has met a condition of release with a nil-cashing restriction and informs the trustee, or
- Automatically once the member attains age 65.

When a TRIS converts to retirement phase the trustee must complete a TBAR for the balance of the pension at that date. A TRIS in retirement phase will have unrestricted non-preserved monies and the commutation restrictions on the TRIS fall away. It will no longer have a maximum withdrawal limit, will be commutable and will also be eligible for ECPI.

Q14 (David): When a member turns 65 and benefits automatically become unrestricted non-preserved, should member statements show this?

A14: Yes, it generally should be reported in the member statements when a member's benefits become unrestricted non-preserved so that they can understand their eligibility to access their superannuation benefits.

Q15 (Katrina): Have the ATO been issuing penalties for late lodgement of TBAR events?

A15: The ATO recently stated that they are currently taking an educative and supportive approach when an SMSF lodges a late TBAR. You can read some comments from ATO superannuation director Helen Morgan here.

This however does not mean that late reporting will have no consequences as the late lodgement could still have an adverse impact such as leading to inadvertent breaches of the cap and being in excess for longer. Even if no compliance action is taken by the regulator for a late report, where a member is in excess the excess transfer balance tax will still apply.

Q16 (Fabio): What do you do when you encounter a fund in pension phase but with no pension documents?

A16: Pension commencement documents are important as they establish the terms of the income stream such as the purchase price, the tax components of the interest and the reversionary status of the income stream.

Without this information it could lead to difficulties as technically the member may not have a superannuation income stream if there is no evidence of that income stream commencing. This is especially true when it comes to estate planning where beneficiaries may be looking for evidence of reversionary details or tax payable if paid to non-dependents.

We would suggest you obtain advice from a lawyer. Depending on the trust deed and what evidence you or the trustees currently have with respect to the pension commencement, a lawyer may be able to complete confirmatory documents. These are documents that confirm the terms of an existing pension, commutation, reversion, etc, especially where there are no, poor or inadequate records.

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