Commuting complying defined benefit pensions in SMSFs

September 2017

In this information sheet we discuss the options available to members (and their advisers) who have a complying defined benefit pension in their SMSF and find they are required to change this arrangement.

Importantly, complying defined benefit income streams are non-commutable except to rollover to another complying income stream (or in other limited circumstances defined in legislation, such as a divorce settlement payment).

From a Centrelink and Department of Veterans (DVA) perspective, complying defined benefit pensions paid to a member in an SMSF are eligible for 100% Asset Test Exemption (ATE) if they were commenced prior to 20 September 2004 or 50% ATE if commenced between 20 September 2004 and 31 December 2005. The ATE means that the value of the assets supporting the income stream are not assessed under the Assets Test means testing when determining Centrelink/DVA entitlements. Retaining the ATE might be an important consideration for those retirees receiving a part or full age pension.

A condition of retaining the ATE is that an actuarial certificate is obtained each year stating that, in the opinion of the actuary, there is a high probability (i.e. greater than 70%) that there are sufficient assets in the fund to be able to pay the required future benefits. Under the Social Security Act 1991, trustees are required to obtain these certificates by 29 December and submit to Centrelink/DVA by 19 January each year.

Options for commuting existing complying defined benefit pensions

There are two key options available to members who wish to commute their existing complying pensions:

Option 1: Commute to a retail complying annuity

If the complying pension is 100% ATE and retaining the ATE is a key priority for the SMSF member, the trustee could roll out the assets supporting the defined benefit pension to purchase a complying annuity with a life office. As the ATE is retained, this option minimises the impact on the member's age pension entitlements.

A complying annuity provides an income stream for the person's lifetime or fixed term, and is held in the individual's name outside the SMSF. To meet the requirements of being a complying pension, the annuity must be non-commutable. However, a benefit may be available on the death of the member (generally equal to the present value of the remaining payments). The complying annuity may also be an attractive option for those members in the pension phase who no longer want or are able to deal the administrative complexity of running an SMSF.

It is important to consult with Centrelink/DVA to ensure the proposed complying annuity satisfies the requirements to retain the ATE.

Option 2: Commute to a market linked pension (TAP)

A market linked pension is the only type of complying pension that can be commenced in an SMSF. Commuting the existing complying pension into a market linked pension would allow the member to retain the assets within the SMSF.

For more information on market linked pensions refer to Accurium's technical article 'Understanding Market Linked Pensions'.

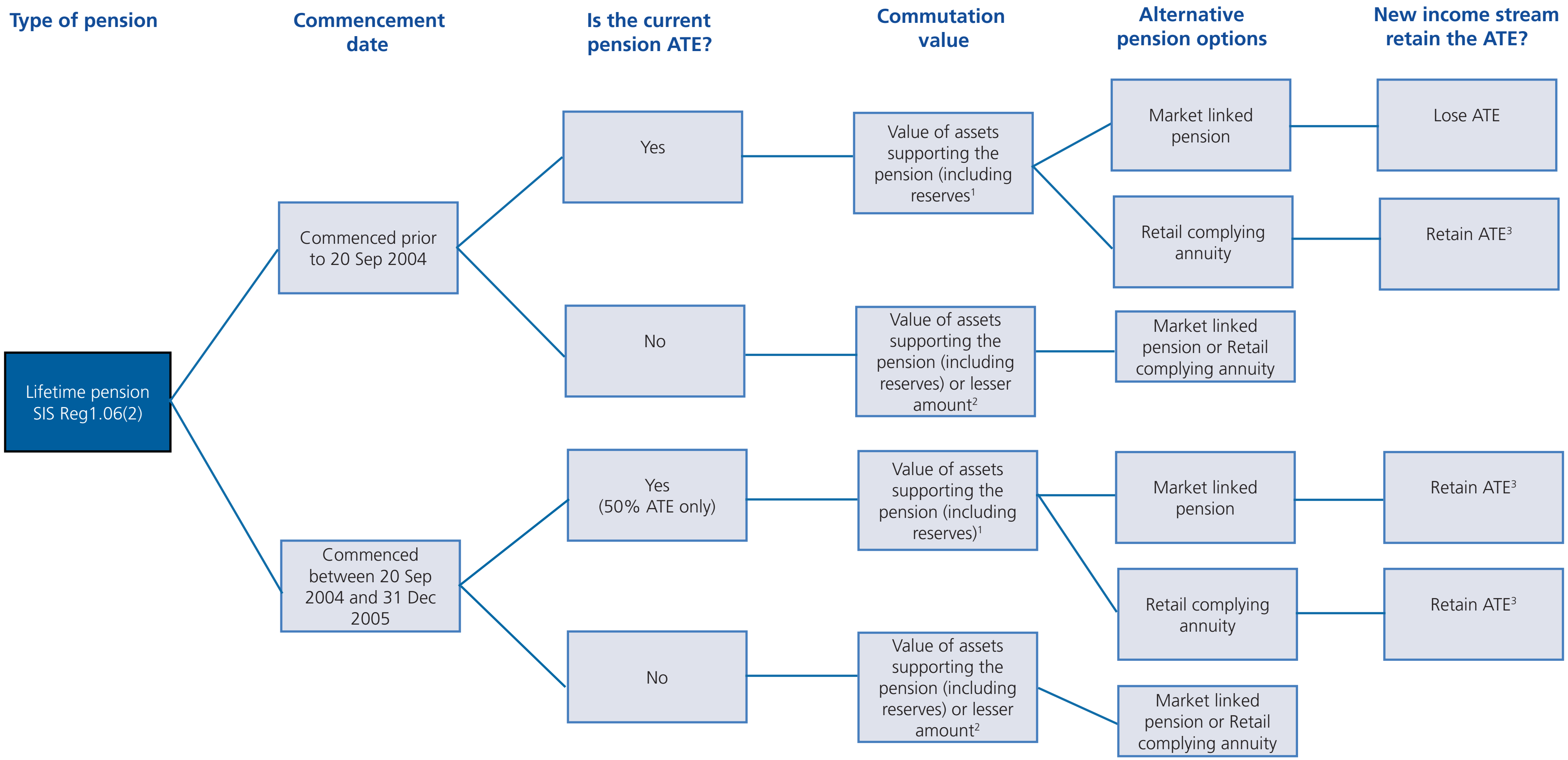
Whether the new market linked pension will retain the original pension's ATE status will depend on the commencement date of the existing pension. Please refer to the flow charts below for more information.

It is important to consult with Centrelink/DVA to ensure the new market-linked pension satisfies the 'waiver of debt' provisions and any requirements to retain ATE.

Note: It is our understanding that market-linked pensions and complying retail annuities commenced on or after 1 July 2017 will not be treated as capped defined benefit income streams under the transfer balance cap. If the purchase price of a new market-linked pension or retail annuity exceeds the member's transfer balance cap then an excess transfer balance will be raised that cannot be commuted. Please consider the member's circumstances and impact of any reversionary pension on future beneficiaries prior to making a decision.

Commuting a complying lifetime pension – Decision flow chart

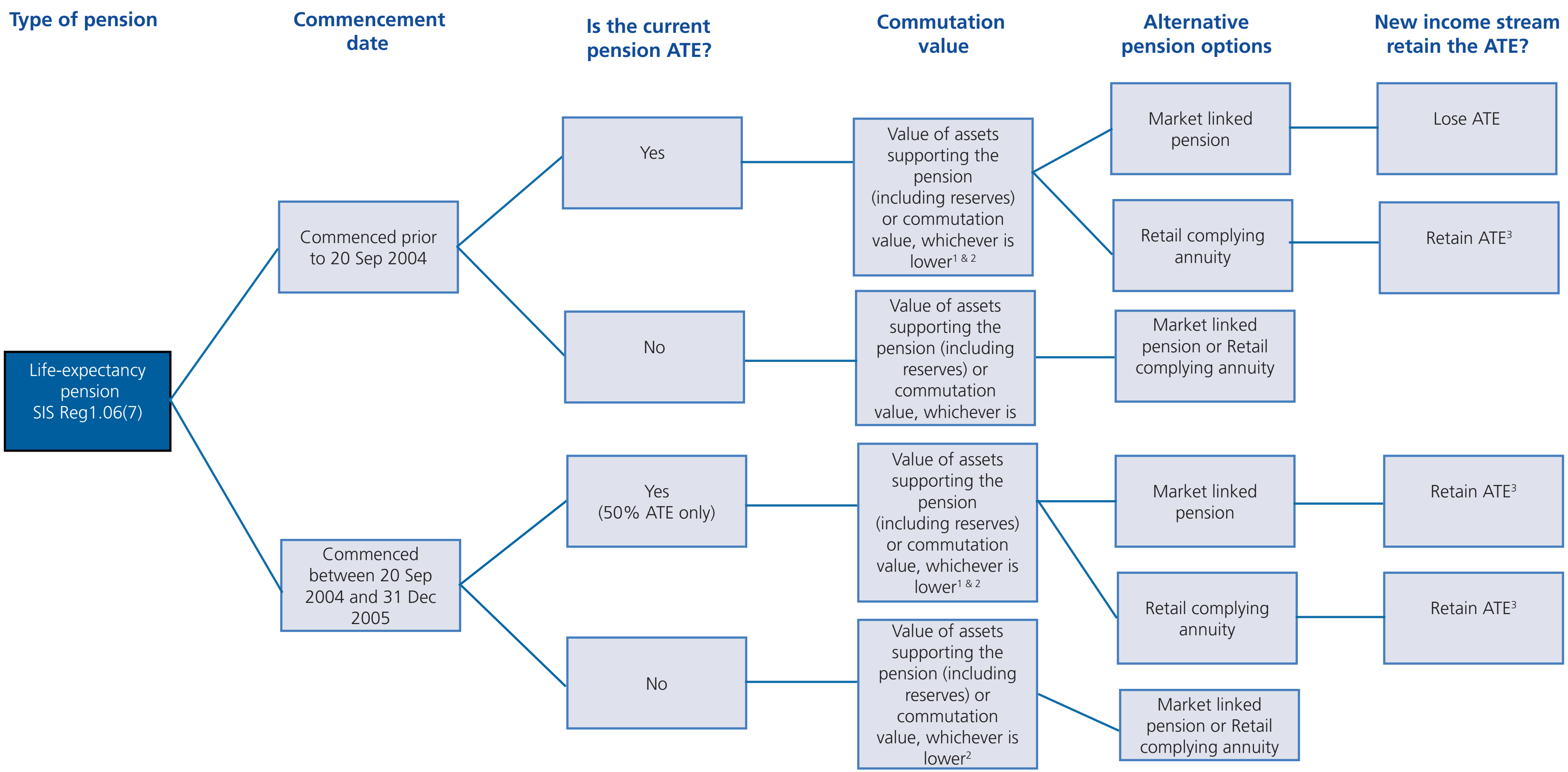
19 September 2017



1. The trustee is required to commute all assets supporting the pension (including reserves) in order to satisfy the Centrelink debt waiver provisions.
2. If the trustee does not use all assets supporting the pension (including reserves) to commence a new market-linked pension or complying retail annuity then the surplus assets will remain in an unallocated reserve. The trustee could allocate amounts from the reserve to member interests but it is important to take note of the taxation treatment of those distributions, as specified in ITAR 291-25.01.
3. In order to retain the ATE the new income stream must satisfy one additional condition of relief as specified in Section 4.9.2.17 of the Guide to Social Family Law. The two most common additional relief conditions are:
   -The SMSF trustees are no longer capable of administering the fund due to age or incapacity, and are winding up the SMSF, or
   -The pension has failed the high probability test and the new pension income stream is commenced within 12 weeks from the date the actuarial certificate is submitted to Centrelink.

Commuting a complying life-expectancy pension – Decision flow chart

19 September 2017



1. The trustee is required to commute all assets supporting the pension (including reserves) in order to satisfy the Centrelink debt waiver provisions.
2. Section 1.08 of SIS Regs restricts the value of a life-expectancy pension that can be commuted to a lump sum in order to commence another complying product. Please refer to the Regulations to determine the maximum value that can be commuted.
3. In order to retain the ATE the new income stream must satisfy one additional condition of relief as specified in Section 4.9.2.17 of the Guide to Social Family Law. The two most common additional relief conditions are:
   -The SMSF trustees are no longer capable of administering the fund due to age or incapacity, and are winding up the SMSF, or
   -The pension has failed the high probability test and the new pension income stream is commenced within 12 weeks from the date the actuarial certificate is submitted to Centrelink.

Phone: 1800 203 123
act@accurium.com.au
www.accurium.com.au