ECPI and actuarial certificates FAQ

The following are responses to questions that arose from our webinar presented on 6 May 2021, 'ECPI and actuarial certificates – tips and traps'.

Q1) SMSF has a TRIS where member reaches age 65 in March 2021 and there is an automatic conversion to a TRIS in retirement phase. Is there a need for the minimum pension for 2020-21 to be paid pro-rata before age 65 and after age 65?

No. From the perspective of meeting the minimum pension requirement, the TRIS does not cease when it moves into retirement phase and there is not a new pension when it moves into retirement phase. Consequently, the minimum pension will be based on their respective TRIS balance at 1 July 2020 and the age of the member. Given a TRIS automatically moves into retirement phase when they attain 65, a TRIS will always have a standard minimum of 4%. However, for 2020-21 the minimum was reduced by 50% and consequently is 2%.

Note: it is only regarded as a new pension from a transfer balance cap reporting perspective as it first moves into retirement phase when the member turns 65. For transfer balance account purposes, the pension only commenced when it moved into retirement phase.

Q2) If we are using the actuarial certificate platform, then the system will automatically calculate the method used and the exempt factor for the year?

When applying for your Accurium actuarial certificate our system will determine, based on the details provided if the fund will be using both the segregated and proportionate method for claiming ECPI or solely the proportionate method and calculate the tax-exempt income proportion accordingly. This is determined based on whether it has been indicated that the fund was eligible to use the segregated method and the movements in the accumulation accounts of the fund during the year.

However, if you are using one of the integrated software platforms to prefill your fund information it is a good idea to ensure that the question regarding the fund eligibility to use the segregated method has been correctly prefilled. Different software platforms determine the eligibility for segregation in different ways, and as this can have a material impact on the exempt income proportion, it is always a good idea to check this.

If you are ever unsure as to your funds' eligibility to use the segregated method please contact us on freecall 1800 203 123.

Q3) I have an SMSF with elderly husband and wife member. The husband died and the wife got the death benefit. However, the husband's death benefit is over $1.6 million. As a death benefit paid as a pension is restricted to the recipient's personal transfer balance cap (TBC), any residual death benefit must be paid out as a lump sum as it cannot be retained in the wife's accumulation account. The fund doesn't have enough money to pay out the deceased husband's balance in excess of what can be paid as a death benefit pension. In that case, the fund cannot claim ECPI. Is this correct?

A superannuation fund can only claim exempt current pension income (ECPI) in relation to retirement phase pensions that meet the pension standards. Where an amount of a deceased member's benefit is unable to be paid as a pension, due to the limitation imposed by the transfer balance cap, it is required to be paid out of the fund. The amount paid is a death benefit payment and consequently is required to be paid 'as soon as practicable'. Where the fund does not have the available cash to affect the lump sum death benefit payment, consideration may be given to a payment of the death benefit in kind by way of an in-specie transfer, subject to any trust deed restrictions.

Where the deceased was in receipt of a non-reversionary pension at the time of their death, whilst the pension ceases, the tax rules allow the fund to continue to claim ECPI until the death benefit is paid. Again, the SIS rules requires the death benefit to be paid 'as soon as practicable'. Where the death benefit is not paid 'as soon as practicable', the fund would be seen as not complying with the death benefit payment requirement and it would be expected that any further claim for ECPI would be denied (refer ATO website QC 26864 'Pension ceasing upon death).

Where the deceased was in receipt of a reversionary pension at the time of their death and consequently the pension reverts to the reversionary beneficiary, for example a surviving spouse, the pension does not cease. However, from a transfer balance cap perspective, it is a new pension for the reversionary pension recipient (this is a reportable transfer balance account event). A credit will arise in the reversionary pension recipient's transfer balance account (TBA), twelve months after it reverted to them. Provided the pension meets the pension standards, e.g. minimum pension, the fund can claim ECPI, notwithstanding the reversionary pension recipient may have an excessive TBA balance, due to the TBA credit arising from pension. However, an excess TBA determination will be issued by the ATO and if not acted upon within the specified time frame, a commutation authority will be issued to the fund. If the commutation authority is not complied with, the pension will cease being in retirement phase and consequently will no longer be able to claim ECPI.

The ability of a fund to be able to pay benefits, including death benefits, when required is a factor that needs to be taken into consideration when formulating and reviewing the fund's Investment Strategy.

Q4) Please give an example of a 'DSFA' asset? What are they?

An SMSF will have disregarded small fund assets in a given financial year if meets ALL of the following:

- In the given financial year the SMSF has any member in retirement phase at any time; AND
- At prior 30 June the SMSF has a member:
  - With total superannuation balance that exceeds $1.6 million; AND
  - Was receiving a retirement phase income stream (pension) from any super fund.

An SMSF with DSFA cannot use the segregated method to claim ECPI for the income year it has DSFA.

The concept of DSFA is not applied to individual fund assets, but applied at the fund level. Where the SMSF meets the above criteria, then all of the SMSF's assets are regarded as DSFA. This is not the same as identifying a particular asset as a 'Collectable or personal use asset', with an SMSF having some assets identified as this type of asset.

Q5) Having segregated assets complicates things. What are the advantages of having segregated assets? It is a lot easier to make everything unsegregated?

The proportionate method of claiming ECPI is significantly more common than elected segregation, that is, where SMSF trustees choose to segregate fund assets to member pension interests. Our data indicates that fewer than 0.1% of SMSFs that obtain an actuary's certificate also used elected segregation. The proportionate or unsegregated approach to claiming ECPI is administratively easier than elected segregation.

Using the segregated method to claim ECPI requires the fund to prospectively identify assets which are to be segregated to provide for current pension liabilities (other than periods of deemed segregation). This is not something that can be done retrospectively when the fund's annual financial statements are being prepared.

An advantage of the segregated method for claiming ECPI is that all income from the segregated asset, including capital gains, are effectively exempt from fund income tax. However, one disadvantage is that any capital loss from the disposal of a segregated pension asset is lost.

An SMSF with 'disregarded small fund assets' is unable to use the segregated method for claiming ECPI. However, this does not prevent the SMSF implementing a segregated investment strategy.

For further information on the methods for claiming ECPI please refer to the Accurium TechHub and search on 'Actuarial certificate and ECPI'.

Q6) For example, the fund has disregarded small fund assets (DSFA) in relation to example earlier and the fund is full pension in 2019-20, we are still required to request actuarial certificate even if it will result to 100% ECPI rate, is that correct?

Correct. Where the SMSF meets the requirements of having DSFA, it cannot use the segregated method to claim ECPI, even for periods where it wholly consists of retirement phase pensions. Under current law, the SMSF will use the proportionate method to claim ECPI for the entire 2019-20 income year and will be required to obtain an actuarial certificate, which would note an ECPI percentage of 100%.

The Government has proposed to remove the redundant requirement to obtain an actuarial certificate under the proportionate method where all members are solely in retirement phase for the entire income year. This measure is to commence from 1 July 2021, however, to date, no draft legislation has been tabled.

Q7) The fund in 2019-20 is full pension and has disregarded small fund assets (DSFA) therefore proportionate method is used. However, for 2019-20 the fund has a tax loss, before any claim for ECPI. Are we still required to request actuarial certificate?

An actuarial certificate is required where the fund claims ECPI using the proportionate method. The certificate must be obtained prior to lodgement of the relevant return. Consequently, if the fund does not obtain the relevant actuarial certificate it will be ineligible to claim ECPI. However, where the fund is in a tax loss prior to any claim for ECPI, there would be no tax benefit to the fund in obtaining the actuarial certificate to claim ECPI.

SMSF trustees can effectively choose not to claim ECPI, where the proportionate method applied, even where the relevant requirements are met. By not obtaining the relevant actuarial certificate, the SMSF is unable to claim ECPI for the period the proportionate method would apply.

For the scenario in your question, the SMSF trustee would not obtain an actuarial certificate and therefore be unable to claim ECPI for the year. The SMSF's taxable income position would be no different, as it's in a tax loss position prior to any claim for ECPI. Note, any capital losses from CGT events that occur during the year would need to be offset against capital gains, with any residual capital loss eligible to be carried forward to a subsequent income year.

Q8) In relation to calculating CGT in the fund, how are calculations impacted if the disregarded small fund assets also contain assets held prior to November 2016?

It is assumed you are referring to the eligibility for assets to have their cost base reset in the 2016-17 income year as part of the CGT relief when the 2017 superannuation reforms were introduced.

The calculation of a capital gain or loss from the disposal of a fund asset that has its cost base reset under the CGT relief provision will be calculated the same, regardless of whether DSFA rules apply. The DSFA rules simply determine the method that can be used to claim ECPI.

Where there is a CGT event in relation to an asset that had its cost base reset in 2016-17 and there is a deferred notional gain to be disclosed as assessable, the amount to be included as assessable cannot be further reduced by ECPI. For example, an SMSF that consisted wholly of retirement phase pensions in 2019-20 would be required to disclose any amount of realised deferred notional gain, regardless of whether it uses the segregated method to claim ECPI, or had DSFA and had to use the proportionate method.

Q9) If the fund does not want to claim ECPI then does it still need to get an actuarial certificate?

An actuarial certificate is only required where the fund claims ECPI using the proportionate method. Where the proportionate method is used, it must also obtain an actuarial certificate. Failure to obtain the actuarial certificate means no claim for ECPI using the proportionate method.

This means that effectively, the SMSF trustee can choose whether or not to claim ECPI where the applicable method is the proportionate method. By not obtaining an actuarial certificate, the SMSF trustee has effectively elected not to claim ECPI.

An SMSF trustee may decide not to claim ECPI, where the proportionate method applies, where the fund is in a tax loss position or the benefit of the tax saving from claiming ECPI is less than the cost of obtaining the actuarial certificate and associated fund administration.

Q10) I am working on another super fund which is fully in pension mode however they made a substantial non-concessional contribution during the year. Do we still need an actuarial certificate completed? Would the answer change if the non-concessional contribution was made and rolled straight into the pension?

It depends. Where the contribution is made and remains in the member's accumulation account, from that point the SMSF will have a mix of retirement phase and non-retirement phase interests. Where the fund has not chosen to segregate assets to the member's pension interests or has disregarded small fund assets (DSFA), any claim for ECPI, for that period, will be under the proportionate method and consequently an actuarial certificate will be required prior to lodgement of the return.

In relation to the period prior to the contribution, if the fund did not have DSFA for the income year, the period from 1 July up to when the contribution was made, would be regarded as a period of deemed segregation and consequently the segregated method must be used to claim ECPI, for that period. The fund will use both the segregated and proportionate methods to claim ECPI for the entire income year.

However, where the fund satisfied the DSFA rules for the income year, it would use the proportionate method to claim ECPI for the entire income year. Again, the fund would need to obtain an actuarial certificate prior to lodgement of the return.

Where the member immediately commences a new retirement phase pension upon making the contribution (note: a contribution cannot be added to an existing pension), whether the fund continues to wholly consist of retirement phase pensions for the entire income year will depend on the relevant documentation. However, generally, it is accepted that the fund will be regarded as continuing to consist wholly of retirement phase pensions for the entire income year. Which method the fund uses to claim ECPI for that income year will depend on whether it has DSFA.

Further, whether the member can apply the entire contribution to the commencement of a retirement phase pension will depend on the cap space in the member's transfer balance account.

Q11) What is the difference between tax agent fee and accounting fee? Aren't they the same?

A tax agent fee is a deduction under section 25-5 of the 1997 Tax Act and is a fee in relation to the preparation of the return for the fund and does not require apportioning where the fund claims ECPI. Accounting fees relate to the preparation of annual financial statements and are deductible under section 8-1 of the 1997 Tax Act, but must be apportioned where the fund claims ECPI.

Q12) If the fund has a period where ECPI is on a proportionate basis and another period where it is fully segregated, do the investment expenses get apportioned the same way? For example, an expense that occurs during the proportionate period is only deductible to the non-ECPI extent but an expense that occurs during the segregated period is fully exempt? Or does the ECPI percentage apply to all expenses regardless of the timing?

Paragraph 7 of TR 93/17 states that:

The correct method for apportioning expenditure between assessable income and non-assessable income depends on the particular circumstances of the case. If there is a single outlay in respect of a thing or service, only part of which is used for gaining or producing assessable income, then the following principles apply:

1. if a distinct and severable part of the thing or service is devoted to gaining or producing assessable income and part is not, the expenditure can be apportioned according to the ratio of those parts; and

2. if an outlay serves both objects indifferently, another method must be used to apportion the expenditure which gives a fair and reasonable assessment of the extent to which it relates to assessable income.

In relation to expenditure of an indifferent nature, the ruling provides the two apportionment methods, though other methods may be acceptable provided it can be demonstrated that they are fair and reasonable for the situation.

1. Apportionment for expenses incurred in deriving investment income only:

Expenditure x (assessable investment income/total investment income).

From a practical perspective, this is commonly referred to as the actuarial method and effectively apportions the total expense by first deducting the actuary's ECPI% from 100% and applying the resultant to the total amount of the deductible expenditure. For example, the ECPI% is 70% and the fund incurred total investment expenses of $200. The portion of the total deductible expense that can be claimed is $60, being 30% (100% minus 70%) of $200.

2. The income ratio method for apportionment of expenses that are general in nature:

Expense amount x (assessable income/total income)

Assessable income, for the purpose of the above formulae, includes all contributions to the fund (assessable and non-assessable) and rollovers (refer paragraph 9 & 9A of TR 93/17).

For an SMSF that claims ECPI under both the segregated and unsegregated (proportionate) method in the same income year, this presents a challenge when apportioning expenses for the purpose of claiming as an income tax deduction.

When apportioning expenses (those expenses that must be apportioned) the basic principle to apply is that any method used is fair and reasonable. Where an SMSF claims ECPI under both methods the following approaches would, in our view, be consider a fair and reasonable method to apportionment:

Expense relates to asset during period not deemed segregated (an investment expense):

- Expense x (100% - ECPI%) – the actuarial method

Expense relates to asset solely to deemed segregated period (investment expense):

- Expense not deductible

Expense relates to asset during both unsegregated & deemed segregated periods (investment expense):

- Expense x (100% - ECPI%) not appropriate as only applies to unsegregated period. Accurium includes in the actuarial certificate, an expense percentage that can be used to apportion expenses that relate to assets (investment expenses) for periods when the asset was deemed segregated and other periods the asset was an unsegregated asset. The SMSF administration platform should be checked to ascertain whether the expense apportioning percentage provided by Accurium can be entered and applied against the relevant expenses.

Expense not related to particular asset or income type (general expense):

- Income ratio method from TR 93/17

Q13) Claim for general expenses: can I decide which method to use? or must be income ratio method?

Refer previous answer. TR 93/17 outlines methods that can be used to apportion expenses. Whichever method is used, it must be considered as a fair and reasonable apportionment method.

Q14) I recently applied an actuarial certificate for one of our clients. When the return was prepared and sent to the auditor, we were advised that the fund was not entitled to claim ECPI because client is under 65 yrs. Why did the system not pick up the age of the member being under 65 at the time of the ECPI application?

We would need further details as the fact the fund member was under age 65 does not on its own prevent the fund from being eligible to claim ECPI. We can only assume that the pension that was being paid to the member was a transition to retirement phase income stream (TRIS), which is not a retirement phase pension. Where a member with a TRIS turns 65, their TRIS automatically moves into retirement phase and the fund can claim ECPI. There are also transfer balance account reporting requirements.

If this is the case, either the TRIS was not correctly identified in the SMSF accounting platform as a non-retirement phase pension or was not identified as such in the actuarial application form.

Accurium provides free technical support to our actuarial certificate clients and they can contact us with questions in relation to actuarial certificates and ECPI on freecall 1800 203 123.

Q15) Audit fee should be classified as tax related expenses. Isn't it and need not to be apportioned?

Audit fees are deductible under section 8-1 of the 1997 Tax Act and are not regarded as a tax related expense. Refer paragraph 4 of TR 93/17.

Q16) I thought we did not need an actuarial certificate when all the members are in pension phase. Are you saying that we still need an actuarial certificate even if all members are in pension phase?

An actuarial certificate is required where the SMSF claims ECPI under the proportionate method. An SMSF that consists wholly of account-based type pensions for the entire income year will claim ECPI under the segregated method, unless it has disregarded small fund assets (DSFA). Where the SMSF has DSFA it must use the proportionate method to claim ECPI and consequently will be required to obtain an actuarial certificate prior to lodgement of the return. The ECPI percentage on the actuarial certificate would be 100%.

Q17) If fund has all members in ABP with Balances over $1.6 million is an actuarial certificate needed?

If the SMSF has disregarded small fund assets (DSFA) for an income year, it will be restricted to using the proportionate method to claim ECPI, which requires an actuarial certificate prior to lodgement. Please search the TechHub and refer to our worksheets: Does your fund have disregarded small fund assets? and Is an actuarial certificate required? to assist with determining which method the SMSF can or must use to claim ECPI.

Q18) I have a query in relation to the treatment of capital gain and losses in a self-managed superannuation fund. The SMSF has members receiving retirement phase income stream and the member has a total superannuation balance over $1.6 million at 1 July 2019, hence the Fund has disregarded small fund assets in 2020 financial year.

The Fund is 100% in retirement phase, the member's total superannuation balance is over $1.6 million in the last financial year and the Fund cannot use segregated method to calculate ECPI. The Fund has to obtain actuarial certificate and use proportionate (unsegregated) method to claim ECPI.

In relation to any capital gains or capital losses incurred by the fund during 2020 financial year, do we still disregard the capital gain or loss under Section 118-12(1) of the ITAA 1997 since the capital gain or loss the Fund made were all from CGT asset that solely used to produce Fund's exempt income?

Yes. For an SMSF that consists wholly of account-based type retirement phase pensions for the entire income year, but has disregarded small fund assets (DSFA), any capital gains or losses that occur during that year that would have been disregarded as a disposal of a segregated current pension asset under section 118-320 of the 1997 Tax Act, had the SMSF not had DSFA, are also disregarded, but under section 118-12 of the 1997 Tax Act.

Note, there is a technical view that a capital gain can only be disregarded under 118-12 where the disposed asset produced exempt income for the life of the asset and not just the income year in which it was disposed. However, our understanding that the ATO only considers the year of income of disposal and not the life of the asset.

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