Transfer balance account reporting revisited

The following are questions that arose from our webinar presented on 29 April 2021 'Transfer Balance Account Reporting revisited'. Below each question is our response.

Q1) Can we keep the pension account if the trustee failed to meet the minimum requirements provided, we won't claim ECPI?

As noted in the webinar, where a pension fails to pay the required minimum pension there are the following consequences:

- The pension ceases for tax purposes from the start of the financial year, meaning there can be no claim for exempt current pension income (ECPI) in respect of the failed pension for the income year. This does not mean that there is an automatic commutation of the pension – it ceases for tax purposes only;

- The pension ceases to be in retirement phase at the end of the financial year. The value of the pension will give rise to a debit in the individual's transfer balance account. The SMSF will be required to lodge a Transfer balance account report (TBAR) which will include the event date of 30 June of the relevant financial year and the value of the pension at the end of the relevant financial year. You will need to select 'Income stream stops being in retirement phase' as the event type at question 14 of the TBAR.

Looking at the processing implications in the accounting or administration platform, you will need to ascertain how the system deals with this scenario as the following should be considered:

- If the pension is fully commuted back to the member's accumulation account, on 1 July, for the purpose of ensuring that the fund's claim for ECPI does not include the failed pension, you will need to determine what the value of that pension would have been at 30 June for TBA reporting purposes. Further, processing a commutation in the platform on 1 July may result in the platform generating a TBA debit and electronic file, plus recording a debit in the member's platform record – which is incorrect.

- Where you leave the pension in place for the year, so that you can ascertain the value of the pension at 30 June for TBA reporting purposes, you need to ensure that the failure to pay the minimum pension is taking into account by the Actuary where the fund claims ECPI under the proportionate method. Where the fund uses the segregated method, eligible assessable income from the failed pension must not be claimed as ECPI. Further, as the pension ceases for tax purposes from 1 July, the tax components will need to be re-calculated where the pension is re-commenced on the following 1 July.

So, in short, review how your administration platform deals with this scenario to ensure correct treatment for tax and TBA reporting purposes.

Q2) Could you explain what is a member commutation? Is it only when members stop their pension stream and transfer the balance out as a lump sum from their super fund?

As a 'commutation' is not defined in either the ITAA 1997 , the ITAR 1997 or the SISR 1994 , it takes its ordinary meaning in the context in which it appears. Tax Ruling (TR) 2013/5 states (at paragraph 110) that 'a member or a dependant beneficiary commutes their superannuation income stream if they consciously and validly exercise their right to exchange some or all of their entitlement to receive future superannuation income stream benefits for an entitlement to be paid a lump sum. For the trustee of the fund, the liability to pay that member or dependant beneficiary periodic superannuation income stream benefits is substituted with a liability to pay a lump sum'.

For an SMSF member, there should be a prospective request to the SMSF trustee(s) to commute, either fully or partially, their future pension entitlements to a lump sum. The Tax ruling further states that 'A request to commute is valid if it is consistent with the governing rules of the superannuation fund, the agreement between the member and trustee under which the superannuation income stream is provided and the relevant requirements of the SISR 1994'.;

Where the member requests a commutation, the resulting lump sum may be retained within the SMSF in the member's accumulation account, unless it is required to be paid out, for example the commutation relates to a death benefit pension. Further, some pensions cannot be commuted, except in limited circumstances, for example, a market linked pension or life-time complying pension.

A commutation of a retirement phase pension will give rise to a debit to the individual's transfer balance account. The SMSF will be required to report this event to the ATO via a TBAR.

Q3) Could you please discuss and double confirm (!) that if a non- retirement phase pension (TTR) is commuted BEFORE turning 65 it does NOT count towards the TBC?

A transition to retirement pension, also known as a transition to retirement income stream (TRIS), is not a retirement phase pension and consequently it does not count towards the recipient's transfer balance cap (TBC). Further, there are no events that need to be reported for transfer balance account purposes. That is, the start of a TRIS or any commutations, either full or partial, are not events that are required to be reported via a TBAR.

The TRIS will commence to be a retirement phase pension when a member satisfies a full condition of release (CoR) with a nil cashing in restriction, for example 'retirement'. The TRIS moves to retirement phase once the member notifies the trustee(s) of satisfying the relevant CoR. However, if the CoR is attaining age 65, this is an automatic transition of the TRIS into retirement phase.

For TBA purposes, when the TRIS moves into retirement phase, it is treated as the commencement of a new retirement phase pension. Consequently, for TBA purposes, the pension does not commence until it moves into retirement phase, for example, from when the member turns 65. Any commutations of the TRIS that occur prior to it moving into retirement phase are not events that need to be reported for TBA purposes and do not affect the individual's TBC.

In the lead up to a TRIS moving into retirement phase, where the value of a TRIS exceeds the individual's personal transfer balance cap, consideration should be given to commuting the pension so that the value at the time it moves into retirement phase does not cause the individual to exceed their personal TBC. Such a commutation of the TRIS, prior to it moving into retirement phase, is not a reportable TBA event.

Q4) Can you please enlighten us about the updated guidelines on Market Linked Pensions and corresponding transfer balance cap (TBC) impact, including any retrospective reporting requirements?

Where a pre 1 July 2017 Market Linked Pension (MLP), which is also a Capped Defined Benefit Income Stream (CDBIS), was commuted post 30 June 2017, there was an issue with calculating the value of the transfer balance account (TBA) debit. At the time, the ATO had the view that the relevant provision of the Tax Act 1997 was technically deficient and resulted in a zero TBA debit value.

This was rectified with the passage of amending legislation (Royal assent 22 June 2020; applying to commutations since 1 July 2017 to a pre 1 July 2017 MLP), which now gives rise to an actual TBA debit value in relation to the commutation. For information on how to calculate the TBA debit value using the new method refer to our TechHub webinar recording 'The latest on complying pensions in an SMSF'; (webinar date: 27/08/2020).

Prior to passage of the correcting legislation, the ATO provided a practical compliance approach to the TBA reporting requirements for a full commutation of a pre 1 July 2017 MLP from which the commuted amount was used to commence a new MLP. The new MLP would not be a CDBIS. In relation to the reportable TBA debit for the commutation of the pre 1 July 2017 MLP and the TBA credit for the new MLP, an SMSF trustee has the following TBA reporting choice:

1. Do not report. That is, do not lodge a TBAR for either the commutation of the pre 1 July 2017 MLP or the commencement of the new MLP; OR
2. Lodge a TBAR for the commutation of the pre 1 July 2017 MLP with a value other than nil, generally based on the intention of the original legislation, and lodge a TBAR for the commencement of the new MLP, based on the capital used to commence the new MLP.

Now that the calculation of the TBA debit in respect of the pre 1 July 2017 MLP has been resolved, the ATO expects an SMSF to review the information already reported, via a TBAR, and consider whether it needs to be re-reported [or reported for the first time]. The ATO intended to provide further guidance by the end of November 2020 as to when retrospective reporting was to be done, however, to date, such guidance has not been provided. The ATO also acknowledges that there would be no re-reporting for a deceased member (note that an individual ceases to have a TBA upon death) and where an SMSF has been wound up, that it may not be possible for reporting to be reviewed. It is generally understood that TBA re-reporting is not required until the ATO provides the further guidance.

There was also an announcement, by the Federal Government, in December 2020 as part of the Mid-Year Economic Fiscal Outlook (MYEFO), of a proposal to allow for the commutation of a MLP in the situation where the credit that arises from commencement of a new MLP causes the individual to exceed their personal TBC and they are unable to commute any other pension to eliminate any excess TBA.

Q5) Can you please provide a scenario for LRBA transactions where TBAR lodgment is necessary?

Under section 294-55 ITAA 1997, a TBA credit will arise in an individual's TBA if:

- An SMSF makes a repayment of a loan, under a Limited Recourse Borrowing Arrangement (LRBA) that complies with section 67 of the SIS Act, which was entered into on or after 1 July 2017; and
- As a result of the loan repayment, there is an increase in the value of the superannuation interest that supports a retirement phase pension.

Law Companion Ruling (LCR) 2016/9 explains that:

'An increase in the value of your superannuation interest supporting your superannuation income stream in the retirement phase will occur where a payment in respect of the LRBA is made fully, or partially, from assets that are supporting superannuation interests that are not in the retirement phase. For example, this may occur where the assets of the superannuation fund are allocated to specific superannuation interests that are supporting superannuation income streams'.

The LCR also provides the following example:

Ram and Madhu are the only members of an SMSF which has allocated specific assets to support the superannuation income streams payable by the SMSF. They both have account-based pensions and accumulation interests.

On 30 June 2018, Ram's retirement phase interest is valued at $400,000 and Madhu's retirement phase interest is valued at $600,000.

The SMSF entered into an LRBA on 1 August 2018 to acquire an asset that solely supports the account-based pensions of both Ram and Madhu. The fund makes a monthly repayment of $10,000 from accumulation interests of both Ram and Madhu towards the borrowing under the LRBA on 1 September 2018. There have been no significant changes in value of the superannuation interest in the retirement phase prior to the repayment.

The transfer balance credits that arise in Ram and Madhu's transfer balance account on 1 September 2018, is apportioned in a fair and reasonable manner in accordance with the proportion of their retirement phase interests in the SMSF. This is calculated as follows:

Ram's transfer balance credit:

$400,000 / ($400,000 + $600,000) x $10,000 = $4,000

Madhu's transfer balance credit:

$600,000 / ($400,000 + $600,000) x $10,000 = $6,000

We have a few comments in relation to this example:

1. The SMSF must segregate assets between retirement phase pension accounts and accumulation interest accounts. We do not take the segregation to be specifically for the purpose of claiming exempt current pension income (ECPI), it may be for investment purposes only. However, it is generally uncommon for an SMSF to have a segregated investment strategy and also not use the segregated method for claiming ECPI;

2. Where the SMSF does segregate assets between retirement phase interests and accumulation interests and the SMSF does not have disregarded small fund assets (DSFA), the fund would use the segregated method to claim ECPI. With the LRBA segregated to retirement phase pension interests, the SMSF would not be able to claim interest on the loan under the LRBA. It would be unusual for an SMSF to segregate an LRBA to pension interests, for both from an income tax and cash flow perspective;

3. The example implies that benefits from accumulation interests are applied to increase the retirement phase pension interests, via making a loan repayment, without compensation. This inference is that accumulation benefits have been transferred to retirement phase without any TBC consequences. However, our concern is that such a transaction would be a contravention of a number of SIS provisions.

Given the requirements and circumstances for a TBA credit to arise from an SMSF LRBA, we would expect such a TBA credit to arise in only limited circumstances.

Q6) Are there any penalties for not reporting TBAR?

Where an SMSF lodges a TBAR late, the fund may be subject to a failure to lodge on time penalty. For an SMSF, generally, the amount of the penalty is calculated at the rate of one penalty unit for each period of 28 days (or part thereof) that the TBAR is overdue, up to a maximum of five penalty units. Currently, a penalty unit is worth $222.

The ATO has been taking an educative and supportive approach where TBARs are lodged late. To date, we are not aware of penalties being imposed for late lodgement of a TBAR. However, where an SMSF trustee is unable to lodge by the relevant due date, they should lodge the TBAR as soon as possible to avoid any potential adverse consequences. They may also consider contacting the ATO.

Q7) If an income stream was set up as reversionary, do we need to report it in the TBAR report?

No. Where a retirement phase pension is commenced, there is no requirement to report that it was established as reversionary. There is no ability in the TBAR to report this. However, where a retirement phase pension has been commenced for an individual as a consequence of the reversion of a pension that was being paid to another person, this must be noted in the TBAR. The common example is where an individual commences to receive a death benefit pension due to the death of their spouse; that pension was originally being paid to their deceased spouse and it reverts to them on death.

For the TBAR, the event type at question 13 will be 'Reversionary income stream' – this will prompt the ATO systems to defer the TBA credit from arising in the pension recipient's TBA for twelve months. The event date at question 17, is the date the pension reverted, being the date of death of the original pension recipient. The value at question 18, is the value of the pension at the date it reverted, also being the date of death of the original pension recipient.

Q8) Can you reset an ABP for a person who retired and is under the age of 65? ABP rules allow it , but the member is no longer employed and therefore unable to retire again.

For an individual to commence a retirement phase pension they need to have reached their preservation age and satisfied a Condition of Release (CoR) with a nil cashing restriction. 'Retirement' is a common CoR with a nil cashing restriction and is defined in SIS regulation 6.01(7) and depends on the age of the member.

If the superannuation fund member is:

- under 60 years old – they can access their preserved benefits only when they have:
  - reached their relevant preservation age; and
  - ceased gainful employment; and
  - no intention to become gainfully employed in the future, on either a part time or full time basis
  - at least 60 years old – they can access their preserved benefits when any arrangement under which they were gainfully employed ceases, e.g. they leave a job. Note: the under age 60 retirement requirement, above, is also available for a person aged 60 to 64.

Once a person attains age 65, they can access their superannuation benefits. Attaining age 65 is a CoR with a nil cashing restriction, separate from the 'retirement' CoR.

Where an individual meets the requirement for 'retirement' their benefits at that time, become 'unrestricted non-preserved', providing them with full access to those benefits. In the scenario where the individual commences an account based pension and then subsequently fully commutes that pension back to their accumulation interest, the benefits remain 'unrestricted non-preserved' – they do not revert back to a preservation status of 'preserved'. Consequently, they can commence a new account-based pension.

However, where the person is under age 65, any new contributions or earnings on superannuation interests will be subject to preservation. So, for example, if the member has made new superannuation contributions, since satisfying the 'retirement' CoR, in order to access those preserved benefits, prior to age 65, in the form of a new account based pension, they will need to satisfy, again, a CoR with a nil condition of release.

Where the member was under age 60 at the time they first 'retired' and consequently satisfied the above requirements for a person under age 60, where they have not entered into a new arrangement of gainful employment, they can simply re-make this declaration to access any preserved benefits prior to age 65.

Where the member was aged 60 to 64 and relied on the 'leave a job' option, as outlined above, in order to access preserved benefits prior to age 65, they will have to either leave another arrangement of gainful employment, leave another job; or satisfy the retirement requirement for a person under age 60. Effectively, this is satisfied by making a declaration that they never intend to be gainfully employed again on either a full time or part time basis and would refer to a previous cessation of an arrangement of gainful employment.

Q9) When a capped defined benefit (lifetime) pension automatically reverts, how is the amount for TBAR reporting calculated?

The lifetime complying pension will be a capped defined benefit income stream (CDBIS). Where the pension reverts to the reversionary beneficiary, for example, a surviving spouse, the pension does not cease, but continues and remains a CDBIS. Consequently, the TBC credit that arises from the reversion, being for the surviving spouse commencing a new retirement phase income stream that is a CDBIS, will be calculated using the special credit rules that would have been used to calculate the TBA credit at 1 July 2017 for the original CDBIS recipient. For a CDBIS that is a lifetime complying pension this is: annual entitlement x 16.

Q10) SMSF with two members: one with accumulation over $1 million and the other member with accumulation balance of $200K. The member with the balance over $1 million starts a pension this year, is reporting quarterly or annually?

As the SMSF commences a retirement phase income stream for the first time, the determination of whether the SMSF will be an annual or quarterly reporter for TBAR purposes will be whether there is a member with a total superannuation balance of at least $1 million at the prior 30 June. In this case, there is and consequently the SMSF will be a quarterly reporter for TBAR purposes and will remain such. It doesn't matter which member commenced the retirement phase pension.

Q11) Upon death, which member reports TBAR – the deceased member or the member receiving the reversionary? What happens if the pension was not reversionary, but the deceased member's death benefit is cashed as a death benefit pension – who and what is reported?

Firstly, a TBAR is lodged by the SMSF, not the member. Refer to the webinar recording for those events that are reported by a member, which are reported via a Transfer Balance Event Notification (TBEN).

The death of a member is not a reportable event for TBAR purposes. Upon the death of an individual, their TBA is extinguished.

Where the deceased member's death benefit is paid as a death benefit pension, the SMSF is required to lodge a TBAR in respect of a commencement of a new retirement phase income stream for the death benefit pension recipient, for example the surviving spouse. This applies regardless of whether the death benefit pension was commenced from accumulation or non-reversionary pension interests of the deceased member or as a consequence of a pension of the deceased member reverting to the reversionary pension recipient.

However, where the death benefit pension commenced as a consequence of the pension reverting on death, the TBAR needs to be noted at question 13 that the event type is 'Reversionary income stream'. This will ensure that the TBA credit that arises in the pension recipient's TBA is deferred for twelve months from the event date.

Q12) When resetting an ABP you need to lodge cancelling TBAR for original amount and lodge the new opening balance – is this correct?

No, that is incorrect. An SMSF will only be required to lodge a cancelling TBAR where previously lodged information for a TBA event was incorrect. In this scenario, the lodged TBAR is cancelled and a new TBAR, with correct information is lodged.

If an ABP is 'reset' which is assumed to mean, it's fully commuted and then re-commenced combing the capital from the fully commuted pension, plus the accumulation interest of the member, then these are all separate TBA events, which require reporting.

For example:

- William commences an ABP for $500,000 on 1 July 2019 – a TBAR will be lodged to report the commenced of a new retirement phase pension. A credit of $500,000 will appear in William's TBA, his TBA balance will be $500,000;
- During 2019/20 William draws a pension of $25,000. There are no TBA reporting requirements for pension payments;
- On 1 July 2020 William:
  - Makes a non-concessional contribution of $100,000 – this is not a TBA reportable event;
  - Fully commutes his ABP for $502,500 –The SMSF will be required to lodge a TBAR for this TBA reportable event. A debit will arise in Williams's TBA for $502,500;
  - Commences a new ABP for $602,500 – The SMSF will be required to lodge a TBAR for this TBA reportable event. A credit will arise in William's TBA for $602,500. William's TBA balance, at the end of 1 July 2020 is $600,000.

Q13) If we receive an excess transfer balance (ETB) determination and we correct a previously incorrect TBAR, are we going to receive a notification from ATO?

Where the ATO issues an ETB determination and it is discovered than information reported to the ATO is incorrect, the SMSF will be required to lodged TBAR(s) cancelling the incorrect information and providing the correct information as soon as possible. Where it is discovered that TBA events have not been reported, the SMSF should lodge a TBAR for that event as soon as possible.

It would be prudent to contact the ATO, prior to the due date on the ETB determination, to determine if an extension of time is required to allow for the new information to be processed by the ATO. The ATO will issue a revoked or amended determination once they have received and processed the new information.

Q14) Where the minimum pension is not paid, but the shortfall meets the requirements of the ATO's tolerance and it's accepted by the SMSF auditor, does the pension need to be commuted?

As noted in a previous question and answer, where the SMSF fails to pay the required minimum pension, the pension ceases for tax purposes at the start of the relevant financial year, but ceases for TBA purpose at the end of the financial year. The ATO has a General Power of Administration (GPA) to treat an ABP as meeting the minimum pension payment requirement even though the minimum was not actually paid. This can also be self assessed by the SMSF trustee(s). The requirement for the GPA and self-assessment is outlined on the ATO's website, search using Quick Code (QC) 39769.

Where the GPA applies and the pension is treated as meeting the minimum pension payment requirement, the pension does not cease for either tax or TBA purposes. Consequently, there is no TBAR lodgement requirement.

Q15) If a member does not draw minimum pension, do we have to obtain an actuarial certificate for the fund?

Generally, an actuarial certificate is only required where the SMSF claims ECPI using the proportionate method. Where the fund fails to pay the required minimum pension, it cannot claim ECPI in relation to that pension. If the SMSF has paid other pensions during the financial year; met the minimum pension requirement and wishes to claim ECPI using the proportionate method, the SMSF must still obtain an actuarial certificate. However, if there are no other pensions and the SMSF will not be claiming ECPI using the proportionate method, there is no requirement to obtain an actuarial certificate.

Q16) ABP is $1.6 million October 2020. The member requested full commutation of his pension and withdrawal out of the SMSF on 1 November 2020. An amount of $1 million was paid on 16 November 2020. Member died December 2020. The balance of his pension was paid 2 January 2021. When is the commutation reported?

Whilst the member requested a full commutation prior to his death, the commutation amount paid prior to his death was $1 million. This will be reported as a TBA event by the SMSF on a TBAR. The event date is 16 November 2020 and the event value is $1 million. Assuming the SMSF was a quarterly reporter for TBA reporting purposes, the TBAR for the $1m commutation was due on 28 January 2021. The amount of his pension interest and any other interests held by the SMSF, paid out of the SMSF as a lump sum, after his death, is a lump sum death benefit payment. There is no TBA reporting requirement. Upon the member's death, the member's TBA is extinguished.

Note: there are Private Binding Rulings (PBR) that deal with the issue of whether benefits requested prior to death, but paid after death are to be treated as a superannuation benefit payment or as a superannuation death benefit payment. Our understanding from these PBRs is that generally, for an SMSF, all benefits paid or cashed after death are to be treated as superannuation death benefit payments, notwithstanding that there were requested prior to death. However, you may wish to seek advice in relation to the treatment of these payments.

Q17) In the example of Harry and Ginny, the TBA reporting is very tight. Sometimes we are not informed immediately that an SMSF member has died. We also need to bring the fund up to date for the required information. How lenient is the ATO if the lodgement is late in these types of circumstances?

As noted in an answer to a previous question, we are not aware of the ATO imposing a penalty for failing to lodge a TBAR on time, currently. The ATO states on their website (QC 33410):

'We recognise that sometimes people don't meet their lodgment obligations on time, even with the best intentions. Generally we don't apply penalties in isolated cases of late lodgment'.

Where you become aware that the SMSF will not be able to meet the TBAR lodgement deadline, or it may have in fact passed, consideration should be given to contacting the ATO to explain this.

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