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Fact sheet: Complying life-expectancy defined benefit pensions

As per SISR section 1.06 (7)

August 2021

Treatment of a complying life-expectancy pension under the superannuation reforms on 1 July 2017

At 1 July 2017 all retirement phase income streams will be counted towards a member's transfer balance account. This will be assessed against the general transfer balance cap of $1.6 million. Where a member's transfer balance account exceeds $1.6 million, commutable income streams, such as account-based pensions (ABPs), must be commuted to reduce a member's transfer balance account to $1.6 million. Where there are no remaining commutable income streams but the transfer balance account remains in excess of $1.6 million due to a complying life-expectancy pension, this will not create an excess transfer balance in recognition that the pension is non-commutable.

How to determine the special value credit for transfer balance cap purposes at 1 July 2017

Step 1	Determine the annual entitlement at 1 July 2017. $$\text{Annual entitlement} = \frac{\text{First payment in 2017-18}}{\text{Number of days in the period the payment refers}} \times 365$$ Please note that the annual entitlement should be calculated based on the original terms of the pension.
Step 2	Special value = annual entitlement x remaining term (rounded up)

How to determine the value for total superannuation balance purposes as at 30 June

The value of a complying life-expectancy pension for the purposes of determining a member's total superannuation balance at 30 June each financial year is the sum of credits and debits for the complying life-expectancy pension in the member's transfer balance account.

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Example

Mary is the sole member of an SMSF. She is receiving a complying life-expectancy pension which commenced on 1 January 2003 for a period of 20 years and the terms of the pension dictate that payments will be made annually in arrears. The first payment in 2017-18 that Mary is entitled to receive is the annual payment of $120,000 on 15 June 2018.

As at 1 July 2017, the value of the assets supporting the complying life-expectancy pension (including reserves) is $750,000 and Mary also has $500,000 in an ABP.

The remaining term of the pension as at 1 July 2017 is 5.5 years.

Special value of the complying life-expectancy pension:

Annual entitlement = (120,000 / 365) * 365 = $120,000

Special value = 120,000 * 6 = $720,000

Mary's transfer balance account:

	Credit	Total
Opening balance on 01/07/2017		$0
Complying life-expectancy pension ABP	+720,000 +500,000	$720,000 $1,220,000
Closing balance on 01/07/2017		**$1,220,000**

Therefore the amount counted towards Mary's transfer balance cap is $1,220,000.

Mary's total superannuation balance as at 30 June 2017 is also $1,220,000.

Mary does not exceed the transfer balance cap of $1.6 million and therefore Mary is eligible to use the segregated method in 2017-18 on fund assets if she wishes.

Since Mary's total superannuation balance is less than $1.6 million she is also eligible to make non-concessional contributions in 2017-18 up to $100,000 or $300,000 using the three-year bring forward rule.

Mary's annual payment exceeds the defined benefit income cap of $100,000. Therefore 50% of the excess (in this instance $10,000) will be added to Mary's personal income and taxed at marginal rates.

Commuting a complying life-expectancy defined benefit pension post 1 July 2017

Complying life-expectancy pensions can be commuted to commence a complying retail annuity or a complying market linked pension. The commutation value of a complying life-expectancy pension is capped at the maximum permitted transfer value calculated according to SISR Schedule 1B, unless the pension is Assets Test Exempt for social security purposes.

The commutation of a complying life-expectancy pension will create a debit against the member's transfer balance account equal to the special value calculated as at the date of commutation.

The commencement of a new complying market linked pension or complying retail annuity will create a credit to the member's transfer balance account. It is our understanding that a complying market linked pension or complying retail annuity commenced from 1 July 2017 will not meet the definition of a capped defined benefit income stream and the credit value will be as follows:

Type of pension commenced post 1 July 2017	Credit against the transfer balance cap
Complying market linked pension	Market value of assets supporting the pension
Complying retail annuity	Purchase price

Example continued

Mary decides to make a pro-rata pension payment and commute her complying life-expectancy pension as at 3 January 2018 and commence a complying retail annuity. At the commutation date, the value of the assets supporting the complying life-expectancy pension (including reserves) is $740,000 and the market value of the assets supporting the ABP is $470,000.

The maximum permitted transfer value as at date of commutation is $840,000. Therefore Mary could commute all the assets backing the life-expectancy pension (including reserves) to a complying retail annuity.

The remaining term of the pension as at 3 January 2018 is 4.9 years and Mary's annual entitlement remains at $120,000.

Mary's transfer balance account:

	Credit	Debit	Total
Opening balance on 01/07/2017			$1,220,000
Complying life-expectancy pension Complying retail annuity	 +740,000	-600,000 	$620,000 $1,360,000
Closing balance on 03/01/2018			**$1,360,000**

The value of Mary's transfer balance account after the commutation of her life-expectancy pension to a complying retail annuity results in a transfer balance account of $1,360,000 which includes the ABP that continues to remain in retirement phase.

Mary's total superannuation balance will be recalculated as at 30 June 2018. If the value of the retail annuity and the value of the ABP assets exceed the transfer balance cap on 30 June 2018 then Mary will not be able to make any non-concessional contributions nor will her SMSF be eligible to use the segregated method in the 2018-19 financial year.

Mary no longer has a capped defined benefit income stream and therefore the defined benefit income cap ($100,000) does not apply to payments from her new complying retail annuity.

If clients have a complying life-expectancy pension at 1 July 2017 and the assets supporting the pension exceed $1.6 million, then the pension cannot be commuted without raising an excess transfer balance - an outcome that cannot be resolved. It will be particularly important for clients to ensure pensions are reviewed before 1 July 2017 as they might not be able to be re-structured post 1 July 2017 unless the assets supporting the pension subsequently fall below $1.6 million.

If you have any questions about this paper please contact us on the detail below.

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