Fact sheet: Complying lifetime defined benefit pensions

As per SISR section 1.06 (2)

August 2021

Treatment of a complying lifetime 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 lifetime 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 16

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

The value of a complying lifetime 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 lifetime pension in the member's transfer balance account.

Example

John is the sole member of an SMSF. He is receiving a complying lifetime pension and the terms of the pension dictate that payments will be made monthly. The first payment in 2017-18 that John is entitled to receive is a payment of $6,500 on 15 July 2017.

As at 1 July 2017, the value of the assets supporting the complying lifetime pension (including reserves) is $1.7 million and John also had $200,000 in an ABP.

Special value of the complying lifetime pension:

Annual entitlement = 6,500 / 31 * 365 = $76,532

Special value = $76,532 * 16 = $1,224,516

John's transfer balance account:

	Credit	Total
Opening balance on 01/07/2017		$0
Complying life-expectancy pension ABP	+1,224,516 +200,000	$1,224,516 $1,424,516
Closing balance on 01/07/2017		**$1,424,516**

Therefore the amount counted towards John's transfer balance cap is $1,424,516.

John's total superannuation balance as at 30 June 2017 is also $1,424,516.

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

Since John's total superannuation balance is less than $1.6 million he is also eligible to make non-concessional contributions in 2017-18 up to $100,000.

John's annual payment does not exceed the defined benefit income cap of $100,000.

Commuting a complying lifetime defined benefit pension post 1 July 2017

Complying lifetime pensions can be commuted to commence a complying retail annuity or a complying market linked pension.

The commutation of a complying lifetime pension will create a debit against the member's transfer balance account equal to the special value originally assessed as a credit at 1 July 2017, less any debits relating to the pension between 1 July 2017 and date of commutation - except for a payment split.

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

John decides to commute his complying lifetime pension as at 1 January 2018 and commence a 20 year complying market linked pension with the entire assets which support the lifetime pension (including reserves). At the commutation date, the value of the assets supporting the complying lifetime pension (including reserves) is $1.65 million and the market value of the assets supporting the ABP is $190,000.

There have been no other debits associated with John's complying lifetime pension between 1 July 2017 and 1 January 2018.

John's transfer balance account:

	Credit	Debit	Total
Opening balance on 01/07/2017			$1,424,516
Complying life-expectancy pension		-1,224,516	$200,000
Complying market linked pension	+1,650,000		$1,850,000
ABP		-190,000	$1,660,000
Closing balance on 01/07/2018			**$1,660,000**

The value of John's transfer balance account after the commutation of his lifetime pension to a market linked pension results in a transfer balance account of $1,850,000 which is $250,000 in excess of the $1.6 million transfer balance cap. Even after John commutes his entire ABP worth $190,000 he still has an excess transfer balance of $60,000.

Unfortunately John cannot commute this excess amount from the market linked pension back to accumulation as the pension is non-commutable. John would pay 15% tax on the notional earnings on this excess in the first year and 30% tax on the notional earnings from the second year onwards.

John's total superannuation balance will be recalculated as at 30 June 2018. If the value of the assets backing the market linked pension and the value of the accumulation assets exceed the transfer balance cap on 30 June 2018 then John will not be able to make any non-concessional contributions or use the segregated method in the 2018-19 financial year.

John no longer has a capped defined benefit income stream in 2018-19 and therefore the defined benefit income cap ($100,000) does not apply to him.

This highlights that where clients have a complying lifetime 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 therefore 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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