

Paying a pension from a self-managed superannuation fund is not difficult, but you do need to know what you are doing. As a market leader in SMSF pension documentation, Topdocs has compiled the following list of commonly asked questions regarding SMSF pensions to help advisers and trustees make informed decisions.

Q. What types of pensions are there?

A. The most common types of pensions and income streams currently being commenced by members of SMSFs are **Account-Based Pensions** and **Transition to Retirement Income Streams**. **Market Linked Pensions** can also still be commenced in limited circumstances and while many Allocated, Transition to Retirement Allocated, Lifetime, Life Expectancy and Flexi-Pensions remain in place, they can no longer be commenced.

Q. What are the characteristics of an Account-Based Pension (ABP)?

A. The recipient of an ABP receives regular payments (subject to a legislated minimum each year – discussed below) that are drawn down from a pension account within their SMSF. The payments continue until death, the account is empty or the pension is otherwise commuted or stopped (as discussed below). Upon death, any account balance will be paid to beneficiaries of the deceased in the form of a lump sum or pension. A significant strength of an ABP is the flexibility to drawdown and access the capital sum supporting the pension.

Q. What are the benefits of commencing an Account-Based Pension?

A. The major benefits are as follows:

- The tax rate of your SMSF ABP balance reduces to NIL once you commence your pension.
- You don't pay tax on the investment earnings or capital growth in the Fund relating to your pension balance.
- You still receive refunds of franking credits.
- You can access any level of income from your Fund subject to an aged based minimum amount.
- The income you access is tax free if you are over 60.
- You can take lump sum amounts whenever you want with no limitation tax free.
- You do not need to change your SMSF Investments when you start an Account-Based Pension.

Q. Are there any benefits in salary sacrificing into the SMSF and also commencing a pension?

A. There may well be significant taxation benefits relating to salary sacrificing where your marginal tax rate is higher than 15% and then commencing a pension stream.

Q. How do Allocated Pensions (APs) differ from Account-Based Pensions?

A. A number of the characteristics of an AP are similar to those of an ABP, a significant difference being that the regular payments are subject to a legislated maximum each year as well as a legislated minimum. As noted above, while many APs remain in place, they can no longer be commenced.

Q. Can an existing pension be converted to another kind of pension?

A. Providing that the fund's trust deed empowers it to do so, the trustee may, using appropriate documentation, convert an existing Allocated Pension to an Account-Based Pension without commuting it and commencing a new pension, but is not obliged to do so. As noted above, Transition to Retirement Income Streams will automatically become standard Account-Based Pensions (with full commutation rights) when the recipient satisfies a condition of release such as turning 65, retiring from the workforce or other trigger event.

Q. Should you convert from an Allocated Pension to an Account-Based Pension?

A. There are a number of factors to consider.

- Allocated pensions require a higher minimum annual payment compared to Account-Based Pensions
- Allocated Pensions have a maximum annual payment. Any payments above that figure would need to be Eligible Termination Payments. For Account-Based Pensions there is no maximum limit.

Q. How do Transition to Retirement Income Streams (TRISs) differ from Account-Based Pensions?

A. A number of the characteristics of a TRIS are similar to those of an ABP, a significant difference being that the regular payments are subject to a legislated maximum each year and the TRIS cannot be commuted to cash except as detailed in the Question **Can an existing pension be commuted?** below.

Q. How do Market Linked Pensions differ from Account-Based Pensions?

A. A number of the characteristics of an MLP are also similar to those of an ABP, significant differences being that the term or length of the pension is set according to legislated criteria, that the regular payments are subject to a legislated maximum each year as well as a legislated minimum and that the ability to commute is limited (as discussed below).

Q. What are the benefits of commencing a Market Linked Pension?

A. As Centerlink exemptions no longer apply for new Market Linked Pension commencements the only reason generally for commencing a Market Linked Pension is where they replace the commutable amount of a Complying Pension commutation.

Q. Who is able to commence a pension?

A. To commence a pension, a member of an SMSF must have access to their accumulation account balance, i.e. generally they must have:

- an unrestricted non-preserved component of an Eligible Termination Payment available for rollover;
- reached their preservation age (as set out in the following table) and retired from the workforce;
- reached age sixty and terminated their most recent employment;
- reached age sixty-five; or
- become permanently disabled.

Date of Birth	Preservation Age
Before 1 July 1960	55
Between 1 July 1960 and 30 June 1961	56
Between 1 July 1961 and 30 June 1962	57
Between 1 July 1962 and 30 June 1963	58
Between 1 July 1963 and 30 June 1964	59
After 1 July 1964	60

Q. Who can commence a Transition to Retirement Income Stream?

A. To commence a TRIS, a member of an SMSF who has not yet retired must simply have reached their preservation age (as set out in the above table).

Q. Who can be a reversionary beneficiary for a pension?

A. Broadly, a reversionary beneficiary **must** satisfy the *Superannuation Industry (Supervision) Act 1993* (Cth) definition of dependant, limited further by the Superannuation regulations in the context of children, to include:

- a spouse (including a de facto spouse);
- a child (including a step child) who is less than 18 years of age or between 18 and 25 years of age and financially dependant on the deceased;
- any other person who lived in an 'interdependency relationship' with the deceased; or
- any other person who was financially dependent on the deceased.

Q. How are Account-Based Pension payments calculated?

A. ABP payments are not subject to any maximum, i.e. payments in any given year can be up to 100% of the pension account balance but, as noted above, payments are subject to an annual minimum, which is calculated by multiplying an age-based percentage (as set out in the following table) on the anniversary of the commencement date of the pension each year by the pension account balance. The legislated minimum is pro-rated in the first year and no payment must be made in the first year if the commencement date of the pension is between 1 June and 30 June inclusive.

Age	Minimum Annual Payment*
Under 65	2%
65-74	2.5%
75-79	3%
80-84	3.5%
85-89	4.5%
90-94	5.5%
95 or more	7%

***Note that each of the above minimum annual payment percentages has been halved and applies for the 2008/09 and 2009/10 financial years only. Unless further relief is granted, we would expect these figures to double back to the “normal” percentages for the 2010/11 financial year and thereafter.**

Q. How are Allocated Pension payments calculated?

A. Minimum and maximum annual payments are calculated based on the pension account balance and life expectancy of the pensioner at the start of each financial year. Note that minimums may be significantly higher than minimums for Account-Based Pensions and that Allocated Pensions are designed to be paid out to zero earlier than Account-Based Pensions. There are reasons why some Allocated Pensions are being converted to Account-Based Pensions – see above.

Q. How are Transition to Retirement Income Stream payments calculated?

A. Annual TRIS payments are subject to the same minimums as Account-Based Pensions. Unlike ABPs, however, annual TRIS payments are also subject to a maximum, i.e. 10% of the pension account balance.

Q. How are Market Linked Pension payments calculated?

A. An annual MLP payment amount (plus or minus 10%) is determined at the commencement of the pension by electing a term of years for the pension to run. The term elected is based on the life expectancy of the primary or reversionary pensioners or the term between the primary or reversionary pensioner’s age and 100 years.

Q. What documentation is required to commence a pension?

A. A comprehensive pension documentation package should comprise a pension application form, pension agreement, pension product disclosure statement (as required by section 1012B of the *Corporations Act 2001* (Cth)), trustee resolutions, fully completed ATO documentation, including PAYG Withholding registration and TFN Declaration documentation (when required for pensioners under 60) and calculation of the minimum and maximum pension payments for the first year of the pension and the pension’s deductible amount.

Q. What ongoing administration is required for Pensions?

A. Actuarial certificates may be required if there are accumulation amounts in the Fund (unless pension assets are segregated). Annual pension payment calculations and appropriate minutes are also required. Specialist SMSF Administration packages such as BGL should automatically calculate the exempt pension income if set up correctly. For some other packages calculations need to be manually completed.

Q. Can I make contributions into a pension account?

A. An SMSF paying a pension may accept further contributions from the member subject to legislative requirements and contribution limits. However, any new contributions are **not** added into the pension capital. Instead they form a new taxable accumulation balance within the fund. This balance is liable for income and capital gains tax. However, on an annual basis, an existing pension may be commuted (stopped) back to accumulation phase. The member’s account balances (pension and contributions) are then added together and the Account-Based Pension recommenced. This is also known as resetting the pension. In this way tax benefits accrue within the fund, as the taxable accumulations do not remain taxable for more than one year.

Q. How are pensions treated by Centerlink?

A. Payments from an Account-Based, Allocated and Market Linked Pension and Transition to Retirement Income Stream accounts less a deductible value are counted as income for the Centerlink and Department of Veterans' Affairs income test. That part of any pension that is classified as a return on capital is not subject to the income test.

While an Account-Based or Allocated Pension or Market Linked Pension commenced after 19 September 2007 or Transition to Retirement Income Stream account balance is included as an asset for the purpose of the assets test – the account balance being revalued every 6 months, a 50% assets test exemption applies for Market Linked Pensions commenced prior to 20 September 2007.

Q. How are pension payments taxed?

A. Taxed payable on pension payments depends on the age of the recipient, as summarised in the following table:

Age	Tax applied
Age 60 or over	Tax free and not assessable
Preservation age to age 59	Taxed at the recipient's marginal tax rate plus Medicare levy and eligible for a 15% tax offset after any relevant deductible amount.
Under preservation age	Taxed at the recipient's marginal tax rate plus Medicare levy less any relevant deductible amount

Account-Based, Allocated and Market Linked Pension balances within the fund are tax exempt. Defined Benefit Pensions may have reserve components in the fund that are taxable.

Q. What is the deductible amount and how is it calculated?

A. The annual deductible amount is the Tax-Free components of the pension divided by the life expectancy factor for the pensioner.

Q. What is exempt pension income?

A. Ordinary income and statutory income that a complying SMSF earns from assets held to provide for super income stream benefits is exempt from income tax. This is referred to as exempt current pension income (ECPI).

Q. Can an existing pension be commuted?

A. Account-Based and Allocated Pensions are fully commutable and can be paid out partially or in full at any time. Transition to Retirement Income Streams cannot be commuted unless the recipient satisfies a condition of release such as turning 65, retiring from the workforce or other trigger event. The income stream then becomes a standard Account-Based Pension with full commutation rights. Market Linked Pensions cannot be commuted except within 6 months of commencement, on divorce or rollover to another complying pension.

Q. Can Defined Benefit Pensions be commuted?

A. Commuting Defined Benefit Pensions requires careful thought and experts should be consulted. Generally speaking Defined Benefit Pensions can be commuted. Complying Pensions are restricted in that the commutation value can only be commuted if a Market Linked Pension is then immediately commenced with that amount. Reserves would need to be utilised to immediately commence a Market Linked Pension or possibly Account-Based Pension. Lifetime Commutable Pensions may be able to be commuted and then commence an Account-Based Pension.

Q. What happens when a pensioner dies?

A. Subject to the terms of the trust deed and the pension documentation, if a pensioner dies while there is still an amount standing to the credit of their pension account, the trustee may be able to continue to pay the pension to a nominated reversionary or to pay a new pension or a lump sum to one or more of the deceased's dependants or a lump sum to the deceased's estate. Note, however, that the trustee must comply with a valid Binding Death Benefit Nomination.

Topdocs can assist you with every step in commencing an SMSF pension. Please contact Topdocs with any queries you may have regarding SMSF pensions on 1300 659 242.