

# SMSF PENSIONS

## **Sierp** *COPY* **Superannuation Fund**

### **Beverly Ann Sierp**

Product  
Disclosure Statement for  
Account Based Pension

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## **1. Introduction**

A member of a SMSF can generally access their superannuation benefits as a SMSF income stream or lump sum when they are retired as that term is defined in the SIS Regulations 1994. A transition to retirement income stream may be commenced at any time after preservation age even whilst working.

## **2. Corporations Act 2001**

The payment of an accounts based pension by the trustee of a SMSF is a financial product for the purposes of the Corporations Act 2001. As a financial product the Corporations Act 2001 provides as follows:

- ***Product Disclosure Statement***

In terms of the information required to be given to the member of a SMSF to make a confident and informed decision in relation to a SMSF financial product, the Corporations Act 2001, requires a licensee, their authorised representative and the trustee of a SMSF to provide a member of a SMSF with a PDS. This pension PDS has been issued by the trustee of the fund to the member seeking to commence a pension. The PDS should be reviewed by members on an on-going basis.

- ***Statement of Advice***

Section 946A of the Corporations Act 2001 requires that a client be provided with a Statement of Advice ("SoA") where they are provided with a recommendation to acquire or dispose of a SMSF financial product.

## **3. SMSF Pensions v Lump sums**

There are effectively three ways for the trustee of a SMSF to provide a member with a tax effective income in a SMSF – so careful consideration must be given to how the member chooses to take income from their fund:

### **Option One: Taking a Pension**

The trustee may pay a SMSF pension from the fund with the member's current accumulation benefits. Post 20 September 2007 there are currently two main SMSF pension types that may be paid by the trustee of the fund under the SMSF Strategies trust deed used by the fund – the transition to retirement pension and the accounts based pension.

The SMSF pension may be built with a reversionary interest meaning that upon the death of the member the pension continues on in the name of the reversionary beneficiary thereby combining SMSF pension planning and SMSF estate planning. Prior to utilising this strategy careful consideration must be had to the Superannuation Laws and who can be paid a reversionary pension and more importantly the concessional tax rates for death benefit pensions. Advice should be sought by any member seeking to put in place a reversionary pension for a spouse or other eligible dependants.

### **Option Two: Living off Lump Sums**

At the time of retirement a member of the fund may access their benefits as a lump sum. The SIS Regulations 1994 provide that a retiree member can leave their benefits in their accumulation account and draw them down gradually as a lump sum until their death. In essence income is provided as a series of lump sum withdrawals from a member's lump sum account rather than taking a pension.

### Option Three: Taking both Lump Sums and an Income Stream

Upon retirement a member of a superannuation fund can provide the bulk of their lifestyle income by way of an income stream with a lump sum only taken if and when needed. This may be in the event of a health or family crisis or an unbudgeted holiday.

With this option the strategy is for the member to hold some of their superannuation benefits in their lump sum account and some in the pension account. How much is in each account and how the lump sum and pension accounts are to be used between retirement and death is a function of three factors:

- what lifestyle income is required – remember this can be drawn down from both sides of the fund;
- the minimum pension draw down rules for the pension. If there is too much in the member's pension side of the fund, excessive income may be required to be withdrawn, thereby taking funds out of a concessional tax environment;
- where the trustee invests on behalf of a lump sum account member the fund is subject to tax at a rate of 15% on income and 10% on capital gains in respect of assets held for more than a year. In comparison income earned on assets used by the trustee to fund a pension account is tax free.

Note: There is estate and tax planning advantages to running both accounts and these should be discussed with the member's SMSF adviser.

### **4. SMSF Accounts Based Pension**

As the fund is a SMSF and the pension has commenced following the retirement of the member, the income stream generally is an account based pension. As a accounts based pension the member must take a minimum payment each year otherwise the Commissioner of Taxation has noted that the income stream would not be a pension thereby jeopardising the fund's tax exempt status on pension assets. The minimum draw down payments under the accounts based pension regulations are as follows for the 2010-2011 income year:

<b>Characteristics</b>	<b>Account based pension</b>
<b>Minimum Payment</b>	
Under 65	3%
65-75	3.75%
75-80	4.5%
80-85	5.25%
85-90	6.75%
90-95	8.25%
95+	10.5%
<b>Maximum Payment</b>	No Maximum
<b>Roll back to Lump Sum</b>	Yes
<b>Lump Sum Commutation</b>	Yes

Where a member has an accounts based pension, at any time they may elect to commute the whole or part of the pension into a lump sum. The taxation consequences of commuting to a lump sum will depend on the member's age at the time of commutation and are discussed below. On the death of the member, a SMSF Will created by the member may require the commutation of the deceased member's pension for the benefit of a dependant. The taxation consequences in relation to any SMSF estate planning and in particular a SMSF Will should be discussed with a qualified SMSF adviser.

A member may also request the trustee of a SMSF to make the pension auto-reversionary which means that the pension transfers from a deceased member automatically upon their death to a spouse, dependant or legal estate. There are a number of important reasons for ensuring that accounts based pensions are auto-reversionary.

Note: Where a member of a SMSF has an existing allocated pension they may consider rolling the pension back into their lump sum account and commence one or more account based pensions. If the member has a defined benefit pension, careful consideration of whether the pension can be rolled back and the consequences of a roll back must take place.

## **5. Taxation of Pensions**

### **5.1 Trustee of the Fund**

Where the trustee commences to pay a pension to a member – whether a transition to retirement or an accounts based pension, the trustee is entitled to a tax exemption on income and capital gains arising in relation to assets set aside to meet the fund's SMSF income stream liabilities. This is different to the lump sum stage of a SMSF where income is taxed at a rate of 15% and capital gains 10%.

Where the trustee runs a pooled investment strategy meaning the assets of the fund are pooled to pay all member benefits including pensions, then the trustee will obtain a proportional tax exemption on income and gains earned by the fund. The exemption proportion is to be determined by reference to the liabilities that the trustee faces in order to pay current pensions versus the fund's total superannuation benefit liabilities. In order to claim the exemption the trustee of the fund must engage the services of an actuary each year to determine the amount of the fund's SMSF income stream liabilities as well as its superannuation liabilities. The cost for actuarial services is commonly \$300 per annum.

In contrast, where the trustee of the fund runs a separate investment strategy for any SMSF pension (segregating assets from the rest of the fund), then any income or gains earned on these assets is tax free. The segregation of assets is a simple book keeping exercise that can be undertaken by the accountant or administrator to the fund. Importantly if the assets have accrued capital gains in the lump sum side of the SMSF, then the transfer of the assets to a separate pension investment strategy in the fund will not create a tax liability at the time of transfer. Further provided the assets funding the pension are disposed of by the trustee at the time the SMSF pension has commenced there will be no capital or income tax consequences in respect of the disposal of the assets.

As a final point where the trustee of the SMSF as part of the fund's pension assets holds Australian shares paying imputation credits, no tax is payable on the dividend. However the trustee may claim the imputation credits to reduce overall tax payable in the fund. If there are excess credits in an income year these will be refunded by the Commissioner of Taxation.

As can be seen there are significant taxation advantages in running a separate investment strategy for pension assets of the fund.

## 5.2 Pension Beneficiaries

### a) Benefits paid to a Member

The Simpler Super laws that commenced on 1 July 2007 introduced the concept of multiple superannuation interests being held by a member who has a lump sum account and at the same time commences a pension. Superannuation interests are important because from these interests flow a superannuation benefit, whether a lump sum from the member's lump sum account or a pension or lump sum from the member's pension account. These benefits when paid will have a tax free/taxable component. The proportion of tax free/taxable component is to be determined by the underlying tax free/taxable proportion of the relevant superannuation interest.

The tax free/taxable component determination is crucial as it plays an important part for a pre-60 year old member (such as a member with a transition to retirement pension) as well as for their dependants and other beneficiaries in the event of the member's death.

### b) The proportioning rule

Superannuation benefits whether taken as a lump sum or pension are to be divided by the trustee of the fund into a tax free and a taxable component. The proportion used is the same as the underlying superannuation interest from where the superannuation benefit is sourced.

For example, a 60 year old member of a complying SMSF taking a transition to retirement income stream may have a tax free/taxable component proportion equal to 40/60. Any income stream benefit taken from that superannuation interest will be 40% tax free and 60% taxable component. This will include a lump sum commutation from the pension at a later time once the member retires.

The tax free/taxable component of any lump sum or pension payment can easily be determined by your SMSF adviser or accountant at the time of commencement of the pension or when a lump sum or pension commutation amount is taken from the fund.

### c) The taxation of benefits to a member

Where a superannuation benefit is paid to a member, either as a lump sum commutation of the pension or direct pension payment it will be taxed as follows:

- **Tax Free Component** - Any tax free component payable is always tax free in their hands irrespective of their age. This includes both lump sums and income streams.
- **Taxable Component** - Table Three highlights the taxation treatment of benefits payable to a member. It should be noted that the preservation age for a person born prior to 1960 is aged 55.
- **Untaxed Component** – untaxed component is only found in SMSFs with life or self insurance and a lump sum is paid to a dependant or the member's legal estate in the event of the member's death.

Table Three – Taxation of the Taxable Component

<b>Type of Benefit</b>	<b>Under preservation age</b>	<b>Between preservation age and age 60</b>	<b>Age 60 and over</b>
Lump sum	20%	First \$160,000 is tax free with any remainder taxed at 16.5%	Tax free
Income stream	Assessable income	Assessable income + 15% tax offset	Tax free

**Note:** *The taxation of superannuation death benefits is different from that above and advice should be sought regarding SMSF Wills from a SMSF adviser.*

## **SMSF Strategies Trust Deed**

The fund's trust deed is the key determinant to what type of pension may be paid from the fund. The SMSF Strategies trust deed allows pensions to be continued where they may have been established many years ago as well as the accounts based and transition to retirement pensions of modern times. Flexibility is a must in superannuation and particularly SMSFs.

For the reference of a member seeking to commence a pension from the fund, extracted below is the key "Guide to the Pension" provisions from the SMSF Strategies trust deed.

## **SMSF Strategy Guide – Rule 25 – Simpler Super Rules**

At any time, upon satisfying a condition of release under the Superannuation Laws, a Member may seek to be paid a Superannuation Benefit from one or more of the Superannuation Interests held by the Trustee of the Fund on their behalf. However, it is not a compulsory requirement of the Fund for a Member, upon satisfaction of a condition of release, to automatically commence their Superannuation Benefit. A Member is entitled to sustain their Superannuation Interests for the benefit of their Dependants or Legal Estate in their event of their death.

There are several circumstances where a Member of the Fund can officially access their Superannuation Benefits from their Superannuation Interests. These circumstances include, but are not limited to the following:

- Temporary Incapacity and Permanent Incapacity;
- Retirement or at aged 65;
- Under Severe Financial Hardship or on Compassionate Grounds;
- When a Member reaches Preservation Age and can commence a Transition to Retirement Income Stream.

Under the Simpler Super Rules a Superannuation Income Stream includes, subject to the Superannuation Laws and the Fund retaining its complying SMSF status, a series of periodical payments created by the Trustee for the benefit of a Fund Member or any other person and shall include conditions relating to the term of the Income Stream or pension, the quantum of payments, any indexation or other factors to be applied to the periodical payments, and when or whether the Income Stream is commutable or has a residual capital value. A Superannuation Income Stream also includes, amongst other periodical payments the following (subject to the terms and conditions of a Trustee of a SMSF offering the following Income Streams under the Superannuation Laws):

- \* A lifetime complying pension [SIS Regulation 1.06(2)];
- \* An account based pension [SIS Regulation 1.03(1)];
- \* An allocated pension [SIS Regulation 1.06(4)];

- \* A market linked pension [SIS Regulation 1.06(8)];
- \* A fixed term complying pension [SIS Regulation 1.06(7)];
- \* A Simpler Super Income Stream [SIS Regulation 1.06(9A)];
- \* A non-commutable life pension [SIS Regulations Schedule 1 – Item 108];
- \* A non-commutable allocated pension [SIS Regulation 6.01(2)];
- \* A Transition to Retirement Income Stream [SIS Regulation 6.01(2)];
- \* A non-commutable pension [SIS Regulation 6.01(2)];
- \* A Temporary Incapacity Superannuation Income Stream – non-commutable income stream [SIS Regulation 6.01(2)]; and
- \* Any other pension or Superannuation Income Stream under the Superannuation Laws.