Pensions and the TBC – Issues and Strategies for our new normal

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Jemma has a Bachelor of Commerce from UWA and is a Certified Financial Planner, a Specialist Member of the Self-Managed Superannuation Professionals Association of Australia (SMSFA), Chartered Tax Adviser and Trusts and Estate Practitioner. Jemma is a regular presenter on superannuation and SMSFs for the Taxation Institute, Institute of Chartered Accountants, CPA and SMSFA across Australia, and is the author of the popular publication “SMSF Guide”, published by the Taxation Institute, currently in its ninth edition and the author and convener of the Taxation Institute’s Graduate Diploma of Applied Tax Law Advanced Superannuation Unit. She was recently named as SMSF Adviser of the Year at the 2018 National Women in Finance awards for the second year running, and the 2018 SMSF Adviser of the Year at the WA SMSF and Accounting Awards.

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Agenda

1. Transition to Retirement – why bother?
2. TRP and conditions of release;
3. Starting a retirement phase pension – tips, traps and strategies;
4. Reversionary Pension – yes, no, wider implications?
5. Pension payments greater than the minimum;

Our New Normal

- Since 1 July 2017 – Transfer Balance Cap;
  - $1.6M per taxpayer;
  - Could be multiple reportable events, or just one;
  - Translates to the proportion of the fund eligible for pension exemption;
- TRP is not as beneficial:
  - Assets not eligible for tax exemption;
  - No limit on TRP balance;
  - Still subject to 10% maximum drawdown;
  - Payments subject to tax if <60;
  - Can't classify payments as lump-sums for tax purposes.

- Estate planning:
  - TBC doesn't survive upon passing of one spouse;
  - Different treatment if reversionary or not;
  - Accumulation account of deceased MUST exit super – depending on TBC position of the spouse;
  - BDBN may not adequately address accumulation benefits;
  - Blended family considerations;
  - Asset transfer considerations;
  - Lump-sum tax considerations;
  - CGT considerations;
  - Stamp duty considerations;
  - More money = more hands = more conflict….

Transition to Retirement – Why Bother

- Definitely not as worthwhile given lack of exemption on assets;
- Works effectively for their original intended purpose:
  - Reducing employment and supplementing income;
  - "Transitioning" to retirement;
- Works well where the individual requires the regular pension payments / cashflow;
- Consider whether condition of release with a nil cashing restriction is or has been satisfied in the past to get the exemption, although then limited to TBC in pension phase, but can take out lump sums;
- Mechanism to equalise benefits between spouses;

REMEMBER – Conditions of Release

- Many people forget that for full access to benefits, or to commence a retirement phase income stream, a condition of release with a nil cashing restriction is required:
  - Between preservation age and 60 – cease gainful employment with the intention of never again being gainfully employed;
  - Between age 60 and 65 – cease an employment arrangement after age 60;
  - Age 65 is a condition of release with a nil cashing restriction.
- Exercise caution with clients:
  - Misconception that age 60 means both tax-free benefits AND the ability to take substantial benefits out of superannuation;
  - Misconception that age 60 means can be in "retirement phase".

Case Study – Pension Commencement

Jack and Marilyn

- Jack – DOB is 27 August 1957 (62 this year);
- Marilyn – DOB is 18 February 1961 (58 this week);
- Benefits in SMSF:

	Jack $	%	Marilyn $	%
Tax-Free Component	100,000	4%	100,000	11.76%
Taxable Component	2,400,000	96%	750,000	88.24%
Total	**2,500,000**	**100%**	**850,000**	**100%**

- Last NCC – July 2017 of $100,000 each;
- $25,000 CC made each year for Jack;
- Marilyn has very little income, only distributions.

- Intentions:
  - Jack to work until maybe age 65 (unless his health makes him retire earlier);
  - Equalise super as much as possible;
  - Maximise super – level of benefits, tax concessions available;

Strategy

1. Jack TRP:
   - Payments are tax-free;
   - 10% maximum - $250,000;
   - Recontribute to super for Marilyn;
2. Marilyn TRP / ABP:
   - Retirement phase available?
   - Convert some of her own benefits to tax-free component?
     - Pension from TRP – not much tax given rebate;
     - Low rate cap – tax-free if eligible to take lump sum;
   - ECPI if RP pension;
   - Multiple pensions to quarantine tax components;

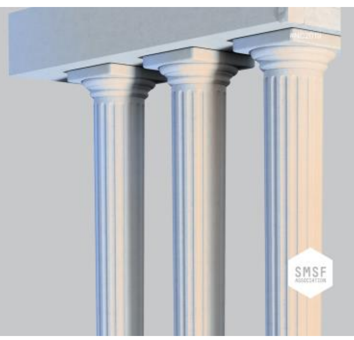
Strategy Ultimately

	Jack TRP $	Marilyn Pension #1 $	Marilyn Pension #2 $
Capital amount in pension post strategy	2,250,000	800,000	300,000
Tax-Free component	4%	11.76%	100%
Proportion of Total Super	67.16%	32.84%	

Other considerations

1. What happens when Jack satisfies a condition of release?
2. Should the pension be reversionary?

TRP to RP



From TRP to RP

- Where a member satisfies a condition of release with a nil cashing restriction, does the TRP automatically become RP pension?
- ITAA 97 Section 307-80(2):
  – Income stream is in the "retirement phase" if the person has satisfied a condition of release (ie. Retirement);
  – So, upon 'retirement', TRP becomes RP (for TBC purposes)?
- Will members be aware?
  – If they are still working after age 65?
  – Cease an employment arrangement after age 60?
  – What are the reporting requirements?

- Issue – TB Credit arises upon the member starting to "be the retirement phase recipient of a superannuation income stream" (ITAA 294-25);
- ATO has indicated:
  - Attaining age 65 – automatic TB Credit;
  - Other COR satisfied – when the Trustee is notified is when the TB Credit arises;
- Planning for clients:
  - Timing is really important;
  - Age 65 – we are likely to be on top of:
    - Running reports (that show all clients approaching 65);
    - Not many TRPs in place in any event;
  - Ceasing employment after age 60 – potentially less likely to be aware unless the client notifies us;
    - Requires written notification to the trustee, so not automatic TBCredit;
    - Generally want the underlying assets to be exempt ASAP, so would look at conversion to RP as soon as aware;

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- Other considerations:
  - What is the value (and therefore the TB Credit)?
  - Planning to ensure no excess TBC;
  - Ensuring the TB Credit is reported in time;
  - Do the conditions of the pension itself allow for it to become an ABP?
  - Or, is it still a TRP / have some TRP conditions, except now counts towards TBC and the assets (up to $1.6M) are exempt from tax?
  - What do the terms and conditions of the original pension say?
  - What are the implications for commutation?
  - Taxation components, other accumulation accounts the member has if stop and recommence?

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- Therefore, very important:
  - That we are on top of this for our clients;
  - If retirement prior to age 65, less of an issue as notification to the Trustee is the trigger, so time to restructure;
  - Also need to consider valuations, interim financials etc:
    - What is the TRP worth at the trigger date?
    - Want to keep at $1.6M maximum, so paperwork can be drafted along those lines;
    - What if the member has ABP already and TRP and approaching the trigger date?
      - Need to ensure the paperwork addresses the TRP conversion and any amounts that may be in excess of TBC at the time;

Reversionary

Reversionary or Not?

- Reversionary income stream / new income stream from deceased's accumulation / pension account is assessed against the beneficiary's own TBC;
- Reversionary:
  - 12 months from date of death to deal with before assessed towards TBC for beneficiary;
  - Value at date of death is the TBCredit;
  - Can't rollback deceased's benefit to accumulation for beneficiary;
    - Pension is commenced (but need to look at TBC);
    - Lump-sum is paid out of the fund;
  - Can rollback survivor's own benefits back to accumulation and retain deceased's pension in place (up to survivor's TBC).

- Deceased's non-reversionary pension used to start a new pension:
  - Needs to be dealt with as soon as practicably;
  - ECPI remains until the benefit is dealt with (as long as ASAP);
  - What is as soon as practicably? 6 to 12 months is about right, longer than that only where circumstances dictate / justify;
  - When the amount is dealt with and a pension commenced, that value would count towards the beneficiary's TBC;
    - Beneficiary may need to restructure before new pension commencement;
    - Value at date the benefit is dealt with is the TBCredit;

- Consider that beneficiaries effectively have 6 to 12 months from date of death to deal with a pension and restructure;
- Where their own pension and the reversionary is > TBC;
- Can't roll pension back to accumulation;
- So, what options are available when the reversionary pension and the beneficiary's own pension are > $1.6M?
  - Commute all or part of the reversionary pension and take a lump-sum;
  - Commute all of part of their own income stream/s back to accumulation;
  - Commute all of part of their own income stream/s and take a lump-sum.

Practical considerations

- Pension reverts:
  - Payments continue to the spouse;
  - ECPI continues with respect to the pension account for 12 months;
  - Have to receive minimum payments on reversionary benefit in relevant financial year;
  - Value of the reversionary income stream needs to be determined and reported to ATO potentially within 28 days after the end of the quarter of death;
  - No TBCredit until 12 months, but reportable sooner;
  - Interim financial statements at date of death?
  - Depending on their particular situation, may require interim financial statements at 12 months also to determine how much to commute of own account;

- Pension doesn't revert:
  - Payments cease - ECPI continues with respect to the pension account for "as soon as practicably";
  - Value of the income stream can be determined and action taken with an effective date of the next 30 June;
  - TBCredit is reported 28 days after the end of the quarter of the benefit being dealt with;
    - Is the value at the date being dealt with;
  - 1 July of the relevant year can be the trigger date for new pension commencement, dealing with the beneficiary's own benefits, and determining whether any lump-sums are required out of super;

Jack – Reversionary or not?

- Jack is looking to start his TRP;
- He is trying to decide whether to have his pension revert to Marilyn or not;
- What should Jack do?
- What are the pros and cons?
- Does he want it to revert for the right reasons?
  - To get the valuation benefit for TBC, not to leave benefits to Marilyn necessarily;
  - He actually wants his money to go to Jack and Pat;
  - What are the wider EP implications?

Pros	Cons
Automatically continues to be paid to the beneficiary	Minimum pension payment has to be made in the year of reversion
Reversion generally takes precedence over BDBN, so more certainty regarding who receives benefits (depends on the deed)	Is the intention that the beneficiary actually gets the money? Reversionary beneficiary may not be the intended recipient
TBC benefit – value at the date of death is the TB Credit, even though TBCredit doesn't occur for 12 months from the date of death	Administratively more cumbersome to deal with upon passing re TBC and reporting of the value – interim financial statements to report to the ATO within 28 days after the end of the relevant quarter of member passing
Retain ECPI for 12 month period of time until TBCredit arises in the reversionary beneficiary's TBC	Administratively cumbersome to restructure mid-year after the 12 months, depending on the circumstances of the individuals
	ECPI could be available for longer than 12 months (within reason)
	Could be easier to restructure effective at the next 30 June / 1 July after the date of death

- The BIGGEST consideration with reversionary is

  WHETHER THAT IS INTENDED!!
- Many pensioners set up reversionary pensions when they want the money to go to their children and not spouses – can easily result in conflict;
- Very important that clients are clear on that front – who they want to get the money;
- Tax considerations is another reason the many put in place reversionary pensions:
  - Transfer balance credit – valuation at date of death;
  - ECPI – applies for 12 months;

Pension Payments Greater than the Minimum

Pension Payments > Minimum

- Are all payments from the fund pension payments?
  - Members withdraw > minimum;
  - If they have accumulation – lump-sum withdrawal?
  - If they don't have accumulation – partial commutation?
  - Do we even bother?
    - Depends on the amount;
    - Depends on the number of actual payments;
    - What is the cost of implementing?
    - Quarterly considerations / touch point with clients.

LS from Accumulation

- Reduces accumulation as a proportion of the whole – increase in ECPI;
- If under age 60 – better outcome from a personal tax perspective;
- Paperwork to reflect withdrawal from accumulation:
  - Put in place at year start that any payments > minimum to be treated as lump-sums;
  - Will also require for each lump-sum payment;
  - Need to know accum'n balance at date of withdrawal;
  - Calc. of tax-free component depends on the proportion that TF comprises the total accum'n at w/d date;
  - No TBAR required.

Partial Commutation

- Reduces the TBA, so can retain more in pension phase when one member dies, or commence a new pension each year with commuted amount;
  - Tax component considerations;
- Procedure:
  - Paperwork to request treatment as partial commutation from pension BEFORE withdrawal;
  - Tax-free component easy to calculate – proportion at pension commencement;
  - TBAR required within 28 days after the end of the quarter of the commutation;

Jack and Marilyn

- Benefits in SMSF:

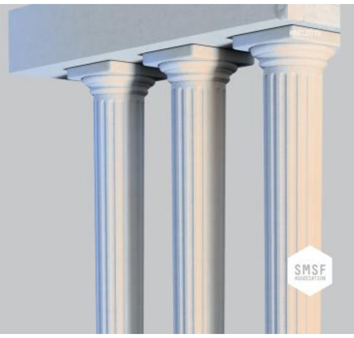
	$	Minimum $
Jack Pension	1,600,000	64,000
Jack Accumulation	650,000	-
Marilyn Pension #1	800,000	32,000
Marilyn Pension #2	300,000	12,000
Total	**3,350,000**	**108,000**

- They have both retired;
- Want to take out $200,000 per annum from the fund;
- How should the additional $92,000 be treated?

Outcome over five years (5% pa earnings rate):

1. Pension payments:
   - Exempt proportion reduces from 80.6% to 73.4%
   - Overall difference in value is ~$10,000 between options 1 and 3, so $2,000 pa. Depends on the rate of return;
   - What is the annual cost of implementation?
2. Partial commutation:
   - Exempt proportion increases from 80.6% to 88%
   - Ongoing administration, depending on the number of transactions – TBAR, commutation docs, new pension commencement;
3. Lump-sum withdrawals:
   - Exempt proportion increases from 80.6% to 92%
   - Ongoing admin, depending on the number of transactions.

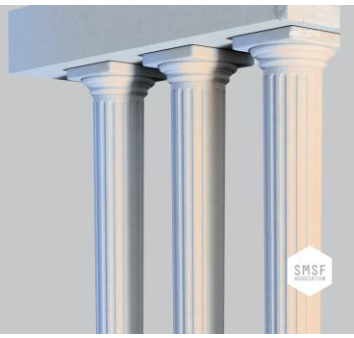
Summary



Summary

- Pensions now more than ever require additional considerations;
- Just the decision to revert or not can be significant and have widespread implications;
- We need to be educating our clients about the implications of taking money out of super greater than the minimum, where they want to optimise any exemptions;
  - Take out fewer payments, so less administration;
  - Alert us when they take additional amounts out of super;

Questions



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