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Strategies to maximise ECPI on client's assets

Melanie Dunn, Technical Services Manager, Accurium

Chris Morcom, Director / Private Client Adviser, Hewison Private Wealth

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Melanie Dunn

Melanie Dunn is Head of Technical Services at Accurium. She is a Fellow of the Institute of Actuaries of Australia specialising in Global Retirement Income Systems with over ten years' experience at Accurium in the superannuation team. Melanie has an extensive knowledge of Australia's retirement system and SMSFs, and has a passion for educating retirees and professionals about the complexities and risks faced in retirement. Melanie is a regular presenter at a number of industry leading events and also provides training and technical articles for Accurium clients and staff. Melanie specialises in complex issues such as retirement modelling, exempt current pension income, complying pensions and segregation strategies.

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Chris Morcom

Hi. I'm Chris and I've been a Private Client Adviser with independent financial planning firm, Hewison Private Wealth, since 1997. I am also an equity partner and a Director of the company.

I have considerable experience and expertise in all facets of financial planning and strategy, investment markets, superannuation and financial management. I am a SMSF Specialist Adviser (SSA®), accredited by the SMSF Association.

Aside from providing financial advice to clients, I am dedicated to continuing the professional development of our staff.

And I have a great interest in working with Not for Profit organisations and service providers to deliver superior financial solutions. I have experience in the development of tailored investment policies for Not for Profit boards including objective performance measures and implementation. I strongly believe that we all exist as part of a wider community and am passionate about ways to assist our community in positive and innovative ways.

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Traditionally ECPI was the realm of the accountant, worked out at year end as part of the annual return… this is no longer the case

Advice case studies

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- Business real property asset sale at retirement
- Starting a retirement phase income stream
- Receiving an inheritance
- Minimum pension payments and lumpy assets

Business real property asset sale

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Business real property asset sale

Bob is 64 (65 in May 19) and his wife Jane is 63 and they have an SMSF with the following and no other superannuation accounts:

SMSF asset	1 July 2018 market values
Consulting rooms	$1,200,000 (cost $800,000)
Cash & shares	$300,000
Total value	**$1,500,000**

SMSF member	1 July 2018 balance in accumulation
Bob	$1,100,000
Jane	$400,000
Total value	**$1,500,000**

Business real property asset sale

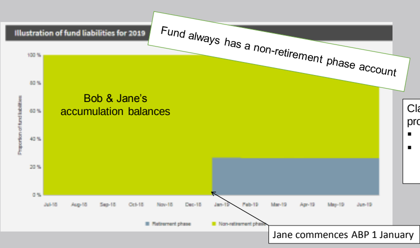
Typical advice solution:

- Start a retirement income stream for Jane at 1 January 2019 with 100% of her balance
- Pay Jane's minimum pension in June
- Start retirement income stream of Bob at 1 July 2019
- Delay property sale until both members in retirement phase

How will this fund claim ECPI and how will the income and capital gains be taxed?

- $53,000 in income expected to be received in 2018-19 (approx. uniformly over the year except for $5,850 in distributions paid at 30 June)

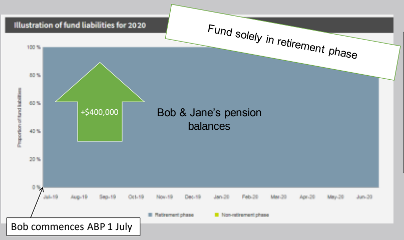
Bob & Jane's SMSF 2018-19



Claim ECPI using the proportionate method

- 13.028% exempt
- Net capital gains have the exempt income proportion apply

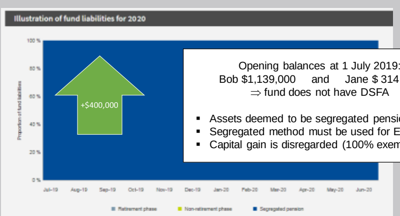
Bob & Jane's SMSF 2019-20



All capital gains and losses are disregarded

How fund claims ECPI depends on whether fund has DSFA
- If don't have DSFA: segregated method
- If do have DSFA: proportionate method

Bob & Jane's SMSF 2019-20



Opening balances at 1 July 2019:
Bob $1,139,000 and Jane $ 314,100
⇒ fund does not have DSFA

- Assets deemed to be segregated pension assets
- Segregated method must be used for ECPI
- Capital gain is disregarded (100% exempt)

Business real property asset sale

Typical advice solution:
- 13.208% of income in 2018-19 is ECPI using proportionate method
- 100% of income in 2019-20 is ECPI using segregated method
- Capital gain realised in 2019-20 is disregarded, $400,000 exempt capital gain

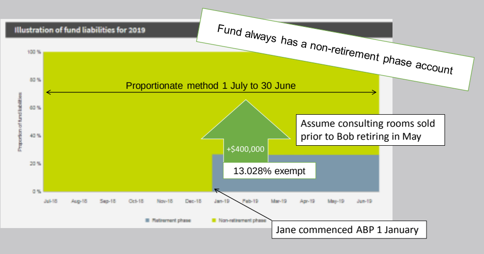
A pretty good outcome…
- No complications for fund administration or ECPI calculations
- Gain realised tax free

Strategies to maximise ECPI

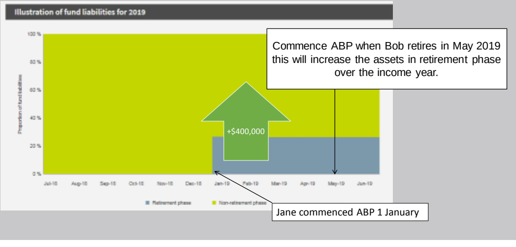
Given Bob & Jane have flexibility to time the sale of the property how would we maximise ECPI if:

1. Opportunity to sell the consulting rooms in 2018-19
2. Consulting rooms will actually be sold at a capital loss
3. Bob's balance was above $1.6million

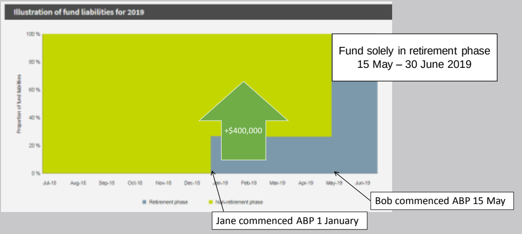
1. Sell consulting rooms in 2018-19



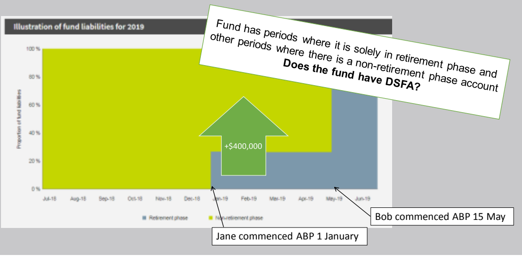
Sell consulting rooms in 2018-19



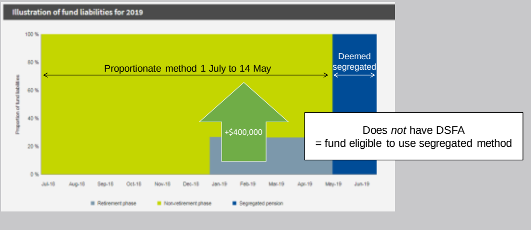
Bob commences pension in May



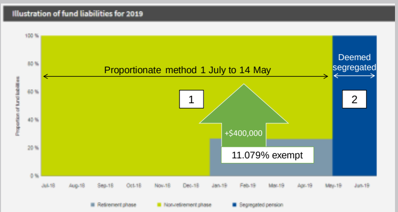
Check for disregarded small fund assets



Deemed segregation



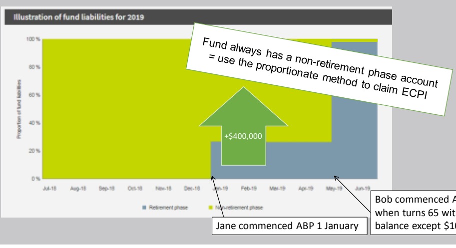
Admin headache



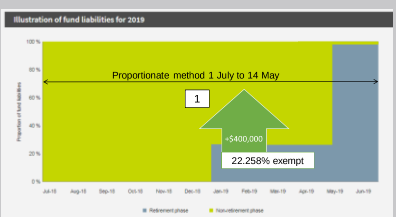
Creates two accounting periods
- Use both proportionate and segregated method for ECPI

Actuary will exclude segregated pension assets
- Results in a lower exempt income proportion applying to capital gain

Avoid a deemed period



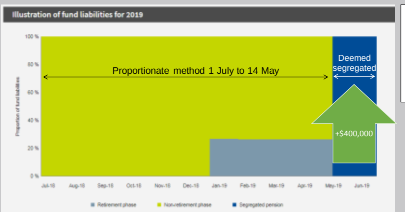
Avoid a deemed period



One accounting period
- Use proportionate method for ECPI

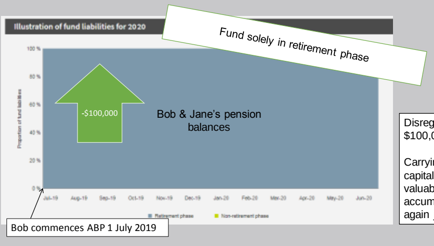
Actuary will include all retirement phase assets
- By avoiding deemed period receive higher exempt income proportion on capital gain

Defer asset sale until Bob turns 65



If we can defer sale until Bob commences ABP
- Gain will be 100% exempt in the deemed period

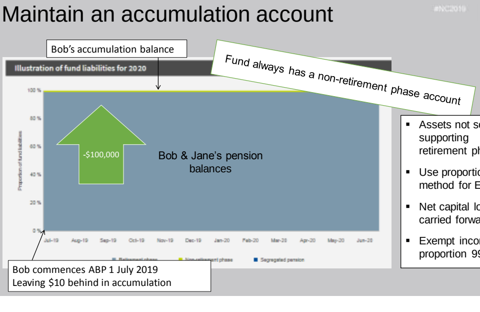
2. Consulting rooms sold at a loss



Disregarded loss = $100,000

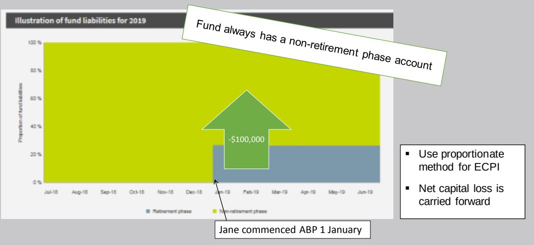
Carrying forward the capital loss may be valuable in future if accumulation members again join the fund.

Maintain an accumulation account

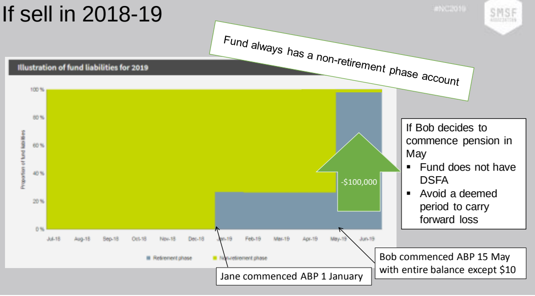


- Assets not solely supporting retirement phase
- Use proportionate method for ECPI
- Net capital loss is carried forward
- Exempt income proportion 99.999%

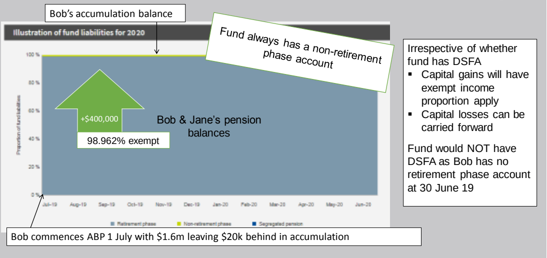
If sell in 2018-19 at a loss



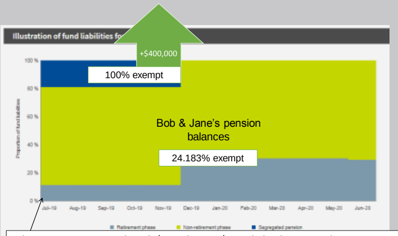
If sell in 2018-19



3. Bob's balance was $1.62m at 30 Jun 19



Elected segregation of a property



Bob commences ABP 1 July with $1.6m leaving $4.4m behind in accumulation
$1.2m property segregated to Bob

In the first year person with balance > $1.6m moves into retirement phase the fund will NOT have disregarded small fund assets

- Can use segregation
- If property is a segregated pension asset capital gain would be 100% exempt

Tips for selling assets

Questions you need to ask:

- Does the fund have DSFA? How will the fund claim ECPI?
- Will the asset sale result in a capital gain or loss?
- What other events will/have happened in the year?
- How will the capital gain or loss be treated at the moment?

Map out the fund's situation and consider whether adjusting the timing of sale, or other events in the year, could maximise the exemption on the capital gain

Starting a retirement phase income stream

Starting a retirement phase income stream

John is 64 (65 in March 2018) and his wife Margaret is 61 and they have an SMSF:

SMSF member	30 June 2017
John	$1,080,167 in accumulation
Margaret	$552,754 in retirement phase
Total value	**$1,632,921**

- John received concessional contributions of $1,035 on the 15th of each month
- John received a rollover of $96,000 on 20 April
- $69,281 in income was received in 2017-18, no material capital gains or losses
- Minimum pension payments were paid
- Fund does not have DSFA in 2017-18

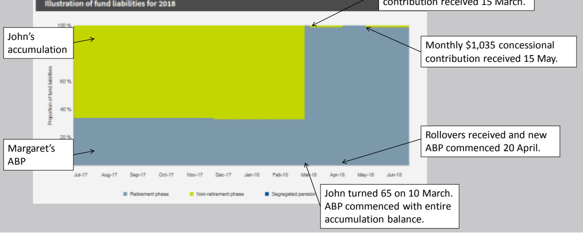
Starting a retirement phase income stream

Typical advice solution looks to maximise retirement phase balances:

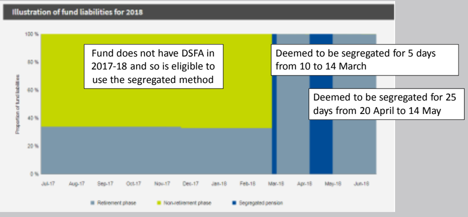
- John's entire balance moved to retirement phase on 10 March (his 65th birthday)
- John's entire accumulation balance on 20 April after the rollover is received is moved to retirement phase

Let's consider the impact of this advice…

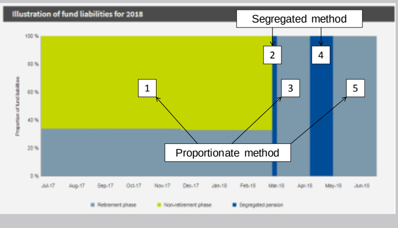
John & Margaret's SMSF 2017-18



John & Margaret's SMSF 2017-18



Admin headache

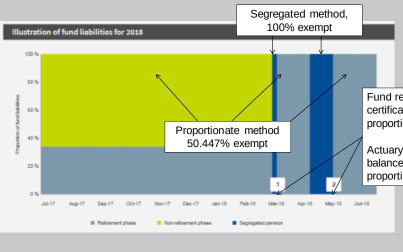


In prior years we would have used proportionate method over the entire year.

Now commencing pensions has maximised ECPI but created complexity

- 5 accounting periods
- Use both segregated and proportionate method to claim ECPI

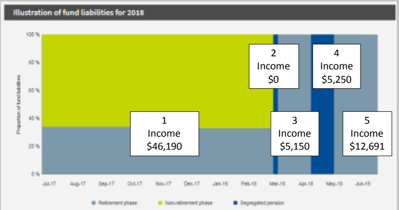
Admin headache



Fund requires an actuarial certificate to claim ECPI using proportionate method.

Actuary will request member balances at beginning of each proportionate period.

Admin headache



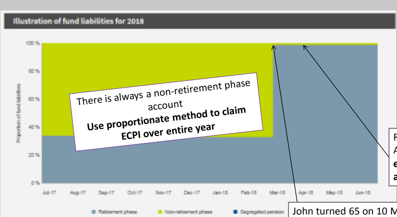
Determine income earned in each period in order to calculate ECPI

Also need to identify what expenses are distinct and severable and those which relate to the whole year and must be apportioned.

Calculating ECPI for 2017-18

- Segregated ECPI
  - ECPI = income on segregated assets = $5,250
- Proportionate method ECPI
  - Actuarial exempt income proportion = 50.447%
  - ECPI = exempt income proportion x income on assets not segregated
  - = 0.50447 x (46,190 + 5,150 + 12,691) = $32,302
- ECPI = segregated method ECPI + proportionate method ECPI = $37,552
- Assessable income = $31,729

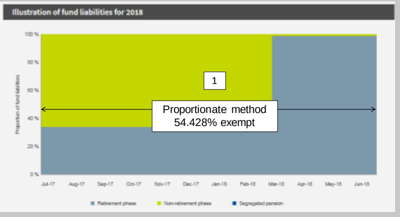
Simplifying administration



Rollovers received and new ABP commenced 20 April **except for $1,000 left in accumulation**

John turned 65 on 10 March.
ABP commenced with entire accumulation balance **except for $1,000 left in accumulation**

Simplifying administration



Have still maximised retirement phase balance but avoided complex administration

- 1 accounting period
- Use proportionate method to claim ECPI over entire year
- Actuarial exempt income proportion considers all fund assets

Calculating ECPI for 2017-18

- Proportionate method ECPI
  - Actuarial exempt income proportion = 54.428%
  - ECPI = exempt income proportion x income on assets not segregated
  - = 0.54428 x 69,281 = $37,708
- ECPI = $37,708 (with deemed periods ECPI = $37,552)
- Assessable income = $31,573

We achieved a very similar ECPI result but have vastly simplified fund administration

- Typically results are very similar when there are no large lumpy gains or losses

Tips for moving to retirement phase

Maintaining a small accumulation balance at all times can avoid deemed segregation

- Typically ECPI outcomes are very similar when there are no lumpy gains or losses
- If there is material lumpy income, capital gains or capital losses during the year then consider impact of those events vs simplified administration
- TRIS moving to retirement phase can also create a deemed period e.g. on attaining age 65, so plan ahead and consider whether to create a small accumulation balance

Don't need to apply this strategy

- Once fund fully in retirement phase for whole year
- If fund has disregarded small fund assets

Receiving an inheritance

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Receiving an inheritance

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Andrea (63) and her husband Tom (64) are permanently retired and have the following account based pensions in their SMSF and no other superannuation accounts:

SMSF member	1 July 2018 balances	Tax free proportion
Andrea	$1,310,000	88%
Tom	$ 805,000	20%
Tom	$ 400,000	100%

- Neither Tom or Andrea have made NCCs in the past 3 years
- Andrea received a $400,000 inheritance. On 4 December 2018 she made a NCC of $300,000 and a spouse contribution of $100,000 for Tom.
- Tom has started part-time work and will be receiving SG contributions of about $200 per month starting on 20th March 2019

Receiving an inheritance

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Andrea and Tom are seeking advice now on 22 February 2019 about what to do with the contributed money…

Traditional advice:

- Immediately start retirement phase income stream with the contributed amounts to maximise ECPI
- Lodge TBAR after the end of March

What is the impact on ECPI and fund administration?

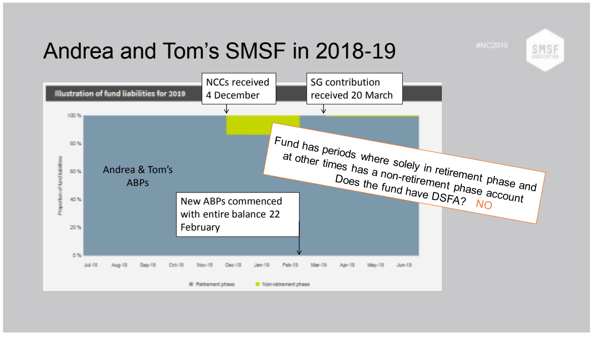
Andrea and Tom's SMSF in 2018-19
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Illustration of fund liabilities for 2019
NCCs received 4 December
SG contribution received 20 March
Andrea & Tom's ABPs
New ABPs commenced with entire balance 22 February
Fund has periods where solely in retirement phase and at other times has a non-retirement phase account
Does the fund have DSFA? NO

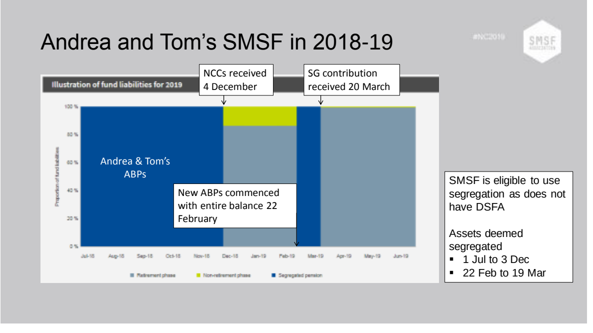
Andrea and Tom's SMSF in 2018-19
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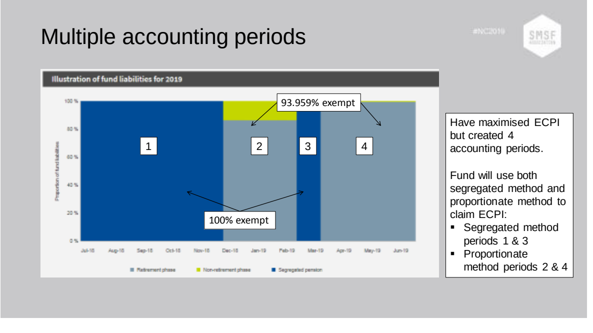
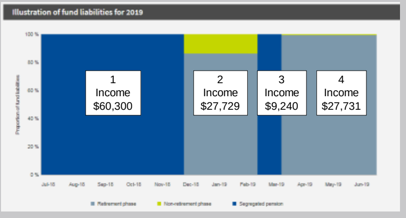
Illustration of fund liabilities for 2019
NCCs received 4 December
SG contribution received 20 March
Andrea & Tom's ABPs
New ABPs commenced with entire balance 22 February
SMSF is eligible to use segregation as does not have DSFA
Assets deemed segregated
▪ 1 Jul to 3 Dec
▪ 22 Feb to 19 Mar


Multiple accounting periods
#NC2019
Illustration of fund liabilities for 2019
93.959% exempt
1
2
3
4
100% exempt
Have maximised ECPI but created 4 accounting periods.
Fund will use both segregated method and proportionate method to claim ECPI:
▪ Segregated method periods 1 & 3
▪ Proportionate method periods 2 & 4

Multiple accounting periods



Have maximised ECPI but created 4 accounting periods.

Fund will use both segregated method and proportionate method to claim ECPI:
- Segregated method periods 1 & 3
- Proportionate method periods 2 & 4

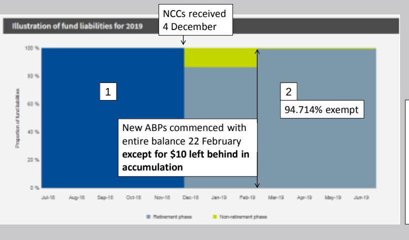
Receiving an inheritance

Segregated method
- ECPI = 60,300 + 9,240 = $69,540

Proportionate method
- Actuarial exempt income proportion = 93.959%
- ECPI = 0.93959 x (27,729 + 27,731) = $52,110

ECPI = 69,540 + 52,110 = $121,650

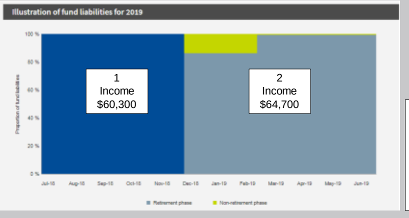
Simplifying fund administration



Avoid second deemed period in order to simplify administration
- 2 accounting periods

Fund will use both segregated method and proportionate method to claim ECPI

Simplifying fund administration



Fund will use both segregated method and proportionate method to claim ECPI:

- Segregated method period 1
- Proportionate method period 2

Receiving an inheritance

Segregated method

- ECPI = $60,300

Proportionate method

- Actuarial exempt income proportion = 94.714%
- ECPI = 0.94714 x 64,700 = $61,280

ECPI = 60,300 + 61,280 = $121,580 (previously $121,650)

Review strategy

- When Tom stops working
- If there is a material income payment or capital gain expected

Tips for simplifying administration

Plan in advice to simplify administration

- Understand client's plans for sale of assets, contributions/withdrawals, pension commencements etc in year ahead
- Map out how fund will claim ECPI and consider impact of events in the year ahead
- If don't have DSFA then maintaining a small accumulation balance at all times can avoid deemed segregation

Minimum pensions and lumpy assets

Cornelia's SMSF

Cornelia turns 85 in June 2019 and her SMSF is fully in retirement phase

- The SMSF owns a residential property worth $1.2million and has cash of $50,000
- The property is let and after costs the SMSF receives $30,000 p.a.
- In 2018-19 Cornelia's minimum pension payment was $88,000. She has drawn $40,000 and will draw the balance before 30 June.

Cornelia has $2million share portfolio outside super inherited from mother

- Re-invests dividends and does not want to sell or spend these assets
- Wants to pass this portfolio onto her daughter

Advice considerations at Feb 2019

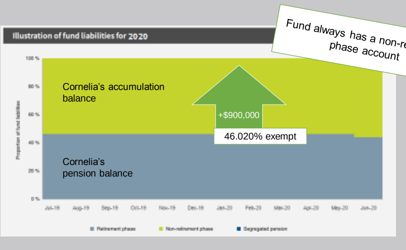
Cornelia is concerned about a few issues:

- How is she going to fund her minimum pension in 2019-20?
- She is not spending her minimums, only needing around $50,000
- Her successful property investment was purchased in 1990 for $300,000. She is considering selling but is unsure of when to do it.

Typical advice solution

1. Reduce assets in retirement phase to reduce minimum payment
   - Partially commute $652,000 to accumulation at 30 June 2019 leaving $560,000 in pension which would provide a payment of $50,400 in 2019-20
   - Keep savings in accumulation phase due to high marginal tax rate outside super
2. Sell property in the next 12 months
   - Improve liquidity in the fund and maximise exemption on capital gain

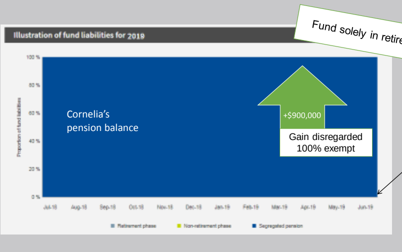
Selling in the 2019-20 year



Fund always has a non-retirement phase account

Use proportionate method to claim ECPI on capital gain

Get sale done before commutation



Fund solely in retirement phase

Cornelia commutes balance at end of day 30 June so that has $560,000 in pension at 1 July 2019.
- Fund uses segregated method for ECPI in 2018-19

Tips for selling assets for liquidity

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Understand the type of fund based on event which have occurred or will occur in the year

- If have DSFA then actuarial exempt income proportion applies and so maximise ECPI
- If don't have DSFA be aware of the impact of deemed segregation and think about how timing of transactions such a pension commutations, contributions could impact how a gain or loss is taxed

Monitor fund liquidity and avoid not meeting the minimum payments

- Fund would lose eligibility to claim ECPI, 0% exempt
- Don't sell assets in a year the fund will not meet minimum pension

It's everyone's job to understand ECPI

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To optimise client outcomes plan ahead

- Sale of assets
- Moving into retirement phase
- One-off lumpy transactions

Contact details

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Call Accurium on 1800 203 123 or email us at act@accurium.com.au

www.accurium.com.au/techhub

www.hewison.com.au