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Strategies to maximise ECPI on client’s assets

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Case studies

In the presentation the following case studies are considered to illustrate how advice decisions can impact fund administration and how the fund claims exempt current pension income (ECPI). We work through these case studies to look at strategies which can maximise a client's exempt income in light of the new rules for ECPI and segregation applying from 1 July 2017.

Case Study 1: Business real property asset sale

It is not uncommon for an SMSF to own business real property used to operate a business for one or more of the fund members. On retirement members may wish to sell the business real property and this can have significant capital gain implications. It is important to understand the new segregation rules when selling large assets in order to maximise the exempt capital gain.

Consider Bob who is 64 (65 in May 2019) and his wife Jane is 63 and they have an SMSF with the following assets at 1 July 2018:

Consulting rooms - Current value	$1,200,000	(Cost $800,000)
Cash & shares	$300,000	
Total Value	$1,500,000	

Income in the 2018-19 year is expected to be $53,000 receive approximately evenly over the year, except for $5,850 in distributions paid at 30 June.

They are both members of the SMSF, with the following benefit structure at 1 July 2018:

Bob	Current Accumulation Balance	$1,100,000
Jane	Current Accumulation Balance	$400,000

Bob operates his business out of the consulting rooms owned by his SMSF and has done so for many years.

He is planning to wind up his business in June 2019 and retire. They have personal assets external to their SMSF and will need to draw a pension at the minimum level to meet their income needs.

Jane receives taxable income from their family trust investments of around $50,000 per annum, and this will continue. She has been working part-time at a local school and has retired effective from 31 December 2018.

Bob and Jane do not wish to retain the business premises for too long after Bob's retirement as they don't want the concerns of upkeep of the property which is now aging and will need some reasonably significant updating in the next few years to optimise the rental income. They are also open to the idea of putting the property on the market now.

Case Study 2: Starting a retirement phase income stream

Those who have continued to draw a transition to retirement income stream leading up to their 65th birthday while still working present an interesting situation after their 65th birthday.

Their TRIS coverts to a retirement phase income stream on their 65th birthday, and this has implications for their SMSF ability to claim ECPI. It can also have implications for the administrative costs associated with running their fund.

The situation is the same for a client who has accumulation phase benefits, turns 65 and wishes to start a retirement phase income stream after their birthday.

Consider John, a medical professional and turned 65 on 10 March 2018. He has an SMSF with benefits in accumulation of $1,080,167 at 30 June 2017, and made concessional contributions of $1,035 on the 15th of each month over the 17/18 financial year. He also received a rollover of $96,000 on 20 April 2018.

John's wife, Margaret, is also a member of the fund and she is aged 61. She has retirement phase income stream benefits of $552,754 and her minimum pension payments were paid.

The fund received income of $69,281 in the 17/18 year and does not have disregarded small fund assets.

Case Study 3: Receiving an inheritance and retirement phase income streams

Often clients who are in receipt of retirement phase income streams can receive a substantial inheritance from older family members.

If the pensioner members are in a position to make a non-concessional contribution (NCC) to their SMSF, consideration needs to be given to ECPI calculations.

Consider Tom and Andrea who are 64 and 63 respectively. They both permanently retired around four years ago and have benefits in their SMSF – Tom's balance is $1,205,000 and Andrea's is $1,310,000. They have the following account-based pensions in place:

Member	Account Based Pension Bal	Tax Free Proportion %
Tom	$805,000	20%
Tom	$400,000	100%
Andrea	$1,310,000	88%

Tom and Andrea have made no non-concessional contributions in the past three years.

Andrea's mother died 8 months ago, and her estate has now been distributed to her 3 children equally. Andrea received $400,000 and on 4 December 2018 used the money to top up their combined super by making a NCC of $300,000 for herself and a spouse contribution of $100,000 for her husband.

In addition, Tom has started to do some part-time work, which will see him receive super guarantee contributions to their SMSF of around $200 per month starting from 20 March 2019.

They are now seeking advice (on 22 February 2019) as to what they should do with the contributed money.

Case Study 4: Minimum Pensions and lumpy assets

Many SMSFs have a large single asset such as a property and a small balance of more liquid assets (shares and cash).

These lumpy assets pose a potential problem as members age and their minimum pensions rise. Added to that is a consideration about timing for the sale of an asset to ensure the fund has sufficient cash to meet ongoing minimum pension requirements.

Consider Cornelia (who turns 85 in June 2019) has a SMSF that owns a residential property worth $1.2 million. The SMSF also has cash in the bank of $50,000. The property is let and after costs the SMSF receives $30,000 per annum.

The fund is 100% in retirement pension phase.

In the 18/19 financial year, Cornelia's minimum pension has been calculated at $88,000. She has already drawn $40,000 and will draw the balance of her minimum pension before 30 June this year.

Cornelia also has a share portfolio worth around $2 million that she inherited from her mother. She does not draw an income from this portfolio and has dividends automatically reinvested. She doesn't want to touch the portfolio as she has a strong desire that the shares are to be passed onto her daughter.

Next year Cornelia's minimum pension payments will rise to 9%. She is also not spending her minimum annual pension (she really only needs about $50,000 a year to live on these days).

Cornelia has been really happy with her property investment in the past – she purchased the property for $300,000 in 1990. But in the past couple of years she has had multiple tenants and is considering the sale of the property…but is not sure if she should do so in the current year or next financial year.

Adviser Checklist

To assist you in making decisions for SMSF clients we provide below a checklist of questions to ask yourself for some common advice scenarios which can be impacted by ECPI and segregation.

Realising capital gains or losses

- Selling business real property after retirement or selling lumpy assets to improve the liquidity position of the SMSF are common scenarios where an SMSF may realise a material capital gain or loss
- The treatment of a capital gain or loss in a year depends on how the fund claims ECPI at the time the sale occurs. Understand the type of fund based on the events which have occurred or will occur in the year.
    - What events have occurred or will occur in the year that may impact ECPI?
- Does the SMSF have disregarded small fund assets?
    - If have disregarded small fund assets, the actuarial exempt proportion income applies and so maximise ECPI to maximise exempt gain, and capital losses can be carried forward
    - If don't have disregarded small fund assets, consider how the timing of transactions such as pension commencements, commutation and contributions may create deemed segregated periods
- Capital gain or loss position on sale?
    - If a gain consider whether there is an opportunity to time sale of capital gain asset when deemed segregation applies
    - Could adjusting the time of sale or other events during the year maximise exempt income of capital gain or enable the loss to be carried forward
    - If loss and it may be useful in future (consider long term impact of Transfer Balance Cap issues for surviving member after death of their spouse), then avoid selling when fund is deemed segregated
- Issues to consider:
    - Non-SMSF member balances and whether disregarded small fund assets exist,
    - Timing of pension establishment to trigger deemed segregation,
    - Is it beneficial to leave a small balance in accumulation to avoid deemed segregation and multiple administration periods, and
    - Can elected segregation be used to isolate the property as a segregated pension asset.

Starting a retirement phase income stream

- Consider whether TRIS moving to retirement phase or starting a retirement phase income stream will create a deemed segregated period
- Maintaining a small accumulation balance can avoid deemed segregation and simplify fund administration by avoiding requirement to use both methods to claim ECPI
- If there is a lumpy gain or loss, or other material income, consider impact of those events vs simplified administration
- Don't need to worry about this strategy if:
  - The SMSF has disregarded small fund assets
  - Once the fund is fully in retirement phase for a whole year and no further contributions likely

Receiving and inheritance or other one-off contributions to the SMSF

- Receiving a one-off contribution or rollovers can create an accumulation interest in an SMSF otherwise fully in retirement phase
- Plan in advance to simplify administration
- Understand your client's plans for the sale of assets, contributions/withdrawals, pension commencements in the year, etc
- Map out how the fund will claim ECPI and consider the impact of events in the year ahead
- If don't have disregarded small fund assets, then consider maintaining a small accumulation balance to avoid deemed segregation

Minimum Pensions and lumpy assets

- Monitor fund liquidity in advance and avoid not meeting the minimum payments
  - If minimum not met, fund has ECPI of 0%
  - Therefore, don't sell assets in the year a fund will not meet its minimum pension

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