TECHNICAL SESSION 7

Pensions restructures: sail into the sunset

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Speaker
Julie Steed

Title
Senior Technical Services Manager

Organisation
Australian Executor Trustees

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Introduction

With the results of the federal election finalised, the previous government's 2021 Budget announcement of a two year amnesty to commute legacy pensions may now be awash. Even if an amnesty does eventuate, there are many strategies that practitioners can implement now that can greatly benefit clients. The April 2022 legislative changes requiring commutation of certain benefits provide further opportunity for some members to restructure their legacy pensions.

In this paper we will use a series of case studies to review:

- Changes to the commutation rules for excess transfer balance amounts – high tide to low tide!
- The issues that arise when clients die – drowning not waving!
- How reserves can be dealt with – swimming with and against the tide!

1. Non-commutable legacy pension recap

There are three types of non-commutable legacy pensions that remain in SMSFs and small APRA funds (SAFs):

- Lifetime pensions covered under SISR[1] 1.06(2)
- Life expectancy pensions covered under SISR 1.06(7)
- Market linked income streams (MLIS) covered under SISR 1.06(8)

Market linked income streams are also known as term allocated pensions (TAPs).

The three pension types are commonly called legacy pensions or complying pensions. Lifetime and life expectancy pensions are defined benefit pensions and market linked income streams are account based pensions.

Legacy pension history

When the SIS Act and Regulations were introduced in 1992 and 1993, there were a significant number of defined benefit funds run by companies and state and federal governments which offered defined benefit pensions. Over the years, the majority of these have closed to new members, in favour of account based benefits. Life offices also offered a range of annuity products covered under almost identical rules.

Legacy pensions or annuities were popular for increasing the total amount of benefits that could be paid in retirement under the old reasonable benefit limit concessions. Reasonable benefit limits were abolished from 1 July 2007.

For clients with more modest balances, legacy pensions or annuities were popular for their Social Security assets test exemptions which may have enabled clients to access the age

[1] *Superannuation Industry (Supervision) Regulations 1994*

pension. Legacy pensions or annuities that commenced prior to 20 September 2004 are 100% assets test exempt and those commenced between 20 September 2004 and 19 September 2007 are 50% assets test exempt.

A life expectancy pension loses any assets test exemption at the end of its term. However, superannuation law does not permit the pension to be commuted. At the end of the term all the remaining assets form part of the reserves.

2. Legacy pensions and the transfer balance cap

There continues to be widespread misunderstanding regarding the transfer balance cap calculations for legacy pensions. They also continue to be a significant source of excess determinations.

In addition, the recent changes to the transfer balance debit calculations have not been widely discussed.

Capped defined benefits

Special rules apply to capped defined benefits, in recognition that they generally can’t be commuted.

Capped defined benefits include:

Pension type	Capped defined benefit is commenced
Lifetime pensions	At any time
Life expectancy pensions	Before 1 July 2017
Market linked income stream	Before 1 July 2017

These rules apply to the relevant superannuation pensions in public sector, corporate defined benefit funds and in SMSFs and SAFs. If the value of a capped defined benefit exceeds a client’s personal transfer balance cap, the pension does not give rise to an excess transfer balance amount by itself.

Defined benefit income cap

Excess capped defined benefits do not cause an excess transfer balance amount. To compensate, additional PAYG tax is payable if the total capped defined benefit annual pension payments exceed the defined benefit income cap threshold.

The defined benefit income cap threshold is defined as:

$$\frac{The\ general\ transfer\ balance\ cap\ for\ a\ given\ financial\ year}{16}$$

From 1 July 2017 the defined benefit income cap was $100,000. Due to the indexation of the general transfer balance cap, this increased to $106,250 from 1 July 2021.

The threshold is pro-rated if a capped defined benefit commences part way through the year (remember that from 1 July 2017 the only new capped defined benefit pensions that can be commenced are lifetime pensions, and they cannot be commenced in an SMSF).

The super fund is required to deduct and remit PAYG tax and issue payment summaries.

The tax components are not proportional for this purpose, they are applied against the threshold in the following order

- Tax-free
- Taxable – taxed element
- Taxable – untaxed element

Component above threshold	Tax treatment
Tax-free	50% taxed at MTR
Taxable – taxed element	50% taxed at MTR
Taxable – untaxed element	Taxed at MTR with no tax offset

Defined benefit income cap example – Shelley

Shelley has a market linked income stream account balance as at 30 June 2022 of $4,000,000. Her expected pension payment for 2022/23 is $217,000 and does not have an untaxed element.

Her annual pension payment above the defined benefit income cap threshold = $217,000 - $106,250 = $110,750.

50% of the amount of excess ($110,750 x 50%) is $55,375 which will be included in her assessable income and taxed at her marginal tax rate.

Transfer balance cap credits and debits

Special value – transfer balance account credit

For lifetime pensions in defined benefit funds in an SMSFs the transfer balance account credit is the annual entitlement multiplied by 16. The annual entitlement is calculated as the entitlement to the first payment, grossed up to annual figure. This is calculated as:

$$\frac{First\ payment\ amount}{Number\ of\ days\ in\ the\ period\ for\ the\ payment}\ x\ \ 365\ days$$

For pre 1 July 2017 life expectancy pensions and market linked income stream the transfer balance account credit is:

$$The\ annual\ entitlement \quad x \quad the\ remaining\ term\ at\ 1\ July\ 2017\ (rounded\ up\ to\ the\ next\ whole\ year)$$

The annual entitlement is calculated as:

$$\frac{The\ first\ payment\ amount\ after\ 1\ July\ 2017}{Number\ of\ days\ in\ the\ period\ for\ the\ payment} \quad x \quad 365\ days$$

Special value – transfer balance account debit

Lifetime pensions

For a lifetime pension, the transfer balance account debit is the same amount as the original transfer balance account credit. The full commutation of a lifetime pension will have a zero net impact on a client's transfer balance account.

Life expectancy pensions and market linked income streams

For life expectancy pensions and market linked income streams, the special value for a full commutation debit is the special value at the date of date of commutation.

The transfer balance account debit for a partial commutation debit was originally calculated using the formula below:

$$Special\ value\ prior\ to\ commutation \quad x \quad \frac{special\ vaule\ prior\ to\ commutation}{special\ value\ after\ commutation}$$

Partial commutations are rare.

After the legislation was introduced, it was realised that the special value formula on commutation gave rise to an unintended consequence. The full commutation of a pension results in zero entitlement to future payments. The annualised payment at the date of commutation was nil therefore the transfer balance account debit was nil.

However, under super law, these pensions cannot be cashed, they can only be rolled over to another legacy pension. The 1 July 2017 credit was positive, a subsequent commutation provided a debit of nil, and the commencement of a new pension generates a transfer balance account credit. Life expectancy pensions and market linked income streams commenced on or after 1 July 2017 are not capped defined benefits, their transfer balance account credit is the account balance.

Government realised that this was not intended and implemented a legislative change to the calculation of the transfer balance account debit for capped defined benefit life expectancy pensions and market linked income streams.

The changes were legislated in June 2020 and apply retrospectively from 1 July 2017.

However, the legislated transfer balance account debit calculation was significantly different to what industry expected and very different to the original explanatory memorandum.

The debit value for the full commutation of life expectancy pensions and market linked income streams commenced prior to 1 July 2017 equals:

- The original special value credit
- Less the total amount of transfer balance account debits
  - Excluding family law split
- Less the total amount of pensions paid from 1 July 2017 to the start of financial year in which the commutation occurred
- Less the greater of
  - The sum of pensions paid during the financial year or
  - The minimum pension payment required during the financial year

Commutations that were effective 1 July 2017 should provide the same transfer balance account debit value under both methods.

However, for commutations processed since 1 July 2017, some debits will now be lower, resulting in a higher transfer balance account balance and therefore less cap space. This could result in an excess transfer balance account amount.

For some clients, the debit will now be higher, resulting in a lower transfer balance account balance and therefore more cap space.

Excess commutations amendment

The government passed Treasury Laws Amendment (Allowing Commutation of Certain Income Streams) Regulations 2022 which is effective from 5 April 2022.

The amendments require (rather than simply allow) an excess transfer balance amount to be commuted from a life expectancy pension or market linked income stream that is rolled over after 1 July 2017. The new pension commenced is not a capped defined benefit. This means there is no protection for the new account not giving rise to an excess transfer balance amount.

Clients now have the option to retain the excess amount in an accumulation account or have it paid as a lump sum. The commutation is only allowable following receipt of an ATO commutation authority. It is also important to review the fund's trust deed and pension documentation to ensure this type of commutation is permitted under the fund rules.

Excess transfer balance tax liabilities only begin from 5 April 2022. This means that clients will not accrue excess transfer balance earnings from the date the new pension commenced, only from 5 April 2022.

Importantly however, for commutations that occurred between 1 July 2017 and 5 April 2022, but which haven't yet been reported to the ATO, the excess transfer balance tax liabilities are accruing from 5 April to the date of the ATO determination. Likewise, for commutations since 5 April 2022 it is important that the fund reports promptly to minimise the excess transfer balance tax. The ATO does not have any discretion to remit excess transfer balance tax. Many market linked income streams have very large balances and any commutation will often result in large excesses. The excess transfer balance earnings compound daily at the general interest charge, which is an annual rate of 8% from 1 July 2022.

Excess commutation – Sandy

Sandy had a market linked income stream at 30 June 2017 with an account balance of $2,500,000. His 1 July 2017 transfer balance account details were:

- Annual pension $196,000
- Remaining term 15 years

Sandy's 1 July 2017 transfer balance credit special value = ($196,000/365 x 365) x 15 = $2,940,000.

Despite this being above his personal transfer balance cap of $1,600,000, he does not have an excess because the market linked income stream is a capped defined benefit.

Sandy wants to take advantage of the new commutation rules by commuting his pension on 30 June 2022 and commencing a new market linked income stream from 1 July 2022.

Sandy's pension payments have all met the minimum pension standards as follows:

Financial year	Pension payments
2017/18	$196,000
2018/19	$213,000
2019/20	$114,000
2020/21	$116,000
2021/22	$143,000
Total	**$782,000**

Sandy's transfer balance account debit is calculated as:

Calculate transfer balance account debit	Amount
Original special value credit	$2,940,000
Less total amount of TBA debits	-
Less total amount of pensions paid from 1 July 2017 to start of financial year in which commutation occurred	- $639,000
Less greater of	
• Sum of pensions paid during the financial year or • Minimum pension payment required during financial year	- $143,000 $142,349
Transfer balance account debit	**$2,158,000**

Sandy's transfer balance account and market linked income stream details are as follows:

Date	Transfer balance event	Credit	Debit	Balance	Excess	MLIS balance
01/07/2017	Original special value	$2,940,000		$2,940,000	Nil	$2,500,000
30/06/2022	Commutation debit		$2,158,000	$782,000	Nil	$2,974,000
30/06/2022	MLIS commencement	$2,974,000		$3,756,000	$2,156,000	$2,974,000
15/07/2022	Excess transfer balance earnings	$7,099		$3,763,099	$2,163,099	$2,974,000
15/07/2022	ATO release commutation		$2,163,099	$1,600,000	Nil	$810,901

Sandy will pay excess transfer balance tax of $1,064, assuming this is his first excess.

If Sandy didn't report until 28 September 2022, the excess transfer balance earnings increase to approximately $42,900, with an excess transfer balance tax of around $6,435, assuming this is his first excess.

Importantly, the ATO Commissioner has no discretion to remit transfer balance tax accrued by an individual.

As a result of the commutation, Sandy no longer has a capped defined benefit and PAYG tax does not apply for payments above the defined benefit income cap. Without the commutation, Sandy would have $27,301 included in his assessable income and taxed at his marginal tax rate.

His exempt current pension income will reduce and this needs to be compared with the reduction in PAYG tax, which will depend on his personal tax situation.

Each client's circumstances need to be individually considered.

3. Legacy pensions and death

The treatment of legacy pensions on death is not always well understood and the rules are not particularly intuitive, so they often cause issues for SMSF trustees. The following table summarises the treatment of legacy pensions on death:

Pension type	Reversionary	Non reversionary
Lifetime	Payments continue to reversionary pensioner No death benefit if pensioner dies after life expectancy or 20 years	No death benefit Remaining capital forms unallocated reserve
Life expectancy	Payments continue to reversionary pensioner	Payments can continue for remainder of the pension's term May commute the Schedule 1B amount Remaining capital forms unallocated reserve
Market linked income stream	Account balance available to pay pension and/or lump sum[2]	Account balance available to pay pension and/or lump sum

Lifetime pension

A lifetime pension ceases upon the death of the reversionary pensioner. Any remaining capital forms an unallocated reserve.

A lifetime pension also has no death benefit payable as a commuted lump sum to a reversionary pension if the pensioner dies after the earlier of their life expectancy at commencement or 20 years. This is often misunderstood in an SMSF. For example, if Neptune commenced a reversionary lifetime pension on 1 July 2003, his pension can continue to be paid to his reversionary pensioner following his death. However, the reversionary pension cannot be commuted if Neptune dies after 1 July 2023.

An extract of the relevant section of SISR 1.06(2)(e)(ii) is replicated below:

[2] Lump sum is not available if the pension term is based on the reversionary pensioner's life expectancy

1.06 Meaning of pension (Act, s 10) (2) Rules meet the standards of this subregulation if they ensure that: (a) the pension is paid at least annually throughout the life of the primary beneficiary in accordance with paragraphs (b) and (c) and, if there is a reversionary beneficiary: (i) throughout the reversionary beneficiary's life; or (ii) n/a (iii) n/a (e) the pension cannot be commuted except in any of the following circumstances: (i) n/a (ii) the commutation is made to the benefit of a reversionary beneficiary on the death of the primary beneficiary and within one of the following periods after the commencement day of the pension: (A) if the primary beneficiary's life expectancy on the commencement day, rounded up to the next whole number, is a period less than 20 years—that period; (B) in any other case—20 years;

A non-reversionary pension could also exist where a pension was established as a reversionary pension but the reversionary pensioner pre-deceased the pensioner.

Life expectancy pension

Where a life expectancy pensioner with a non-reversionary pension dies, an eligible beneficiary can continue to receive pension payments for the remainder of the term. A lump sum death benefit can be paid and Schedule 1B of the SISR prescribes the factors that are used to determine the amount of the commutation. The remaining capital forms an unallocated reserve.

Commuting a lifetime pension

In many instances there are incentives to commute a lifetime pension to a market linked income stream and make the new pension non-reversionary. A new non-reversionary market linked income stream allows a surviving spouse to receive the full balance as a lump sum death benefit. Reversionary market linked income streams can't be commuted other than to another market linked income stream.

Death benefits tax example – Sandy

Sandy is a widower and he expects his adult daughter Marina to receive his death benefit. His benefits are 60% taxable component and 40% tax-free component.

Commuting his capped defined benefit market linked income stream to a new market linked income stream within the SMSF allows Sandy to remove $2,163,099 from superannuation where it will be taxed as a death benefit to his daughter to a death benefit tax-free environment.

The difference to Marina is illustrated in the following table:

	Capped DB MLIS	New MLIS & outside super		Difference
Account balance	$2,974,000	$810,901	$2,163,099	Nil
Taxable component	$1,784,400	$486,541	n/a	- $1,297,859
PAYG tax	$303,348	$82,712	n/a	- $220,636
Net benefit	$2,670,652	$728,189	$2,163,099	$220,636

4. Legacy pension reserves

Lifetime and life expectancy pensions were generally established under rules whereby clients exchanged their accumulated capital amount for a promise to pay a future income stream. As such, each member does not have an account balance attributed to them. This applies even in a single member, single pension SMSF.

Each year the fund actuary determines the amount that is supporting the future promise to pay pensions. The investment returns on this amount are exempt current pension income.

Any balance is a reserve that is not solely supporting a pension and is not eligible for exempt current pension income.

Allocations from reserves

Allocations from a reserve that are 5% or more of a member's account balance can be allocated to a members' accumulation account each year. The allocation must be made in a fair and reasonable manner. An amount allocated from the reserve that is less than 5% of a member's account balance does not count towards the member's concessional contributions cap. An allocation from the reserve at 5% or greater will count towards the member's concessional contributions cap. The amount is not a concessional contribution, so the member does not have to meet a work test. It is not taxed at the fund level, it simply counts towards the member's concessional contribution cap.

Clients may also have a concessional contribution cap that is higher than the standard annual cap if they are eligible to use the concessional contribution five year carry forward. This requires clients to have a total super balance at the previous 30 June of less than $500,000.

Many SMSFs have built up considerable reserves due in many instances to the investment decisions of the member exceeding the actuarial expectation made when the pension commenced (over 16 years ago!). Accordingly, the allocation process can take a long time. Alternatively, it can result in excess contributions tax.

If a member dies with a reserve, it can be distributed to other members of the fund. However, the less than 5% maximum or having it count toward the concessional contributions cap rules still apply.

5. Commutation of lifetime or life expectancy pension

There are already several reasons clients would consider commuting a lifetime or life expectancy pension. A primary concern is in relation to the death of a member and the remaining capital on death forming an unallocated reserve.

For many clients, including the balance of the assets and reserves supporting the pension may no longer affect their Social Security entitlements. Alternatively, the assets test exemption may already have been lost if the pension has failed the high probability test. For life expectancy pensions the assets test exemption may already have been lost if the life expectancy term has expired.

Moving to a market linked income stream may also provide greater flexibility of pension payments.

Other clients would prefer access to their capital, in many instances to fund entry into aged care.

For others, their interest and/or ability to manage trustee responsibilities has significantly diminished and the commutation to a market linked income stream may offer an opportunity to rollover to a retail offering and close the SMSF.

Consequences of commutation

When a capped defined benefit in an SMSF is commuted after 1 July 2017 it is generally commuted to commence a market linked income stream, which will no longer be a capped defined benefit.

PAYG does not apply for payments above the defined benefit income cap which will result in a PAYG saving.

Where an excess transfer balance amount arises, the excess amount can be retained in accumulation phase and there may be a reduction in exempt current pension income. This will be the case for the commutation of a market linked income stream to commence a new market linked income stream. However, for the commutation of a lifetime or life expectancy pension to a market linked income stream, any change in exempt current pension income will depend upon the level of reserves in the pension.

There may be advantages for clients who expect their death benefit to be paid to adult children. The excess transfer balance amount commutation legislation can now allow clients to move assets that will be subject to a death benefit PAYG tax rate of 17% out of super where no PAYG tax will be payable.

Actuarial requirements

Lifetime and life expectancy pensions are required to meet the high probability test annually to retain any Social Security assets test exemption.

This test requires that the fund actuary can certify that there is a high degree of probability (generally above 70%) that the fund will be able to pay the pension as required by the fund rules.

Where a fund's actuary cannot certify that the fund meets the high probability test, the pension will lose its assets test exemption.

The fund actuary is also required to determine the fund's solvency position and declare that the fund is in a satisfactory financial position. This commonly requires the actuary to determine there is at least a 50% probability that the fund will be able to pay the pension as required by the fund rules.

Where a fund fails the solvency requirements, the trustee is required to prepare a plan to return the fund to a solvent position or wind the fund up. Unlike a corporate or state or federal government defined benefit fund, there is no ability for an SMSF to have an employer sponsor make additional contributions to the fund and there is no ability to add capital to the pension. Accordingly, in an SMSF winding-up the pension is generally the only option. If there are multiple members and/or pensions and accumulation accounts, it may be possible to only wind-up the insolvent pension and retain the remaining benefits in the SMSF.

However, the only option to rollover a legacy pension is to a retail market linked income stream or life office annuity, and these are becoming increasingly difficult to source. In some instances, the only option may be to commence a market linked income stream in the SMSF.

Legacy pensions wind-up options

Where a legacy pension needs to be wound up there are limited commutation options under super law. In addition, there are Social Security consequences, as outlined in the following table:

Pension type	Super options	Centrelink treatment
Lifetime commenced	Rollover to complying annuity	Retain 100% ATE
pre 20/09/2004	Rollover to MLIS	Lose ATE
Lifetime commenced	Rollover to complying annuity	Retain 50% ATE
20/09/2004 - 31/12/2005	Rollover to MLIS	Lose ATE or retain 50% ATE if additional condition met
Life expectancy commenced	Rollover to complying annuity	Retain 100% ATE
pre 20/09/2004	Rollover to MLIS	Lose ATE
Life expectancy commenced	Rollover to complying annuity	Retain 50% ATE
20/09/2004 - 31/12/2005	Rollover to MLIS	Lose ATE or retain 50% ATE if additional condition met

Additional conditions to retain 50% assets test exemption

The additional conditions to retain a 50% assets test exemption are contained in the Social Security Guide 4.9.2.17. Importantly, these only apply to assets test exempt pensions purchased from 20 September 2004 that are rolled over to a new lifetime, life expectancy or market linked income stream.

One additional condition is that a lifetime or life expectancy pension has failed the high probability test.

Another is that an SMSF member has died, and the administrative responsibilities of the fund have become too onerous due to the age or incapacity of a trustee.

Both additional conditions are only allowable once and clients should retain documentation supporting the additional condition.

6. Commencing a market linked income stream

It is becoming increasingly difficult to source retail legacy pension or annuity offerings. In future, many SMSFs looking to commute a lifetime, life expectancy or existing market linked income stream may only have the option of commencing a new market linked income stream in the SMSF. The fund’s trust deed will need to be reviewed to ensure that members are able to commence this type of income stream.

The purpose of a market linked income stream is to provide a pension, paid at least annually for the required payment term. This type of pension is designed to last for a specific term, based on a client’s life expectancy, and to have a zero capital balance at the end of the term.

Term of the market linked income stream

When a market linked income stream is commenced, the pension term is determined at the time of commencement. There is some flexibility regarding the term, but once chosen, it is fixed for the life of the pension. It is not relevant what any term or life expectancy of the previous pension was. In some instances, this will provide clients with the opportunity to select a shorter term which will exhaust the pension sooner. In some instances though, the improvement in longevity, as reflected in the Government Actuary’s life expectancy tables will result in a longer term being required.

For market linked pensions commenced from 1 January 2020, the 2015-2017 life expectancy tables are used.

The terms that can be chosen can be based on:

- Life expectancy
- Life expectancy as if five years younger
- The difference between current age and 100

If the pension is reversionary and the reversionary beneficiary has a longer life expectancy, the term can be based on the life expectancy choices above of the reversionary beneficiary. The life expectancies are rounded up to the nearest whole number.

How the pension is calculated

The pension amount is calculated by dividing the account balance by the appropriate payment factor, rounded to the nearest $10.

The payment factor depends on the length of the term remaining, and the term of the pension is determined from a life expectancy range set by government tables.

Once the actual amount is calculated, it can then be varied by plus or minus 10 per cent. Where the standard account based pension minimum percentages are reduced (ie 50% reduction for 2019/20, 2020/21, 2021/22 and 2022/23) these reductions also apply to the market linked income streams. This means that the benefit can be reduced to 45% of the standard amount calculated.

The annual pension payment is pro-rated in the year of commencement and no annual pension payment is required if the pension commences in June.

Commutations

Once commenced, a market linked income stream cannot be commuted except:

- if the benefit resulting from the commutation is transferred directly to the purchase of another legacy pension product
- if the commutation is required to pay superannuation contributions surcharge or a family law split
- if the commutation is required to comply with a commutation authority
- on death

Market linked income stream factors

The following table is an extract from the 2015-2017 life expectancy tables for clients commencing a market linked income stream from 1 January 2020:

Life expectancy tables2015 - 2017			Available terms From 1 January 2020			MLIS payment factors	
Age	Male	Female	Age	Male	Female	Term remaining	Payment factor
70	15.90	18.18	70	16 – 30	19 – 30	24	16.06
71	15.14	17.35	71	16 – 29	18 – 29	23	15.62
72	14.39	16.53	72	15 – 28	17 – 28	22	15.17
73	13.66	15.73	73	14 – 27	16 – 27	21	14.70
74	12.95	14.93	74	13 – 26	15 – 26	20	14.21
75	12.25	14.15	75	13 – 25	15 – 25	19	13.71
76	11.57	13.39	76	12 – 24	14 – 24	18	13.19
77	10.90	12.64	77	11 – 23	13 – 23	17	12.65
78	10.25	11.90	78	11 – 22	12 – 22	16	12.09
79	9.63	11.18	79	10 – 21	12 – 21	15	11.52
80	9.02	10.49	80	10 – 20	11 – 20	14	10.92
81	8.44	9.81	81	9 – 19	10 – 19	13	10.30
82	7.89	9.16	82	8 – 18	10 – 18	12	9.66
83	7.36	8.54	83	8 – 17	9 – 17	11	9.00
84	6.86	7.94	84	7 – 16	8 – 16	10	8.32
85	6.39	7.37	85	7 – 15	8 – 15	9	7.61
86	5.95	6.86	86	6 – 14	7 – 14	8	6.87
87	5.54	6.32	87	6 – 13	7 - 13	7	6.11

Commencing a market linked income stream – Coral

Coral is the sole member of the Calm Sea SMSF. She is 82 and has a lifetime pension which commenced on 1 July 2003. She is concerned about the remaining capital on her death being forfeited to reserves, which will happen any time after 1 July 2023. She will commence a market linked income stream in her SMSF on 1 October 2022.

Her 1 July 2017 first pension payment was an annual payment of $150,000. The value of the assets supporting the pension and the reserves on 1 October 2022 are $1,400,000.

Coral's 1 July 2017 transfer balance credit special value = ($150,000/365 x 365) x 16 = $2,400,000. Despite this being above her personal transfer balance cap of $1,600,000, she does not have an excess because the lifetime pension is a capped defined benefit.

Coral's transfer balance account debit equals her transfer balance account credit of $2,400,000.

Coral's transfer balance account and market linked income stream details are as follows:

Date	Transfer balance event	Credit	Debit	Balance	Excess
01/07/2017	Original special value	$2,400,000		$2,400,000	Nil
01/10/2022	Commutation debit		$2,400,000	Nil	Nil
01/10/2022	MLIS commencement	$1,400,000		$1,400,000	Nil

As a result of the commutation, Coral no longer has a capped defined benefit and PAYG tax does not apply for payments above the defined benefit income cap.

Coral is 82 on 1 October 2022 and is starting a market linked income stream with $1,400,000. Coral can choose a term between 10 years (her life expectancy) and 18 years (to age 100).

Life expectancy tables 2015 - 2017		
Age	Male	Female
82	7.89	9.16

Available terms From 1 January 2020		
Age	Male	Female
82	8 – 18	10 – 18

MLIS payment factors	
Term remaining	Payment factor
10	8.32

Coral chooses the shortest possible term of 10 years, and her payment factor is 8.32.

Her pension payment for 2022/23 is calculated as $1,400,000 / 8.32 = $168,270 (rounded to the nearest $10). Coral can then increase the payment by up to 10% being $185,097. This amount is then prorated for the remainder of the financial year $185,097 x 273 / 365 = $138,443.

7. Proposed amnesty

In the May 2021 Federal Budget, the former government announced a proposal to allow legacy pensions to be commuted. It was proposed that the legacy pensions could be rolled back to accumulation phase. From there the funds could stay in accumulation, be used to start an account based pensions or withdrawn from super.

The proposal was to allow an amnesty for two years. It was not intended to be compulsory for clients to commute a legacy pension but many clients and practioners are keen to cease these arrangements which are no longer fit for purpose.

It is also not intended that there will be any Social Security concessions, the event of rolling back to accumulation will result in any assets test exemption being lost.

It is unclear what the new government's views on a legacy pension amnesty are.

8. Conclusion

There remain many misunderstandings in relation to the calculations of legacy pension transfer balance account credits and debits. Practitioners can assist their clients navigate this complex topic and avoid excess transfer balance determinations.

Dealing with legacy pension death benefits and reserves takes complexity to a new level, particularly given that many practitioners will only ever have a very small number of clients with legacy pensions. Seeking assistance from other professionals, including the SMSF's actuary may assist to provide superior outcomes for clients.

9. Disclaimer