SMSF Manual

A simple guide to Self Managed Superannuation Funds

**EXTRACT:** Chapter 7: Superannuation benefits

2017
A Tax and Super Australia publication.

Brought to you by your trusted and experienced team at Tax and Super Australia: Lisa Greig, Gabriella Rusu, Denys Smerchanskyi and Roseann Tanner.

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Our tax and super landscape is constantly changing.

**Tax and Super Australia** has the agility and expertise to provide you with accurate Australian tax and SMSF guidance through all its ongoing complexities.

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Impact of the impending Superannuation legislation

These are indeed uncertain times for superannuants.

The proposed superannuation reform measures announced in the 2016-17 Federal Budget has been a polarising issue for the Government, Labor Opposition and the community alike.

The return of the Coalition Government with a narrow majority following the Federal Election now means that there is even less certainty for superannuants in planning for their retirement. As such, speculation on the final form of any proposed measure will only exacerbate the current uncertainty.

Therefore, this edition of the SMSF Manual 2017 only contains measures which, at the time of writing, has been enacted. This should provide you with much needed certainty.

Stay up-to-date with the latest changes to the superannuation law by visiting our dedicated SMSF Toolkit at: www.taxandsuperaustralia.com.au/SMSFtoolkit

For digital users, the digital edition of the SMSF Manual 2017 is updated quarterly to reflect any measures which are ultimately enacted. The print copy is updated annually.

All legislation contained in the manual is current as at 7 October 2016.
Your online SMSF toolkit

All your online SMSF resources in one place.

For your convenience, we have consolidated all your SMSF resources in one place. Visit www.taxandsuperaustralia.com.au/SMSFtoolkit

These resources include:

• SMSF forms and templates
• Rates and thresholds guides
• Checklists
• Sample SMSF deeds and documentation
• Latest changes and updates to the superannuation law and ATO guidance
• Case study: sample superannuation fund, and
• Other contemporaneous documents.
| Glossary |
|-----------------|-------------------------------------------------|
| **ABN** | Australian Business Number |
| **ABP** | Account based pension |
| **ABR** | Australian Business Register |
| **ADF** | Approved deposit fund |
| **AMIT** | Attributable managed investment trust |
| **APRA** | Australian Prudential Regulation Authority |
| **ASF** | Australian superannuation fund |
| **ATO** | Australian Taxation Office |
| **AWOTE** | Average weekly ordinary time earnings |
| **BAS** | Business activity statement |
| **BDBN** | Binding Death Benefit Nomination |
| **BRP** | Business real property |
| **CC** | Concessional contribution |
| **Commissioner** | Commissioner of Taxation |
| **CRA** | Compulsory release authority |
| **CSF** | Complying superannuation fund |
| **DBD** | Death benefit dependant |
| **ECCC** | Excess Concessional Contributions Charge |
| **ECPI** | Exempt current pension income |
| **ECT** | Excess non-concessional contributions tax |
| **EPoA** | Enduring Power of Attorney |
| **GCS** | Government co-contribution scheme |
| **GIC** | General interest charge |
| **GPA** | General power of administration |
| **IAS** | Income activity statement |
| **ITAA97** | Income Tax Assessment Act 1997 |
| **ITAA36** | Income Tax Assessment Act 1936 |
| **ITAR97** | Income Tax Assessment Regulations 1997 |
| **ITAR36** | Income Tax Assessment (1936 Act) Regulation 2015 |
| **ITRA86** | Income Tax Rates Act 1986 |
| **LISC** | Low income superannuation contributions |
| **LPR** | Legal personal representative |
| **LRBA** | Limited recourse borrowing arrangement |
| **LVR** | Loan value ratio |
| **MCS** | Member contribution statement |
| **MTR** | Marginal tax rate |
| **NALI** | Non-arms length income |
| **NANE** | Non-assessable non-exempt |
| **NCC** | Non-concessional contribution |
| **NOA** | Notice of assessment |
| **PDS** | Product Disclosure Statement |
| **PST** | Pooled superannuation trust |
| **RESC** | Reportable employer superannuation contributions |
| **RITC** | Reduced income tax credit |
| **RSA** | Retirement savings account |
| **RSE** | Registrable superannuation entity |
| **RSF** | Retirement Savings Fund |
| **SAF** | Small APRA fund |
| **SAPTO** | Seniors and pensioners tax offset |
| **SCS** | Superannuation contributions splitting |
| **SCSA** | Superannuation contributions splitting application |
| **SDB** | Superannuation death benefits |
| **SDBIS** | Superannuation death benefit income stream |
| **SDBLS** | Superannuation death benefit lump sum |
| **SFLU** | Super Fund Lookup |
| **SG** | Superannuation Guarantee |
| **SGC** | Superannuation Guarantee Charge |
| **SGAA92** | Superannuation Guarantee (Administration) Act 1992 |
| **SIC** | Shortfall interest charge |
| **SIS Act** | Superannuation Industry (Supervision) Act 1993 |
| **SIS Reg** | Superannuation Industry (Supervision) Regulations 1994 |
| **TFN** | Tax file number |
| **TPD** | Temporary or permanent disability |
| **TTR** | Transition to retirement |
| **UIGE** | Unrelated interposed geared entity |
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# 7: Superannuation benefits

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7.000 Overview

The main provisions governing the taxation of superannuation benefits can be found in Divisions 301 to 307 ITAA97. Overall, the taxation treatment depends mainly on the following factors:

- the age of the recipient
- form of the superannuation benefit – income stream or lump sum, and
- whether the benefit is a life benefit or a death benefit.

Generally, superannuation benefits are taxed concessionally as compared to other income.

Before superannuation benefits can be paid to a member a number of conditions must be met in relation to preservation and cashing. These conditions of release are listed in Schedule 1 of the SIS Regulations.

7.050 When are superannuation benefits payable?

The following are the primary events that give rise to a release of superannuation benefits.

- transition to retirement
- retirement
- total and permanent disability
- terminal illness, and
- death.

Other reasons include limited access due to financial hardship and these are covered later at 7.205. In addition, a temporary resident departing Australia permanently may also cash their benefits.

How are benefits paid?

When benefits are paid by a superannuation fund they may be received by the member or in the case of death benefits by one or more beneficiaries, and depending on the circumstances may be paid as one or more lump sum payments or as one or more income streams.

Section 307-65 ITAA97 defines a superannuation lump sum as a superannuation benefit that is not a superannuation income stream benefit.

A superannuation income stream benefit is defined in s307-70 ITAA97 to be a superannuation benefit specified in the regulations that is paid from a superannuation income stream.

The term superannuation income stream is defined in r995-1.01 ITAR. It is a pension or annuity paid in accordance with subregulations 1.06(1) and 1.05(1) SIS Reg. It also includes a pension paid in accordance with Retirement Savings Account Regulations 1997 subregulation 1.07(1). These definitions include pensions and annuities existing as at 1 July 2007, as well as those starting under the new rules.

The definition of an annuity in r1.05(1) SIS Reg requires the annuity to be purchased with the whole or part of a rollover superannuation benefit or a directed termination payment. Therefore an annuity purchased with non-superannuation money is not a superannuation income stream.
7.100 Preservation age

Preservation rules are in place to ensure that all of a member’s retirement savings are maintained in the superannuation environment for at least the period until the member has retired or has met a condition of release and accessed their benefits.

Preservation age is the minimum age at which a superannuation fund member may fully access their superannuation benefits if they retire permanently from the workforce.

It is also the age at which a transition to retirement may commence.

Preservation age is currently 55 and is legislated to increase incrementally by one year for each year the date of birth of the member happens after 1959-60.

Those born in the four intervening years have a preservation age as shown in the preservation age table below. The table shows the financial year of birth.

Preservation age table

The table below shows preservation age as a function of date of birth.

<table>
<thead>
<tr>
<th>Date of birth</th>
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<tr>
<td>Birthday before July 1960</td>
<td>55</td>
</tr>
<tr>
<td>Birthday July 1960 to June 1961</td>
<td>56</td>
</tr>
<tr>
<td>Birthday July 1961 to June 1962</td>
<td>57</td>
</tr>
<tr>
<td>Birthday July 1962 to June 1963</td>
<td>58</td>
</tr>
<tr>
<td>Birthday July 1963 to June 1964</td>
<td>59</td>
</tr>
<tr>
<td>Birthday after June 1964</td>
<td>60</td>
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</tbody>
</table>

Superannuation entails contributions being directed into a tax advantaged structure while the member is working or is in a position to save and make contributions to super. While these contributions are intended to grow through investment earnings and further contributions, the account reflects the preservation status of the benefits held.

A superannuation account must also have a measure of its tax-free and taxable components. These are dealt with separately at 7.600. These tax components should not be confused with the preservation components of the account that determine accessibility of the superannuation benefits.
7.200 Preservation components

All contributions and investment earnings received by a fund are categorised as preserved benefits. This is a continuation of a long-standing rule that has been in place since July 1999. Since this was not always the case, different rules applied in the past and these were grandfathered in respect to the release of benefits. As a result, a member's account balance may be notionally split into a number of “preservation components” reflecting the previous preservation status of portions of the account.

Some benefits may be available for release, based on previous rules, while the remainder is preserved. Other benefits may be partially preserved and require a further condition of release before full access is possible.

In order to accommodate this mix of preservation components, the following preservation categories apply:

- preserved benefits
- restricted non-preserved benefits, and
- unrestricted non-preserved benefits.

7.210 Preserved benefits

Preserved benefits are contributions made under an award or agreement typically superannuation guarantee (SG) contributions.

As noted above, all contributions (including salary sacrifice contributions and those made from post-tax savings for which a tax deduction is not claimed) made to superannuation from 1 July 1999 (including all investment earnings from benefits in the account) are preserved and are therefore not available for access until a condition of release occurs.

7.220 Restricted non-preserved benefits

Restricted non-preserved benefits are typically undeducted contributions made before 1 July 1999 plus all earnings of those contributions received before 1 July 1999. They may also include certain redundancy payments made on 1 July 1999.

These benefits can be accessed subject to any of the above conditions of release including when the member leaves on termination of gainful employment from an employer who had (or any of whose associates had) at any time contributed to that fund for the member.

No age restrictions apply to this condition of release.

7.230 Unrestricted non-preserved benefits

Unrestricted non-preserved benefits have already met a condition of release but are still in the superannuation system; but they haven’t yet been paid out. They may be accessed at the member’s discretion. They might include pre-1 July 1999 personal post-tax contributions for which a deduction was not claimed or benefits that were previously restricted non-preserved, associated with pre-July 1999 service that has been reclassified into this category (unrestricted non-preserved benefits) when the member’s employment with the associated employer ceases.
7.240 Voluntary cashing of benefits

Voluntary cashing occurs when the member meets a condition of release and receives access to their benefits from superannuation.

The following questions need to be considered in relation to voluntary cashing of benefits from an SMSF:

• The preservation status of the benefit involved. Is it preserved, restricted non-preserved or unrestricted non-preserved?
• Has the member satisfied a condition of release, leading to unrestricted non-preserved benefits?
• Are there any cashing restrictions placed on the payment of the benefit?

The following rules generally apply for the voluntary cashing of benefits:

• any preserved benefits may be cashed when a condition of release is satisfied and preservation age has been reached
• any restricted non-preserved benefits may be cashed on termination of employment with an employer, that contributed to the superannuation fund on behalf of the member, and
• an unrestricted non-preserved benefit may be cashed at any time.
7.300 Conditions of release

The conditions of release for superannuation benefits are listed in Column 2 of Schedule 1 of the SIS Regulations. A member of a fund is taken to have satisfied a condition of release if the event specified has occurred in respect of the member.

When a condition of release with nil cashing restrictions (full access) occurs, both the preserved and the restricted non-preserved benefits are notionally transferred into the unrestricted non-preserved benefits category and are available for access by the member.

Any of the following occurrences result in a condition of release with nil cashing restrictions:

- retirement after reaching preservation age
- attaining the age of 65
- acquiring a terminal medical condition
- death
- permanent incapacity, and
- termination of employment on or after 1 July 1997, where the preserved benefit at the time of termination is less than $200.

A restricted condition of release is met when a member reaches preservation age. In that situation the member may access their superannuation as a non-commutable income stream.

See Transition to retirement at 7.440.

7.310 Conditions of release of preserved benefits

Preserved superannuation benefits can only be accessed if a condition of release has been met. The current conditions that allow preserved benefits to be accessed are as follows.

Less than $200 on termination

A preserved benefit that is less than $200 (the preservation threshold) can be accessed when a member terminates employment. This applies when a person leaves a place of employment and there has been less than $200 compulsory employer contributions accumulated in the fund at that time. This does not apply to the extent that the amount is a Government co-contribution and interest accruing on the co-contribution.

Condition of release

A preserved benefit of $200 or more cannot be cashed and must therefore be held in superannuation or a rollover fund until one of following conditions of release is met.

Age 55 to less than 60

If the member is at least age 55, but less than age 60, has “retired” from employment for gain or reward, and never intends to be gainfully employed or self employed again for ten hours or more per week for gain or reward in any business, trade, profession, vocation, calling, occupation or employment there are no restrictions.

The test of retirement is more stringent before a person reaches age 60. A trustee may, as a matter of course, require a statutory declaration be provided by a person who has turned 55, but is under 60, stating that the person intends to never again be gainfully employed on either a full-time or part-time basis.

Transition to retirement

Transition to retirement provisions have been in place since 1 July 2005. Superannuation fund members who have reached preservation age may access their benefits by way of a non-commutable income stream. Access is not subject to permanent retirement from the work force and their work status is irrelevant. For details refer to 7.440 (Transition to retirement) and 7.100 (Preservation age). The capacity to
access benefits via the transition to retirement provisions offers members financial flexibility. They have a source of income they can rely upon from their superannuation savings once they reach preservation age.

**Age 60 to less than 65**
If the member is at least age 60 but less than age 65 and an arrangement under which he or she was “gainfully employed” has terminated after age 60 eg change from full time to part time work, irrespective of future work intentions.

**Age 65 or more**
If the member is at least age 65, there are no access restrictions for superannuation benefits. This applies regardless of whether the member has retired or continues to work. The member may access their benefits fully, partially or not at all.

*Under the provisions that applied before 1 July 2007, upon reaching age 65 a member was required to commence the receipt of their superannuation benefits as soon as practical if they were not working at least part time.*

**Death**
The death of a member is a full condition of release, resulting in all of the deceased’s remaining superannuation benefits becoming re-classified as unrestricted non-preserved. These benefits must be distributed to beneficiaries as soon as practicable after death in accordance with the superannuation provisions and the trust deed.

**Permanent ill health**
If a member has ceased gainful employment due to ill health and is unlikely to work again in a job for which he/she is reasonably qualified by education, training or experience, this constitutes a full condition of release and there are no cashing restrictions placed on the payment of benefits to the member.

**Terminal medical condition**
A terminal medical condition exists in relation to a person at a particular time if the following circumstances exist:

(a) two registered medical practitioners have certified, jointly or separately, that the person suffers from an illness, or has incurred an injury, that is likely to result in the death of the person within a period (the certification period) that ends not more than 24 months after the date of the certification

(b) at least one of the registered medical practitioners is a specialist practicing in an area related to the illness or injury suffered by the person, and

(c) for each of the certificates, the certification period has not ended.

There are no cashing restrictions that apply.

**Severe financial hardship**
If the member satisfies one of these “severe financial hardship” objective tests (this condition of release is administered by the fund trustee(s) (or RSA providers)) a limited amount of money can be released:

- the member has been receiving Commonwealth income support benefits (excluding any Austudy payment and youth allowance paid to a full time student) for a continuous 26 weeks and satisfies the trustee that he or she cannot meet reasonable and immediate family living expenses – see order to cash a release with a restriction (below), or

- the member is at least 55 years and 39 weeks and since turning age 55 has received Commonwealth income support benefits for a cumulative period of 39 weeks, and is not gainfully employed full or part time (ie not working for ten or more hours per week) on the date of application.

*The amount that can be released under the “severe financial hardship” test is limited to a single lump sum between $1,000 and $10,000 in any year.*
Compassionate grounds

A person can apply to APRA for a determination that an amount of his or her preserved benefits, or restricted non-preserved benefits, may be released on compassionate grounds – see order to cash a release with a restriction (below). This condition of release is administered by APRA for all funds including SMSFs and gives APRA a qualified discretion to approve the release of preserved benefits where objective criteria is satisfied that:

- the release is required on one of the following grounds, and
- the person does not have the financial capacity to meet an expense arising from that ground.

The money to be released must be required:

(a) to pay for medical treatment and medical transport for the person or his or her dependant where two registered medical practitioners (at least one of whom must be a specialist) have certified that the medical treatment is necessary to:
  - treat a life threatening illness or injury, or
  - alleviate acute, or chronic, pain, or
  - alleviate an acute, or chronic, mental disturbance, and
  - the treatment is not readily available to the person, or the dependant, through the public health system.

Medical transport can be by land, water or air and must be for medical treatment that has been certified for a reason mentioned above.

(b) to enable the person to make a payment on a loan, to prevent:
  - foreclosure of a mortgage on the person's principal place of residence, or
  - exercise by the mortgagee of an express, or statutory, power of sale over the person's principal place of residence.

  The person gives to the Regulator a written statement from the mortgagee that payment of an amount is overdue; and if the person fails to pay the amount, the mortgagee will:
  - foreclose the mortgage on the person's principal place of residence, or
  - exercise its express, or statutory, power of sale over the person's principal place of residence.

  The amount that the regulator can release cannot exceed an amount that is:
  - equal to three months’ repayments under the mortgage, and
  - 12 months’ interest on the outstanding balance of the loan at the time the statement is made.

  The written statement from the mortgagee must include details of both of these amounts.

(c) to modify the person’s principal place of residence, or vehicle, to accommodate the special needs of the person, or a dependant, arising from severe disability

(d) to pay for expenses associated with the person's palliative care, in the case of impending death

(e) to pay for expenses associated with a dependant’s:
  - palliative care, in the case of impending death, or
  - death
  - funeral, or
  - burial, or

(f) to meet expenses in other cases where the release is consistent with a ground mentioned in (a) to (e), as the Regulator determines.

The ATO has advised that in the event of a condition of release arising from either “severe financial hardship” or “compassionate grounds”, benefits must be paid in cash and may not be taken in specie.
Temporary incapacity

The release of funds to cater for temporary incapacity is also permissible as a non-commutable income stream cashed from the regulated superannuation fund:

- to continue (in whole or part) the gain or reward which the member was receiving before the temporary incapacity, and
- for a period not exceeding the period of incapacity from employment of the kind engaged in immediately before the temporary incapacity.

Temporary incapacity means physical or mental ill-health that caused the member to cease to be gainfully employed but does not constitute permanent incapacity. It includes a member who has ceased temporarily to receive any gain or reward under a continuing arrangement for the member to be gainfully employed.
7.400 Pensions

Account based pensions are a de facto standard for superannuation income streams. Pensions in this section refers to account based pensions unless otherwise stated.

Deeming

The concessional approach (the income test) will exist for account based pensions where eligibility for Age Pension entitlement applies. The general deeming provisions will apply to all new superannuation account-based income streams and potentially also where existing arrangements have precluded eligibility for benefits under the rules in place before the deeming provisions applied to superannuation assets.

The deeming provisions are meant to allow a consistent approach to income testing for the treatment of financial assets.

Access to defined benefit income streams is permissible but trustees of SMSFs may in general only purchase them from retail or other large funds. Unfortunately new streams do not attract any assets test concessions for Centrelink benefit purposes.

The following table lists the age bands and the percentage of the account balance that must be withdrawn each year to meet the minimum standard for this pension. The third column indicates that the full amount may be withdrawn as a pension payment if required.

### Account based pension – standard drawdown table

<table>
<thead>
<tr>
<th>Age band</th>
<th>Minimum* drawdown as a percentage of the account balance</th>
<th>Maximum** drawdown as a percentage of the account balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 65</td>
<td>4%</td>
<td>100%</td>
</tr>
<tr>
<td>65 to less than 75</td>
<td>5%</td>
<td>100%</td>
</tr>
<tr>
<td>75 to less than 80</td>
<td>6%</td>
<td>100%</td>
</tr>
<tr>
<td>80 to less than 85</td>
<td>7%</td>
<td>100%</td>
</tr>
<tr>
<td>85 to less than 90</td>
<td>9%</td>
<td>100%</td>
</tr>
<tr>
<td>90 to less than 95</td>
<td>11%</td>
<td>100%</td>
</tr>
<tr>
<td>95 and older</td>
<td>14%</td>
<td>100%</td>
</tr>
</tbody>
</table>

* The amount calculated from the minimum drawdown percentage is rounded to the nearest $10. If the calculated amount ends in $5 or more it is rounded up to $10, otherwise it is rounded down to $0. For example $12,527.80 becomes $12,530 but $15,434.95 becomes $15,430.

**Transition to retirement pensions have a maximum annual drawdown limit of 10%.

Where the first year of payment/s commenced after 1 July the calculation of the minimum includes a prorating of the amount based on the number of days of pension (including commencement day) and the number of days in the year. When a pension is commenced in June, the provisions allow for a nil drawdown if this is desired.

Where pension relief applies, the rounding is carried out before the applicable relief reduction.

Pension benefits that are paid to members who have reached preservation age from taxed superannuation funds are entitled to a tax rebate of 15% on the taxable component of the benefit. Recipients under disability conditions of release are entitled to the 15% tax rebate on the taxable component of the benefit if they are under preservation age.
Standard for account based pensions

- The minimum drawdown amount is calculated as the product of the net account balance and the minimum drawdown factor as shown in the drawdown table above and dependent on the recipient's age.
- For purposes of the drawdown table, a beneficiary's age is their age on 1 July in the financial year in which the payment is made or on the commencement date in the year the pension first started if this is not 1 July.
- The account balance is the net balance (purchase price) on the commencement date of the pension. Subsequently it is the 1 July balance.
- The payment standard for the account based pension requires that an amount that is no less than the minimum drawdown amount as calculated from the above table is paid each year from the pension account in one or more payments.
- The minimum amount payable in the year of commencement (if not 1 July) is determined on a daily pro rata basis in respect of the remainder of the financial year including the commencement day.

If the pension is commenced in the month of June, it is optional to draw down the pro rated amount.

- No specific provisions may be made for amounts to be retained in the account following the member’s death unless benefits are paid as a reversionary pension.
- In the event of death an existing pension may revert to a dependant or be paid out as a lump sum. A reversionary pension may not be paid to a non-dependant.
- Death benefits paid to a non-dependant may only be paid as a lump sum payment.

Should a member continue to adhere to the previous allocated pension drawdown standard they would meet the new account based pension standard.

Other characteristics

- **Tax-free earnings:** The investment earnings of assets that support pensions are tax-free in the fund.
- **Partial Commutation:** A partial commutation occurs when a member in receipt of a pension consciously exercises their right to exchange something less than their full entitlement to receive future pension payments for an entitlement to be paid a lump sum. As there is still an obligation to continue to pay pension benefits, a partial commutation does not result in the cessation of the pension. If an account based pension is partially commuted, the commuted amount is included as part of the minimum payment necessary to meet the minimum drawdown standard (SMSFD 2013/2). However for income tax purposes the commuted amount may be treated as a superannuation lump sum benefit (TR 2011/D3 and TR 2013/5) subject to prior nomination by the recipient to have the benefit treated as a lump sum for taxation purposes. Commutations are generally not permitted for transition to retirement pensions unless the interest includes unrestricted non-preserved benefits.

- **Full commutation:** A full commutation takes effect as soon as the trustee's liability to pay periodic pension payments to a member is substituted in full with a liability to pay the member a lump sum instead. The account based pension ceases at this time. A full commutation denotes that the pension is no longer on-going and that the pension had ceased before the commutation payment was made. A payment made as a result of a full commutation therefore does not count for purposes of the minimum pension standard.

- **Ceasing the pension – full internal commutation:** If a pension is to be stopped part way through a year, the pro rated minimum amount must be drawn down reflecting the period of the year that has elapsed before the pension is stopped. Minutes of decisions taken by trustees and members must be maintained.

- **Flexibility:** The account based pension offers flexibility. The minimum drawdown is less than the minimum amount from an allocated pension. Beneficiaries wishing to drawdown minimum amounts will benefit from the lower account based pension amount while benefitting from the account being held in pension mode. The maximum drawdown is the entire account balance unlike the allocated pension that necessitated a lump sum withdrawal for access to the full account balance.
SMSFD 2013/2 and TR 2013/5 clarify the Commissioner of Taxation’s views on certain details regarding a pension.

Commencement date of a pension cannot be earlier than:
- the day on which the member and trustee agree to the terms and conditions, or
- where the pension entitlement arises pursuant to the terms of the trust deed of the fund, the commencement time in accordance with the deed.

A pension ceases:

“... when there is no longer a member who is entitled or a dependent beneficiary of a member who is automatically entitled, to be paid a superannuation income stream benefit”

Common circumstances in which a pension ceases:
- failure to meet the pension rules and the SIS Reg payment standards
- exhaustion of capital
- full commutation, and
- immediately upon death of the member, unless a dependent beneficiary is automatically entitled to a pension either under the terms of the original pension or under the deed.

The pension exemption will continue for a period after death, where death benefit payments are made as soon as practicable after death where the pension is not reversionary. If it is reversionary, it continues until the trustee or reversionary beneficiary ceases the pension.

In practical terms, the view that a pension ceases immediately upon the death of the member, notwithstanding the stance adopted by the Commissioner in TR 2013/5 that a pension ceases immediately upon the death of the member.

The Commissioner’s guidance under TR 2013/5 places the onus on trustees to ensure that the pension standard is met each year. In the event of the standard not being met, there are potentially a number of adverse consequences, including a withdrawal of the pension exemption, assessment of benefits at the member’s marginal tax rate, the re-application of the proportioning rule and possibly other consequences.

- **Investment risk:** The investment risk is borne by the member since the account balance will fluctuate according to the performance of the underlying investments.
- **Mortality risk:** The risk of running out of assets during the retirement period is real.
- **May not support borrowings:** Neither the capital supporting this pension, nor the income stream it generates can be used to obtain borrowings.
- **Centrelink:** The entire account is assessed for Centrelink assets test purposes.
- **In specie payments:** The ATO and APRA have indicated that benefits received under pension arrangements must be received as cash benefits. In specie benefits may only be paid as lump sum benefits.

**Should it be necessary to draw down in specie benefits from a fund that is paying a current pension this may be done once the minimum annual standard payment is made in cash.**

**EXAMPLE: Minimum pension payment**

Zoe is a 63 year old female who commences an account based pension at the start of the 2015-16 financial year. Her SMSF holds a balance of $327,423 on 1 July 2015. She has retired from the workforce.

What is the minimum amount she must withdraw from her pension account?
Since her she is within the age band 55 to less than 65, the minimum drawdown percentage rate is 4% due to the temporary relief provisions.
She commences her pension on 1 July 2015 with an account balance of $327,423.
The minimum annual payment is calculated as 4% x $327,423 = $13,096.92 and rounded to $13,100.
**Pro rata pension payment**

How does the postponement of the start of her pension to 1 January 2016 affect her if her new account balance is $365,000 on this date?

What is the minimum amount she must withdraw from her pension account?

She must draw down at least the equivalent annual minimum of $14,600 ($365,000 x 4%) that is an amount adjusted to reflect the proportion of the year in days during which the pension applies.

The period 1 January 2016 to 30 June 2016 inclusive amounts to 182 days. The pro rata payment period is therefore the fraction 182/366 of a year, and the calculated minimum amount she must draw down is therefore 182/366 x $14,600 = $7,260.11 rounded to $7,260.

**Pension payment in June**

Assume that Zoe took on a short term work assignment and therefore defers the commencement of her pension until the assignment ends.

She works until the end of May 2016 and commences her pension on 1 June 2016. Her account balance is $432,000. This included earnings, contributions and her salary sacrificed into superannuation from the short term work assignment.

What are some of the options she has in respect of her drawdown?

- **Nil payment:** Since she is commencing the pension in June of a year, the first option is that she may opt not to withdraw anything for the 2015-16 year.

- **Small pension payment:** She may also opt to draw down 30/366 of the minimum annual amount based on her account balance at 1 June 2016. She may withdraw 4% of 30/366 x 432,000 = $1,417

- **Large pension payment:** An amount in excess of this is also permitted, including the full account balance.

**7.410 Commissioner's power of general administration**

Where the “pension” payment in an income year is less than the minimum payment amount, the Commissioner may exercise his power of general administration (GPA) to allow the fund to continue to claim the exemption for current pension income (ECPI) where all of the following conditions are satisfied:

1. The trustee failed to pay the minimum pension amount in that income year because of either:
   - an honest mistake by the trustee resulting in a small* underpayment, or
   - due to matters outside the trustee's control.
     * The Commissioner considers a small underpayment to be one that does not exceed one-twelfth of the minimum pension payment in the relevant income year. This is approximately equivalent to a month's income stream payment.

2. All other requirements were met by the trustee for entitlement to the ECPI exemption except for a failure to meet the minimum payment amount.

3. Upon becoming aware of the shortfall, the trustee makes a catch-up payment as soon as practicable** in the following income year; or treats a payment made in the current income year, as being made in the prior income year.
   **Generally, if the underpayment is due to an honest trustee error, “as soon as practicable” means within 28 days of the trustee becoming aware of the underpayment. If the underpayment is due to matters outside the trustee's control, “as soon as practicable” is considered to be within 28 days of the trustee being in a position to be aware of the underpayment.

4. Had the trustee made the catch-up payment in the prior income year, the pension standards would have been met.

5. The trustee treats the catch-up payment, for all other purposes, as if it were made in the prior income year.
If all five of the above mentioned conditions are satisfied:

- the income stream is taken not to have been interrupted. A new pension is therefore not commenced in the following year. The proportioning rule does not need to be applied again to determine the tax-free and taxable components
- the trustee of the fund may continue to claim ECPI for earnings on assets supporting that pension, notwithstanding the fund’s failure to meet its obligations under the superannuation law, and
- the payments made to the member during that income year are treated as income stream payments and not lump sums.

*If any of these conditions is not met, exercise of the GPA is not relevant.*

### 7.420 Self-assessment to GPA concession

A trustee may self-assess and apply the GPA concession if all of the following apply:

- failure to meet the minimum pension requirements was an honest mistake or outside the trustee’s control
- the underpayment was small (see above)
- all of the other GPA conditions have been met, and
- the trustee has not previously been granted the Commissioner’s concession for failing to meet the minimum requirements.

*In all other cases, trustees must write to the Commissioner outlining the reasons for not meeting the minimum standard for consideration of the GPA.*

### 7.430 Actuarial certificate

When a fund pays a pension, the investment income of the assets supporting the pension is exempt from tax. The segregated current pension asset approach or the non-segregated current pension asset approach may be used to qualify for the tax exemption.

#### Segregated current pension assets

The first approach involves segregated assets of the fund with the income associated with those pension assets being exempt and identified as the earnings of those segregated assets. An actuarial certificate is not necessary in relation to segregated current pension assets that support account based pensions.

Refer also to TD 2013/D7 *Income tax: in what circumstances is an asset of a complying superannuation fund a segregated current pension asset under section 295-385 of the Income Tax Assessment Act 1997?*

**TD 2013/D7W: Withdrawal**


**Notice of Withdrawal**

Draft Taxation Determination TD 2013/D7 is withdrawn with effect from 11 December 2013.

TD 2013/D7 explained the Commissioner’s preliminary view about when an asset of a complying superannuation fund is invested, held in reserve or otherwise being dealt with for the sole purpose of enabling a fund to discharge liabilities payable in respect of superannuation income stream benefits, for the purposes of paragraph 295-385(3)(a) or subsection 295-385(4) ITAA97.

A number of submissions were received during the course of consultation and it became clear that approaches vary materially across the industry.

A new Determination dealing specifically with the key issue of bank accounts will be issued in the near future, and the ATO will further consider and consult on the balance of the matter.

Notwithstanding this notice, the Commissioner has also expressed the following views.
An asset of a complying superannuation fund will be invested, held in reserve or otherwise being dealt with for the sole purpose of enabling a fund to discharge liabilities payable in respect of superannuation income stream benefits, (“the relevant sole purpose”), where the whole asset is so invested, held or dealt with.

An asset cannot be partly invested, held or dealt with partly for the relevant sole purpose and partly for another purpose, and part of an asset cannot be invested, held or dealt with for the relevant sole purpose, and another part of the asset invested, held or dealt with for another purpose. That is the case for all types of assets that are capable of being a segregated current pension asset if invested, held or dealt with for the relevant sole purpose. Section 295-385 ITAA97 applies at the level of each single, discrete, indivisible asset at law, including:

- a bank account, being a single chose in action at law
- a share in a company, being a single chose in action at law
- a unit in a trust, that is a discrete identifiable equitable interest
- a legal title to a real property or a legal title to a lot in a strata title, and
- any other discretely identifiable item of legal or equitable property or right or interest that is an asset for the purposes of s295-385 ITAA97.

Asset segregated for part of year

If a particular asset is a segregated current pension asset for only part of an income year, only the income that is received from the asset at the time that it is a segregated current pension asset will be exempt from income tax.

Segregated bank accounts

Some outgoings that require apportionment between current pension liabilities and other liabilities will of necessity be paid to or from a single bank account. Where such amounts are paid to or from a segregated bank account, in order to maintain segregation the fund will have to make a transfer or set off between the fund’s segregated bank account and its general bank account within a reasonable time.

NOTE: Taxation Determination TD 2014/7 indicates that some banks offer what are commonly referred to as “sub-accounts”. Where all transactions and balances are recorded, maintained and reported on a sub-account basis, then a sub-account held for the relevant sole purpose may be a segregated current pension asset for the purposes of s295-385 ITAA97. This is the case even if other sub-accounts within the higher-level account are not held for the relevant sole purpose.

This interpretation by the Commissioner applies to actual sub-accounts which are formally maintained by banks, and also to informal or notional sub-accounts where proper accounting records are maintained by other non-bank parties (for example, a trustee of a superannuation fund).

Members

There is no requirement to segregate assets in respect of each individual member of a complying superannuation fund who is in receipt of superannuation income stream benefits. Segregation of the current pension assets as a whole, from the other assets of the fund, is all that is necessary.

Disposal of assets

If an asset is purported to be segregated shortly before disposal, and then disposed of in circumstances where a capital gain is claimed to be exempt income, it will be a question of fact having regard to all the circumstances as to whether it was invested or otherwise being dealt with for the sole purpose of enabling the fund to discharge liabilities in respect of superannuation income stream benefits, and whether the anti-avoidance provisions in Part IVA ITAA36 would apply in connection with the obtaining of a tax benefit, being an amount not being included in the assessable income of the fund.

Non-segregated current pension assets

The second approach involves non-segregated assets. The pension exemption applies to a proportion of the income reflecting the assets that pay current pensions, and is expressed as the ratio of the average value of the fund current pension liabilities to the average value of the fund superannuation liabilities. For non-segregated assets supporting current pension liabilities, an actuarial certificate is necessary. The actuary will proportion the fund income to reflect the amount that is exempt from tax and the remainder is taxed at the normal concessional superannuation tax rate of 15%.
Asset adequacy certificates are not required for account based pensions, since investment and mortality risk is borne by the retiree.

In addition to any requirements for actuarial certificates, before paying a pension, assets must be valued at their current market value.

**NOTE 1:** Generally where an SMSF pays a pension using segregated pension assets it may claim the exemption under s295-385 in respect of those assets paying pensions. An actuarial certificate is not required where the fund is paying prescribed pensions under the regulations, namely account based pensions, allocated pensions and market linked pensions. However an annual actuarial certificate is necessary where a non-prescribed pension (eg defined benefit) is paid regardless of whether the fund is also paying one or more prescribed pensions. The classification of segregated current pension assets under s295-385(4) does not apply where income streams other than prescribed income streams are paid (s295-385(5)).

**NOTE 2:** For defined benefit (life expectancy and lifetime) legacy pensions, an annual actuarial adequacy certificate is necessary, certifying that to a high degree of probability the assets will provide adequate income in the future to support the pension liabilities. In practical terms the certificate may also be combined with one that provides the % exemption for the year just elapsed in respect of funds with non-segregated assets under s295-390, for inclusion with the tax return.

**NOTE 3:** The tax exemption on income generated by assets used to support pension payments does not apply where income is derived from non-arm’s length income.

**NOTE 4:** The tax exemption does not apply to assessable contributions.

### 7.440 Transition to retirement

The concept of transition to retirement is to provide those in the pre-retirement period of their life with additional flexibility through a certain level of access to their superannuation benefits.

The transition to retirement period covers the time from preservation age (see the table at 7.100) until either permanent retirement or in any event age 65. Transition to retirement is independent of the employment status or intentions of an individual.

Transition to retirement pensions that commenced from July 2007 are limited to a maximum drawdown in a financial year of 10% of the net account balance of the supporting assets.

**Non-commutable income streams**

It is necessary for transition to retirement pensions to be accessed such that their commutation does not occur during the transition to retirement period (neither complying pensions nor market linked pensions are commutable in any event). For this reason they are also referred to as non-commutable income streams.

The benefits may not be taken as lump sums even in those situations where the income stream is traditionally a commutable one, eg an account based pension. The exception is where the member is retiring permanently from the workforce, or on reaching age 65.

A further exemption applies where a lump sum is taken to give effect to a non-member spouse payment split or to meeting a surcharge commitment.

For those who have already commenced a commutable income stream, for example an account based pension, it may be rolled back into the accumulation phase in a complying superannuation fund at any time. When the drawdown is to be re-commenced, normal rules for accessing benefits apply.

- **Having commenced an account based pension under a transition to retirement condition of release, its non-commutable property ceases if the member retires permanently from the workforce or reaches age 65 regardless of employment status.**

- **During a transition to retirement pension a lump sum benefit may be paid where it comprises only unrestricted, non-preserved benefits.**
**EXAMPLE**

Effie works with the EZL chemical company. She also runs her own SMSF with an account balance of $560,000 and commences a transition to retirement pension on 1 July 2009 when she was already 55. She makes salary sacrifice contributions to her SMSF. The tax-free proportion of her account at the end of 30 June 2009 is 45%. The pension payment she chooses to receive is 5% of the account balance.

She will draw down according to the account based pension standard, but wouldn’t be able to make a lump sum withdrawal or exceed the limit of 10% of the account balance. See 7.600 for definitions of taxable and tax-free components.

Since she has reached her preservation age and is less than 65 she may draw down any amount between the minimum of 2% (as per minimum drawdown relief) and the maximum is 10%.

Annual drawdown selected is 5% x 560,000 = $28,000

Tax-free amount of the benefit = (Tax-free proportion of the benefit) x (benefit paid)

Tax-free portion of the benefit = $28,000 x 45%

= $12,600 (this is non assessable non exempt income)

The assessable amount of her benefit = Total benefit – tax-free amount

Assessable benefit = $15,400

The assessable benefit has a tax rebate attached of 15%, amounting to $2,310.

Forty five per cent of the benefit is tax-free and Effie receives a rebate of $2,310 for the balance.

The receipt of income from her superannuation fund is clearly very tax efficient.

Salary sacrificing can increase her superannuation savings as these contributions are taxed at 15% instead of her marginal tax rate. She could save more in superannuation by using these tools to best advantage.

**SMSFD 2014/1** indicates that where permitted, a lump sum cashed out of a superannuation system under a TRIS partial commutation may count towards satisfying the minimum pension drawdown requirements. It does not however count towards the ten per cent maximum.

**EXAMPLE**

Sheldon is receiving a transition to retirement income stream.

On 1 July 2013, the account balance of Sheldon’s transition to retirement income stream was $300,000. The minimum annual amount required to be paid was $12,000.

On 1 May 2014 Sheldon requested, in accordance with the governing rules of the fund, to partially commute to the extent of $20,000 and have paid to him the $20,000 as a result the $20,000 was permitted to be paid to Sheldon as an unrestricted non-preserved benefit because the amount of Sheldon’s unrestricted non-preserved benefits when the commutation took effect was $25,000.

The $20,000 partial commutation payment was paid accordingly to Sheldon on 3 May 2014 as an unrestricted non-preserved benefit.

The partial commutation payment counted towards the minimum annual amount required to be paid from the pension account. As $20,000 exceeded the minimum annual amount. The trustee did not need to pay any further amount.

Subsequently in the 2013-14 financial year, Sheldon advised the trustee that he still wished to be paid $15,000 as an income payment from the income stream before 30 June 2014. That payment was made on 3 June 2014.

The $20,000 payment does not count towards the maximum annual amount allowed to be paid from the pension account. Even though a total of $35,000 was paid to Sheldon in the 2013-14 financial year, the trustee did not exceed the maximum annual amount for the income stream for that year of $30,000 (being 10% of $300,000).
In specie payments
The ATO has indicated in the past that a pension payment must be made by way of money. It could not
be made as an in specie payment or asset transfer.
In SMSFD 2014/1 and as indicated in SMSFD 2013/2—a lump sum resulting from the partial commutation
of a pension may be made by way of an asset transfer or in specie, notwithstanding that the partial
commutation would be counted for purposes of the minimum pension amount.

7.450 Tax-free benefits: Age 60 and over
Superannuation fund members (and reversionary beneficiaries) age 60 or over and in receipt of benefits
from taxed superannuation funds are eligible to receive their benefits tax-free. The entire income is
classified as non-assessable and non-exempt.
Lump sum payments made from taxed superannuation funds to individuals 60 or over are tax-free as are
pension payments made from taxed superannuation funds to individuals 60 or over.
This also applies to pensions that were commenced on or before 30 June 2007. If the member is aged
60 or over the benefits are tax-free.

Not reported on the tax return
Importantly, a payment made to a member 60 and over (whether received as a lump sum payment or as
a pension payment) does not have to be reported on the individual's income tax return.

<table>
<thead>
<tr>
<th>Payment from a taxed superannuation fund to a member aged 60 or more</th>
<th>Rate of taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension payment</td>
<td>0%</td>
</tr>
<tr>
<td>Lump sum payment</td>
<td>0%</td>
</tr>
</tbody>
</table>

The taxable and tax-free components are not relevant in respect of the tax assessment for a
recipient who is 60 or more. See also Death benefits at 7.700 for possible future implications.

Individual taxation
The superannuation benefit is ignored for purposes of determining the relevant taxation of other income.

Additional assessable income is assessed against the current individual income tax-free
threshold of $18,200 and the progressive marginal tax rates that are applicable thereafter.

EXAMPLE 1
Jerry, age 63, commenced an income stream from a taxed superannuation fund on 1 July 2015. His
drawdown for the year is specified to be $30,000. He has other assets from which he derives further
income of $35,000.
The income received from his superannuation fund is ignored for tax purposes. His assessment is
determined on the basis of the non-superannuation income of $35,000.
(Jerry would not have to register for PAYG instalment payments for the superannuation income
stream income though he may do this for his non-superannuation income.)

The tax treatment of income received by a member 60 or over from a taxed superannuation
fund is non-assessable, non-exempt and independent of whether the income stream
commenced prior to or after the introduction of Better Super.
The extent to which the assessable portion was previously rebatable does not matter in respect
of the tax treatment of the income received by Jerry from his taxed superannuation fund. As
noted earlier if he is 60 or over it is tax-free.
The extent to which there is an annual deductible amount, as calculated at the commencement
of the income stream, according to the previous rules, is irrelevant in respect of the individual's
taxation with respect to the income they receive from a taxed superannuation fund. The criterion is
simply whether the member has reached 60.
Member 60 or over in receipt of a pre-1 July 2007 pensions

Pensions commenced prior to 1 July 2007, received by those 60 or over from a taxed superannuation fund will be received tax-free after that date.

**EXAMPLE 2**

What is the outcome if instead Jerry commenced the allocated pension on 1 July 2006 from his SMSF with the income stream being rebatable at a rate of only 10% (some of the assets were excessive).

What are the tax consequences of this income for Jerry?

He intends to draw down $30,000 in 2015-16 while he also receives additional income of $25,000 from investments. Since Jerry is at least 60, the income from his taxed superannuation fund is non-assessable and non-exempt. The income he receives from his superannuation fund is therefore ignored for tax purposes.

His assessment is based on an annual income of $25,000.

Note: The issue of the income stream not being fully rebatable is irrelevant for his personal tax assessment. Since he is over 60 and in receipt of income from a taxed superannuation fund this income is tax-free in Jerry’s hands.

**7.460 Member age 55 to under 60**

Any benefit paid from a taxed superannuation source will contain the associated tax-free or exempt portion of the benefit based upon the tax-free proportion of the superannuation interest. The remainder of the benefit will be the taxable component of the benefit (see 7.600). Thus in respect of any superannuation derived income received after 30 June 2007, the benefit is split into a tax-free amount, if there is any (this is non-assessable and non-exempt income) and a taxable amount (if any) that is assessable income.

The rules that apply differ, in relation to whether the benefit is paid as a lump sum or as a pension benefit. The actual tax payable also relates to the proportion of the interest that is tax-free.

**7.470 Foreign superannuation pensions**

Foreign sourced pensions retain a deductible amount that is calculated on the basis of the undeducted purchase price of the pension.

**7.480 Pension payments**

**Pensions commenced post-30 June 2007**

Each pension payment is split according to the tax-free proportion of the interest (see 7.600) with the balance of the pension payment being assessable for tax.

The assessable component of the benefit is fully rebatable at a rate of 15% for recipients who are aged 55 to less than 60.

The issue of rebates for those who have reached age 60 is irrelevant because the entire pension is fully tax-free once the member is age 60.
EXAMPLE

Pam age 58 commenced an income stream from a taxed superannuation fund on 1 July 2007. Her drawdown for the year was $40,000, all of it being the taxable component of the benefit. Her tax-free component was therefore nil. She has other assets from which she derives further income of $35,000.

Since all the income received from her superannuation fund is a taxable component of benefit (her tax-free proportion is 0%) it is all included in her tax assessment. This is unlike the example above for Jerry where the tax-free proportion of his account is irrelevant for purposes of assessment, because he has reached age 60.

The assessable income for Pam is $75,000 however she also receives a tax rebate associated with her superannuation fund income stream of 15%, namely $6,000 she can offset against her tax assessment.

Note that the fund must register for PAYG withholding (see Administrative arrangements at 7.800).

The same principle in respect of the tax treatment of benefits applies to pensions that were in existence prior to 1 July 2007 and that are paid from a taxed superannuation fund to members who are 60 or over.

Pre-1 July 2007 pensions

For pensions that commenced on or before 30 June 2007, the tax treatment that applied previously will continue to apply unless a trigger event occurs (see 7.650).

This means that the income is assessable (less a deductible amount if applicable) and potentially rebatable, with the individual being taxed at marginal tax rates. The deductible amount reflects a “return of capital” or return of contributions made from after tax savings (undeducted contributions).

This arrangement continues where pensions that were already in existence prior to 1 July 2007 are paid from a taxed superannuation fund for this age category and the previous % rebate applicable at the commencement of the pension will continue to apply (even though they might be less than 15%) until a trigger event occurs (see 7.650). The components of the account must then be recalculated for purposes of determining the tax-free proportion of the account with reference to the trigger event.

A pension that commenced pre-July 2007 will retain the rate of rebate and the annual deductible amount, typically until the member turns 60 when the benefit is received tax-free or if a trigger event intervenes when a recalculation is carried out and a purely Better Super approach is adopted.

Income streams that were in existence prior to the commencement of Better Super will retain the rebates that applied prior to 1 July 2007. A recalculation of the components of the fund becomes necessary when a commutation occurs, the member reaches 60 or the member is deceased. See also Crystallised segment at 7.620.
7.500 Lump sum and disability superannuation benefits

7.510 Superannuation lump sums

A lump sum benefit paid from a superannuation fund may include assessable income. However tax concessions may be available to reduce the amount of tax payable.

SMSFs are not permitted to hold untaxed elements as part of a member’s superannuation interest. Any untaxed element of a rollover to the SMSF from a retail fund is subject to 15% tax in the year when it is received.

Components

The components of a lump sum benefit include its tax-free component, determined from the tax-free proportion (see 7.600), with the taxable component consisting of the remainder.

The taxable component may comprise two elements, an element taxed in the fund and one that is untaxed in the fund. These elements are referred to as the taxable component, element taxed in the fund and taxable component element untaxed in the fund respectively. Each attracts a different concessional treatment.

An element taxed in the fund is essentially a taxable component created in a taxed superannuation fund. While tax would have been paid in the fund, an additional tax liability may arise when this is paid out as a benefit. This component of a benefit is assessable income, although with certain taxation concessions may be available.

Similarly an element untaxed in the fund is a benefit created from an untaxed source, with tax typically not being paid on the benefit until it is received by the member. The benefit is assessable income with taxation concessions being available.

Taxation

The tax liability in respect of a lump sum payment is based on the taxable component of the benefit, after taking account of any tax concessions that might apply.

Tax-free component

The tax-free component of a benefit is received free of tax by the beneficiary and may be viewed as a return of capital.

Taxable component

The taxable component is assessable but as noted above it may include an element taxed in the fund and an element untaxed in the fund. These may attract tax concessions.

The following relates to the taxation of a taxable component element taxed in the fund.

Low rate cap

The low rate cap places a lifetime limit on the aggregate level of lump sum concessions, where the taxable component is assessed at the 0% concessional rate.

The table below sets out the concessional rates that apply.

For example the tax liability for a taxpayer of preservation age, who is not yet 60 and in receipt of a lump sum including a taxable component is determined as follows.

If the taxable component is greater than the low rate cap, the amount up to that threshold is taxed at the 0% rate. Any amount in excess is taxed at the higher rate of 15% plus Medicare levy.

Generally, if the taxable component is equal to or less than the low rate threshold, the entire taxable component has a rate of tax of 0% applied to it.

Generally, the low rate cap available is the value of the current low rate cap (eg $195,000 in 2015-16 and in 2016-17) less any amounts already used by the taxpayer, including where the concession is used with a taxable component untaxed in the fund. See Notes 1 & 2 below.
Following the full utilisation of the low rate cap, “indexation-lift” provides the opportunity for the taxpayer to utilise the incremental amounts created from future indexations.

The table below shows the rate of withholding to be applied to the taxable component of the benefit. The last row of the table is included for completeness.

A benefit received from a taxed superannuation fund by a member aged 60 or over is tax-free. This is classified as non-assessable non-exempt (NANE) income.

- If the taxpayer’s marginal tax rate is less than the rate of withholding applied to the taxable component payment, the taxation on the taxable component will be at the marginal tax rate.
- If the marginal tax rate is higher than the rate of withholding a tax offset will apply to ensure the rate of tax on the taxable component does not exceed the rate of tax withheld. Typically such tax offset is calculated by the ATO.

### Taxation of lump sums paid from a taxed superannuation fund

A lump sum benefit is split between its taxable component which is taxed as follows, with the tax-free component being paid free of tax.

#### Low rate cap 2015-16 and 2016-17

<table>
<thead>
<tr>
<th>Age</th>
<th>Tax rate 0%</th>
<th>Tax rate* 15%</th>
<th>Tax rate* 20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 55</td>
<td>n/a</td>
<td>n/a</td>
<td>Entire amount</td>
</tr>
<tr>
<td>55 to under 60</td>
<td>Up to threshold of $195,000</td>
<td>Above the threshold of $195,000</td>
<td>n/a</td>
</tr>
<tr>
<td>60 and over</td>
<td>Entire amount</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>

* Medicare levy to be added to non-zero tax rate. The Medicare levy rate is 2%.

**NOTE 1:** A single low rate cap applies which may be used for both the taxed and untaxed element of the taxable component when paid as a lump sum. (An additional low rate cap does not apply for the untaxed element.) Where a member receives both taxed and untaxed elements, the total low rate cap allowed may not exceed the low rate cap shown above (eg $195,000 in 2016-17 and 2015-16).

**NOTE 2:** The low rate cap is allocated against the taxed element first before allocating the remainder against the untaxed element.

For those diagnosed with a terminal medical condition their lump sum payments are received tax-free. This is irrespective of age (see 8.500).

### 7.520 Lump sum disability superannuation benefits

A disability superannuation benefit is a superannuation benefit that could be a superannuation lump sum or a superannuation income stream that is paid as a result of:

- physical or mental ill-health, and
- two legally qualified medical practitioners have certified that, because of the ill-health, it is unlikely that the person can ever be gainfully employed in the capacity for which they are reasonably qualified because of education, experience or training.

The definition under subsection 995-1(1) ITAA97 extends eligibility for disability superannuation benefits to a person who was “gainfully employed”. The meaning of “disability superannuation benefits” is also altered to include benefits paid from an income stream that commenced before 1 July 2007. “Gainfully employed” is defined in subsection 995-1(1) ITAA97 and means employed or self-employed for gain or reward in any business, trade, profession, calling, vocation, occupation or employment. The change to the definition removes the link to employment and enables a disability superannuation benefit to be paid from a superannuation fund to a person who is self-employed, as long as they meet the other requirements of the provision.
The tax-free component of a lump sum disability superannuation benefit

If a person receives a disability superannuation benefit as a lump sum, s307-145 ITAA97 applies to determine the tax-free component of the benefit. Under this section the tax-free component of the benefit is the sum of:

- the tax-free component worked out using the proportioning rule and
- an amount that reflects the period the person would have expected to be gainfully employed.

The formula to calculate the latter is:

\[
(\text{Amount of benefit}) \times (\text{Days to retirement}) / (\text{Service days} + \text{Days to retirement})
\]

“Days to retirement” is the number of days from the day on which the person stopped being gainfully employed to his or her last (prospective) retirement day, employment terminated under contract or when on turning 65.

“Service days” is the number of days in the service period and reflects the definition of eligible service period that is now largely irrelevant under the new provisions.

The tax-free component cannot exceed the amount of the benefit.

PAYG withholding for disability lump sum benefits

The following withholding rates apply for disability lump sum benefits paid from superannuation funds where a tax file number (TFN) is provided*.

<table>
<thead>
<tr>
<th>Income component of benefit</th>
<th>Age at date payment is received</th>
<th>Component subject to PAYG withholding(^2)</th>
<th>Rate of withholding (excl Medicare)(^1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable component - taxed element</td>
<td>Below preservation age</td>
<td>Whole amount</td>
<td>20%</td>
</tr>
<tr>
<td></td>
<td>Preservation age to age 59</td>
<td>Amount up to low rate cap</td>
<td>Nil</td>
</tr>
<tr>
<td></td>
<td>Age 60 and above</td>
<td>Amount above low rate cap</td>
<td>15%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Whole amount</td>
<td>Nil</td>
</tr>
</tbody>
</table>

* If the member has not provided a TFN before the payment is made, a withholding tax rate equal to the top marginal tax rate plus Medicare applies for the entire taxable component.

1: The above non zero rates of withholding must be increased by the Medicare levy at the rate of 2%.
2: See 7.500 for low rate cap.

Funds are required to provide a payment summary within 14 days of making the lump sum payment.

**EXAMPLE 1: Calculation of tax – lump sum disability superannuation benefit**

Kim receives a disability lump sum benefit of $200,000 from her superannuation fund following a serious work injury and was unable to be gainfully employed from 29 March 2011. Her service period up to the lump sum payment was 7,950 days and the number of days from lump sum to retirement (notionally when she turns 65) is 6,450 days. Just prior to the lump sum benefit being paid the total value of her superannuation interest was $500,000 with a tax-free component of $150,000.

Her interest contained no taxable component with an element untaxed in the fund.

The taxable component (element taxed in the fund) was therefore $350,000.

The tax-free component of the disability benefit paid is calculated as follows:

- The tax-free proportion of the superannuation interest just prior to the benefit being paid determines the “normal” tax-free component of the benefit.
- The “additional” tax-free component is a measure of premature loss of service due to disability and is calculated in Step 2. It leads to an increase in the tax-free component of the benefit and a corresponding reduction in its taxable component, with a lower tax payable on the benefit.
Step 1: Calculate tax-free proportion of interest just prior to benefit payment
Tax-free component of interest = $150,000
Total interest = $500,000
Tax-free proportion = (Tax-free component of interest) / (Total interest) or ($150,000 / $500,000) = 0.3
The tax-free percentage is 30%.
‘Normal’ tax-free component of the lump sum = Tax-free percentage of interest x Lump sum
benefit paid = 30% x $200,000 or $60,000

Step 2: Calculate “additional” tax-free component due to lump sum benefit arising from disability
Additional tax-free component = Benefit paid x [(Days to retirement) / (Service period + Days to retirement)]
Benefit paid = $200,000
Days to retirement = 6,450 days
Service period (to benefit) = 7,950 days
The additional tax-free component = $200,000 X [6,450 / (7,950 + 6,450)] = $89,583.32

Step 3: Add the two amounts worked out above to get the total tax-free component of the disability superannuation benefit
Total (disability) tax-free component = $60,000 + $89,583.32 = $149,583.32
Taxable component of the disability benefit = $200,000 – $149,583.32 = $50,416.68
In this example Kim is below preservation age.
The tax rate on the taxable component (element taxed) is 22% (which include Medicare levy of 2%).
She pays tax of $11,091.67 on the disability benefit.

EXAMPLE 2: Calculation of tax – lump sum disability superannuation benefit
If the same benefit of $200,000 was paid and Kim had reached preservation age but was not yet 60, and had also fully used her lifetime low tax threshold amount in respect of lump sums, the following would apply.
Service period to the lump sum payment = 13,950 days
Lump sum to retirement = 2000 days
The additional tax-free component is calculated as:
Benefit paid x [(Days to retirement) / (Service period + Days to retirement)]
= $200,000 x (2000) / (13950 + 2000) = $25,078.36
This is significantly less than the previous “additional tax-free component” of $149,583.32, due to the much shorter ‘days to retirement’ (2000 days versus 6,450 days) together with the ‘longer service period’ (13,950 days versus 7,950 days.)
The taxable component is consequently greater.
Total (disability) tax-free component is $60,000 + $25,078.36 = $85,078.36
Taxable component is $200,000 – $85,078.36 = $114,921.64
Tax payable at 17% on the taxable component = $18,962.07
Generally the tax payable for taxpayers who have reached preservation age is dependent on the age of the beneficiary and whether the once in a lifetime concessional low tax threshold or any part of it is unused. The amount exceeding the threshold is taxed at 17%. For beneficiaries age 60 and over the entire taxable component (element taxed) is tax-free.

The higher the proportion of foregone employment period caused by disability to the total employment, the larger the addition to the tax-free component due to the disability.
7.521 Disability income stream tax offset
Disability income stream benefits are eligible for tax offsets as follows:

<table>
<thead>
<tr>
<th>Age</th>
<th>Tax offset amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below preservation age</td>
<td>Taxed element × 15%</td>
</tr>
<tr>
<td>Preservation age to below age 60</td>
<td>Taxed element × 15%</td>
</tr>
<tr>
<td>Aged 60 and over</td>
<td>Untaxed element × 10%</td>
</tr>
</tbody>
</table>

7.522 Terminally ill – tax-free access
Tax-free superannuation lump sum payments can be made to members with a terminal medical condition for payments.

A member is deemed to be terminally ill if two medical practitioners (at least one of these a specialist) certifies that the member is suffering from an illness that in the normal course would result in death within 24 months.
7.600 Tax-free and taxable components

A membership interest in an SMSF is made up of just two components:

- the tax-free or tax exempt component, and
- the taxable component.

The taxable component of an interest is calculated as the amount that is left over when subtracting the tax-free component from the total value of the superannuation interest.

\[
\text{Taxable component} = \text{Superannuation interest} - \text{tax-free component}
\]

As a general rule the taxable component of a membership interest in a taxed superannuation fund is the element taxed in the fund and the tax-free component of a membership interest is the sum of:

- the contributions segment, and
- the crystallised segment.

At the time of payment of a benefit from a taxed superannuation fund, the fund must calculate the tax-free and taxable component for each benefit paid. Subsequently a proportioning rule is used to calculate the tax-free and taxable components of future benefits paid.

7.610 Contributions segment

All contributions made from 1 July 2007 that have not been included in the assessable income of the fund form the contributions segment. In many cases this would simply be the member’s non-concessional contributions or personal contributions for which an income tax deduction was not claimed.

Superannuation benefits rolled over into a separate interest are in a sense also viewed as being contributions, whereas the taxable component of the benefit rolled over into the interest is not taken to be part of the contributions segment. It is not taxed again on rollover.

7.620 Crystallised segment

For the calculation of the crystallised segment reference must be made to the contributions history prior to 1 July 2007.

The crystallised segment is calculated based on the assumption that an eligible termination payment (ETP) was made to the member just prior to 1 July 2007, consisting of the entire superannuation interest of the member from the account.

The crystallised segment is calculated to be the sum of the following components of the interest:

- the concessional component
- the post-June 1994 invalidity component
- undeducted contributions
- the capital gains tax (CGT) exempt component, and
- the pre-July '83 component.

These five components combine to form the tax-free portion or the crystallised segment of the account. Some accounts have none of these components and comprise fully taxable interests.

Others may have some undeducted contributions and some pre-July 1983 service attached to the account.
7.630 Taxable component calculation

The taxable component of the superannuation interest is calculated by subtracting the tax-free component from the total value of the superannuation interest. Although the taxable component can consist of an element taxed in the fund and/or an element untaxed in the fund, the taxable component of a superannuation interest in a taxed fund normally consists solely of an element taxed in the fund, whereas generally the taxable component of a superannuation benefit paid from an untaxed fund consists solely of an element untaxed in the fund. SMSFs are not permitted to hold untaxed elements as part of a member’s superannuation interest (see 8.400).

EXAMPLE

Murray, age 65, commenced a pension on 1 July 2007 from his SMSF. The account balance was $480,000 with $110,000 of undeducted contributions with a service date of 1 May 1975.

The crystallised segment is calculated based on the assumption that an eligible termination payment (ETP) was made to the member just prior to 1 July 2007.

Start service date ................................................................. 1 May 1975
ESP total days to 30 June 2007 ............................................ 11,749
Pre-July 1983 days .............................................................. 2,983
Post-June 1983 days ........................................................... 8,766

Components of the fund

<table>
<thead>
<tr>
<th>Account balance (ETP)</th>
<th>$480,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>UDC</td>
<td>$110,000</td>
</tr>
<tr>
<td>Concessional component</td>
<td>0</td>
</tr>
<tr>
<td>Post-June 1994 invalidity component</td>
<td>0</td>
</tr>
<tr>
<td>Non-qualifying component</td>
<td>0</td>
</tr>
<tr>
<td>Excessive</td>
<td>0</td>
</tr>
<tr>
<td>CGT-exempt</td>
<td>0</td>
</tr>
</tbody>
</table>

Pre-June 1983 component (the smaller of the following two calculations)

Calculation 1 (UDC is not taken into account)

\[(ETP – C – IC – NQ – EC – CGT) \times \text{(Pre-July 1983 period)} / \text{(Total period)} = 121,869\]

Calculation 2

\[ETP – CC – IC – NQ – EC – CGT – UC = 370,000\]

Pre-July 1983 = $121,869
Post-June 1983 = $248,131
Exempt component = $110,000 + $121,869 = $231,869
Crystallised segment = Exempt component at end 30 June 2007 = $231,869
The taxable component = $248,131

Since Murray expects to receive a pension, the following will be more useful to him:

Tax-free proportion \((\text{Exempt: Total}) = \frac{231,869}{480,000} = 48.31\%\)
7.640 Proportioning rule

As a general rule, when a superannuation benefit is paid from a superannuation interest it is likely to include both a tax-free and a taxable component, depending on the make up of the original interest. We have referred to the ratio of the tax-free component in the interest to the total interest as the exempt ratio or tax-free proportion.

Income stream

When an income stream payment is made, the tax-free proportion of the income stream is retained for the duration of that income stream. Thus any payment received from the income stream is received according to the tax-free proportion of the income stream.

When an income stream ceases the tax-free proportion determines the proportions of the exempt and taxed component of the interest and these amounts are the new components of a new accumulation interest or they are added to an existing accumulation account on the basis of the account’s components.

Lump sums

Similarly, with lump sum payments made from a superannuation fund, the tax-free proportion of the interest forms the basis for determining the split between the exempt or tax-free component of the lump sum payment and the taxable component of the lump sum payment. The proportions are determined immediately prior to the withdrawal of a lump sum.

Proportioning rule in practice

As noted the benefit typically includes both a taxable component and an exempt or tax-free component. These appear in the same proportion as they occurred in the interest from which the payment commenced.

**EXAMPLE: Applying the proportioning rule when paying a benefit as an income stream**

Nancy is 58. She commenced an income stream from the NancyQ SMSF on 1 July 2008 when her interest in the fund was $500,000. It included a tax-free component of $75,000. She intended to receive a gross amount of $20,000 for the year.

What are the tax-free and taxable components of her payment?

Since the tax-free component of her interest was $75,000, the balance of $425,000 is the taxable portion of her interest.

The tax-free proportion of the interest is given by \(\text{Tax-free component} / \text{Account balance} = \frac{75,000}{500,000}\)

The tax-free proportion is 15%. Therefore 15% of any payment she receives from this income stream is the tax-free portion and the balance or 85% of any payment received is the taxable portion of the benefit.

Since she receives a gross payment of $20,000, the tax-free component is 15% \(\times\) $20,000 = $3,000.

The annual tax-free component of the payment is $3,000 however the balance of $17,000 is assessable.

Since Nancy is not yet age 60, there is likely to be a potential PAYG implication for the NancyQ SMSF.

There is also a need to recognise the assessable income from the superannuation benefit received by Nancy in her individual tax return.

**EXAMPLE: Applying the proportioning rule when paying a benefit as a lump sum**

Eric, age 57, has retired permanently from the workforce and has therefore met a condition of release for his benefits. His account balance is $480,000. He has other investment related income and does not want to commence an income stream. He wants to leave his account in accumulation however he wants to drawdown a gross amount of $50,000 on 1 July 2015 to clear all outstanding debts.

On 1 July 2007 the crystallisation of his account indicated that the total tax-free portion of the account was $120,000 and the balance was the taxable amount in the fund. Eric has not made any non-concessional contributions to his account after 30 June 2007.
At 1 July 2015 the account balance is $480,000. Of this amount the tax-free component is unchanged at $120,000 from 30 June 2007 as there have not been any further non-concessional contributions. The tax-free proportion is therefore $120,000 / $480,000 = 25%.

Eric’s benefit is $50,000. It comprises a tax exempt component of 25% of $50,000 = $12,500. This is tax-free for Eric.

The balance of the payment is assessable because Eric is under the age of 60. Assessable income for Eric is ($50,000 – $12,500) = $37,500.

Eric is over 55 and therefore may be able to make use of the concessional (once in a lifetime) low rate threshold of $195,000 in 2015-16.

If he is able to do this he would also receive the taxed element of the benefit tax-free.

**EXAMPLE: Applying the proportioning rule when paying a benefit**

Peter is 56 and withdraws a $50,000 lump sum from his taxed superannuation fund. Just before this benefit is paid, he had a superannuation interest with a value of $400,000. The superannuation interest includes a tax-free component of $100,000, made up of a $5,000 contributions segment and a $95,000 crystallised segment.

What is the taxable component of his benefit?

**Step 1: Calculate the tax-free proportion of the interest.**

Determine the tax-free component and value of Peter’s superannuation interest just before the benefit is paid:

- Tax-free component = $100,000; value of the interest = $400,000.
- The tax-free proportion is $100,000 / $400,000 = 25%.

**Step 2: Calculate the taxable component of Peter’s lump sum benefit**

Apply the proportioning rule to the lump sum payment to determine the tax-free component of Peter’s lump sum as follows:

- Lump sum amount is $50,000, and tax-free proportion is 25%.
- The tax-free amount of the lump sum benefit is $50,000 x 25% = $12,500.

The taxable component of Peter’s lump sum benefit is therefore ($50,000 – $12,500) = $37,500.

**Exceptions to the proportioning rule**

Section 307-120 ITAA97 directs that the tax-free and taxable components of most superannuation benefits, are calculated using the proportioning rule unless an alternative provision applies to determine the components. The exceptions are a:

- superannuation guarantee payment
- superannuation co-contribution benefit payment, or
- contributions splitting superannuation benefit.

Under s307-130 ITAA97, a superannuation guarantee payment made directly to the employee or former employee will contain only a taxable component. Under s307-140 ITAA97, a contributions-splitting superannuation benefit will contain only a taxable component. Under s307-135 ITAA97, a superannuation co-contribution benefit payment will have only a tax-free component.

The components of lump sum disability benefits and benefits that contain an element untaxed in the fund may be modified under sections 307-145 and 307-150 ITAA97 respectively. In both cases, the tax-free component calculated using the normal proportioning rule is increased.
Modifications to the proportioning rule for a disability superannuation lump sum benefit

To determine the tax-free component of a disability superannuation lump sum benefit, a modified version of the proportioning rule is used. This approach calculates the tax-free component as above, without any modification. It also calculates an amount equal to the benefit multiplied by the prospective days to retirement divided by the service period plus prospective days to retirement. The larger amount is used as per s307-145 ITAA97.

TA 2009/10: Non-commercial use of negotiable instruments involving SMSFs

This Taxpayer Alert describes arrangements involving the non-commercial use of negotiable instruments, some of which include the trustee of an SMSF giving a promissory note to a member to pay a benefit. The ATO considers such arrangements give rise to breaches of the benefit payment standards under SIS Act and SIS Reg.

7.650 Trigger event for pre-July 2007 pensions

The components of the member’s interest must be identified to reflect the components as represented by the exempt and taxed components of the account (see 7.600).

Since a membership interest may be in either the pension or the accumulation phase, separate procedures apply.

For an interest that is already in pension mode, this will continue in its current state unless a trigger event takes place at which point a re-calculation must be done.

Trigger event

A trigger event is deemed to have occurred in relation to an income stream:

a) on 1 July 2007 if the member is 60 years of age or more
b) on the date when the member actually turns 60
c) on the date the member dies
d) on the date when either a full or partial commutation occurs

A trigger event requires the calculation of the two components of the pension account. The tax-free proportion of the account is then determined (proportion of exempt component to the total pension account) which is retained for the duration of the pension.

The proportioning can determine the absolute size of the exempt component at a future time.

\[
\text{Exempt component} = \text{Pension account balance} \times \text{tax-free proportion}
\]

Thus if the superannuation interest of a deceased member’s pension is to be paid to a non-dependant this calculation must be carried out to determine the exempt or tax-free amount. The balance is taxed at 15%.

Accounts in accumulation phase require the re-computation of the amounts into the two simplified components at the commencement of 1 July 2007 (see Crystallised segment at 7.620).

Typically an exempt component in the accumulation phase remains fixed in size with the passage of time until it is increased through a non-concessional contribution (ie a post-tax or undeducted contribution).

A taxpayer who is in receipt of an income stream from a taxed superannuation fund and will turn age 60 in the year of income may have the PAYG instalment reduced to reflect the income tax-free portion of the income from the date of turning 60.

If a taxpayer turns 60 in the year of income and is able to defer the receipt of income from their fund until after age 60, they may consider doing this.

A superannuation interest that pays a benefit from an interest that has a 100% tax-free proportion is tax-free for a beneficiary who has not yet reached 60.
**EXAMPLE**

Victor is aged 55 and has just received the trust deed to his new SMSF. He deposits $450,000 from the sale of his home and commences an income stream immediately on 1 July 2008.

Since this forms the entirety of the funds in his account, all of which comprises non-concessional contributions, this is the Tax-free component of the account with no taxable component.

Since there are no earnings or concessional contributions to the fund, the Tax-free proportion of the account is 100%. What about the taxation of income streams paid to those under 60 from a taxed superannuation fund that is 100% exempt?

This is a special case because the tax-free proportion of the interest is 100%.

Therefore all benefits paid by the interest are non-assessable non-exempt.

Put simply, these payments are tax-free despite the fact that the recipient is under 60.
7.700  Death benefits

Dependant beneficiaries

Subject to certain conditions (see Note below), upon the death of a member their benefits in the fund may be paid to dependants from accumulation or pension interests by way of a lump sum, a new superannuation income stream or a reversionary pension.

A lump sum death benefit is received tax-free by dependants.

A new income stream is assessable for recipients not yet 60 in respect of the benefit’s taxable component.

A reversionary pension benefit is tax-free when paid to a dependant aged at least 60 or if the deceased member was at least 60 at the time of death regardless of the reversionary’s age.

NOTE: If a child dependant is in receipt of a reversionary pension this benefit may only be received as a pension as long as the beneficiary is not over 25. Any residual benefit must be fully paid out before the dependant is over 25. This lump sum benefit is tax-free in the hands of the beneficiary.

Otherwise (if the deceased member was not yet 60 and the benefit was to be paid as a reversionary pension) the tax payable depends upon the age of the beneficiary. The benefit is tax-free if the recipient is at least 60. Otherwise it is assessable with the taxable portion of the payment being fully rebatable at 15%.

The portion of a pension payment represented by its tax-free proportion is non-assessable and non-exempt (NANE) income.

If the primary beneficiary of a reversionary pension is not yet age 60 at the time of death, the taxable component of the reversionary benefit is assessable (with the 15% rebate) until the reversionary reaches age 60. Upon reaching age 60 the benefit is NANE.

(The provisions preclude the receipt of such reversionary pensions by non-dependants. For the tax treatment of non-dependant beneficiaries see the concluding part of 8.600.)

NOTE: A trustee may be able to pay a benefit to an individual because that individual is a dependant in respect of the SIS Regulations however in respect of the tax rules the definition is much more restrictive and therefore there could be adverse taxation outcomes.

Lump sum death benefits are received tax-free by dependants irrespective of age. This includes payments that may have a tax-free or taxed component including an element untaxed in the fund.

EXAMPLE

Arthur, age 60, was married to Jean age 57 and passed away unexpectedly. He was in receipt of an account based pension from his SMSF, with a current balance of $476,000. Jean, his only dependant, is named in the binding death nomination signed by Arthur.

Jean may opt to receive the entire account balance of $476,000 as a lump sum superannuation death benefit. This is received tax-free by her.

Alternatively she may opt to receive a reversionary account based pension. These payments are also tax-free to her.

NOTE: Death benefits arising from the proceeds of a life policy owned by the fund and taken out on the life of the deceased are tax-free in the hands of a dependant.

EXAMPLE

When Keith Dunray, a 53 year old widower passed away, he left behind his 22 year old dependant daughter Kim. The Dunray Super Fund received a life insurance payout of $500,000 from the Not So Lucky Life Company. This represented a substantial boost to the $150,000 interest held in his account. Kim chose to receive the entire death benefit payment from the Dunray Super Fund as a lump sum benefit of $650,000. The death benefit payment she receives is tax-free. It is a superannuation death benefit lump sum payment received by a dependant.
The Commissioner has indicated that the requirement to make a minimum payment prior to commutation would not apply in circumstances where the commutation arose from the death of the pensioner member. This enables an existing pension to retain its ECPI in the year of death, where the minimum draw down standard was not met before the pensioner’s death.

We expect that such a view will be unchanged as a result of the recent provisions extending the ECPI until after the member’s death, and until the benefits are paid out.

**Definition of dependant: SIS Act**

The term dependant under the SIS Act definition refers to the spouse and any child of the member, independent of the financial dependency of the child on the member at the time of death. A spouse under SIS Act includes a de facto spouse but does not include an ex-spouse.

A dependant is also someone who is financially dependent on the person and under s10 SIS Act a dependant includes a person with whom the deceased had an interdependency relationship.

**Definition of dependant: Tax Act**

On the other hand for tax purposes a dependant includes the current or ex-spouse of the member; a bona fide de facto and any child of the member who has not reached the age of 18 years. It also includes someone who is financially dependent on the person or one with whom the deceased person had an interdependency relationship.

Under s302-195 ITAA97, a death benefits dependant of a deceased person is defined as:
(a) the deceased person’s spouse or former spouse, or
(b) the deceased person’s child, aged less than 18, or
(c) any person with whom the deceased person had an interdependency relationship under s302-200 immediately prior to death, or
(d) any other person who was a dependant of the deceased just before their death.

**Interdependency relationship**

Section 302-200 defines an interdependency relationship in respect of a death benefits dependant as follows:

Two persons, irrespective of whether or not they are related by family, are said to have an interdependency relationship under s302-200(1) if:
(a) they have a close personal relationship, and
(b) they live together, and
(c) one or each of them provides the other with financial support, and
(d) one or each of them provides the other with domestic support and personal care.

Further, two persons, irrespective of whether or not they are related by family, are said to have an interdependency relationship under s302-200(2) if:
(a) they have a close personal relationship, and
(b) they do not meet one or more of the requirements of an interdependency relationship under s302-200(1) above in respect of items (b), (c) and (d), and
(c) the reason they do not satisfy those requirements is that either or both of them suffer from a physical, intellectual or psychiatric disability.

**Non-dependant beneficiaries**

Death benefits may only pass to non-dependants where they are paid as lump sum benefits. The payment of a death benefit income stream is not available to a recipient who is a non-dependant for tax purposes.

Lump sum death benefit payments to such beneficiaries may not be retained or rolled over within the superannuation environment. The receipt of such benefits must take place outside the superannuation environment and subsequently returned to superannuation if required subject to the contribution caps.
CGT ON DEATH BENEFIT

Exempt current pension income (ECPI) provisions apply to the earnings of pension assets following the death of the member until such time as the benefits are paid out to beneficiaries; subject to the death benefit payments being effected as soon as practicable following the member’s death.

**Exempt or tax-free component**

The exempt component is tax-free to the recipient.

**Taxable component**

The taxable component is assessed and taxed as follows:

- For the element taxed in the fund (the most common situation) the rate is 15% plus Medicare levy.
- For the element untaxed in the fund the rate is 30% plus Medicare levy.

<table>
<thead>
<tr>
<th>Death benefit lump sum payment made to a non-dependant</th>
<th>Rate of taxation excluding Medicare levy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax-free component</td>
<td>0%</td>
</tr>
<tr>
<td>Taxable component – taxed element</td>
<td>15% plus Medicare*</td>
</tr>
<tr>
<td>Taxable component – untaxed element</td>
<td>30% plus Medicare*</td>
</tr>
</tbody>
</table>

*The above non-zero rates must be increased by the Medicare levy.

### 7.710 Nomination of a beneficiary

Superannuation benefits are held in trust by the trustee on behalf of the member or member’s dependants. When a member dies, their benefits do not generally form part of their estate. Usual practice is that members nominate who they prefer to receive death benefits. This nomination can be for one or more beneficiaries, all of whom must be the member’s dependants and can be binding on the trustee where the trust deed permits a binding nomination to be made.

When a member makes a binding nomination the trustees, or directors of the trustee, should verify that:

- the trust deed allows a binding nomination to be made, and if it does not, have the deed amended to allow such a nomination, and
- the information in the nomination is sufficiently clear (ie the proportion) and valid (ie the person is the member’s spouse, child (of any age) or other person financially dependant on the member or the member’s legal personal representative) before the benefit is actually paid.

The personal legal representative of the member’s estate can be nominated and where this is done, the benefit will go to the member’s estate. However, this will almost certainly delay the payment reaching dependants, add an additional unnecessary layer of complexity, and incur additional legal and/or accounting costs for the estate. These delays, complexities and costs will escalate if the deceased member’s will is challenged.

**Trustee must follow a valid binding death nomination**

Where the trust deed permits a member of the fund to require the trustee to provide any benefits in accordance with sub regulation (2), the trustee must pay a deceased member’s death benefit to the person(s) nominated in a binding death nomination, provided that:

- the trust deed permits it
- the nominated person(s) is the legal personal representative or a dependant of the member
- the proportion that will be paid to that person is certain or can readily be worked out, and
- it has been signed and dated by the member and two people (witnesses) neither of whom are nominated as beneficiaries, and it contains a declaration by the witnesses stating that the notice was signed by the member in their presence.
A binding nomination ends the earlier of:

- it being revoked or amended by the member, or
- if an earlier date is fixed in the trust deed.

One view that has been popular is that a binding death nomination must be validated every three years. However more recently the prevailing view is that a properly signed binding death nomination is valid until it is revoked or amended by the member.

7.720 Reversionary pensions

In general and subject to the terms of the trust deed, superannuation benefits may be received as one or more lump sums and/or as one or more income streams. For benefits paid as the result of the death of a member, restrictions apply as to the form in which the benefits may be received by a non-primary beneficiary.

To reiterate, non-dependants may only receive death benefits as lump sum/s whereas dependants may receive lump sums and/or income streams and generally children must cash out benefits as a lump sum no later than age 25 (see 8.600).

A reversionary pension is a special case of a death benefit being paid to a dependant as an income stream. One of its important features is that it automatically reverts to the dependant as nominated following the primary pensioner's passing. The existing pension therefore continues uninterrupted, except that it is now received by the reversionary beneficiary without recommencing as a new pension.

Non-commutable income streams are typically existing defined benefit and market linked income streams have the relevant reversionary life expectancy factored into the pension at its commencement.

For account based income streams the relevant minimum drawdown rate for the year of death is the rate that was established at the start of that year. In the new financial year following the death of the member the relevant minimum drawdown rate for the year reflects the age of the new recipient.

Public offer products have the details of reversionary pension issues in their product disclosure statement (PDS).

If a member in receipt of a transition to retirement account based pension passes away, the reversionary beneficiary may choose to receive an account based pension due to the death condition of release of benefits.

For the tax treatment of superannuation benefits see Chapter 8.
7.800 Administrative arrangements for paying benefits

All SMSFs must meet their obligations in relation to the lodgment of an annual fund tax return and their annual audit.

The administrative arrangements for members under 60 reflect the existing arrangements applicable prior to 1 July 2007.

A streamlined arrangement applies for those 60 and over.

7.810 Pension payments

Pre-July 2007 pensions

For current pensions that were commenced pre-1 July 2007 the following administrative obligations must be met for recipients who are under 60. (These are the same requirements that were necessary for all income stream recipients in the past irrespective of age and therefore should already be in place if pensions commenced prior to 1 July 2007). They include:

- registering for PAYG
- ensuring the regular payment of PAYG
- submitting a PAYG Summary at end of year
- providing a TFN, and
- varying withholding amounts if necessary.

For an allocated pension being paid prior to 1 July 2007 and subsequently drawn down as an account based pension, the extent of administration required depends on whether the recipient has reached 60. The same applies for other pensions.

60 and over

For those 60 and over there is a need to wind down the PAYG arrangements for their pensions because this obligation is no longer necessary.

Under 60

For those under 60 the same obligations must be met that were required prior to 1 July 2007 as shown above.

Post-30 June 2007 pensions

For pensions commencing post-30 June 2007 to recipients 60 or over there are no reporting requirements. For those under 60 the above obligations will have to be met for their assessable income.

A taxpayer who is in receipt of an income stream from a taxed superannuation fund and will turn age 60 in the year of income may have the PAYG instalment reduced to reflect the income tax-free portion of the income from the date of turning 60.

Those who turn 60 in a year of income may consider deferring their drawdown/s until after their birthday.
The following table provides a summary of the withholding obligations for funds paying income stream benefits.

**Summary of withholding obligations**

<table>
<thead>
<tr>
<th>Age of member</th>
<th>Tax-free component</th>
<th>Taxable component</th>
</tr>
</thead>
<tbody>
<tr>
<td>60 years and over</td>
<td>Funds are not required to withhold any tax</td>
<td>Withhold tax from the amount paid prior to member</td>
</tr>
<tr>
<td></td>
<td>from a payment and issue a payment summary</td>
<td>turning 60 years</td>
</tr>
<tr>
<td>If a member turns 60 during the year</td>
<td>No tax withheld</td>
<td>Withhold tax</td>
</tr>
<tr>
<td>Preservation age but under 60</td>
<td>No tax withheld</td>
<td>Withhold tax</td>
</tr>
<tr>
<td>Below preservation age</td>
<td>No tax withheld</td>
<td>Withhold tax</td>
</tr>
</tbody>
</table>

**Checklist**

- Funds should use the appropriate tax table depending on the period for which the income stream covers, i.e., weekly, fortnightly or monthly.
- If a member has not provided their tax file number, withhold tax at the rate of 46.5% from the tax-free component.
- For members who turn 60 during the year or who are at preservation age but under 60, as the member is entitled to 15% of the taxable component as a tax offset, the amount of tax to be withheld is adjusted to take into account the tax offset.
- If a lump sum is paid, then to the extent that this lump sum represents superannuation income stream amounts that accrued in a previous year or years, the tax-free and taxable components of the lump sum should be included at the relevant Lump sum in arrears labels.

**7.820 Before commencing a pension**

As part of the management of an SMSF, the trustee's duty includes a general requirement to maintain a full set of up-to-date minutes for the fund. Accordingly, before the payment of benefits occurs, it is necessary for the trustee to receive written notification from the member seeking to receive their benefits from the fund.

In particular for a pension, the request should indicate whether the entire accumulated benefits are to be used to support the pension or whether only a proportion of the benefits are to be used for the purpose. For lump sum payments, an indication of the amount is also necessary (i.e., the full amount or some proportion of the total benefit) or other measure as appropriate.

The notification may indicate a future date for payment or commencement date of a pension, together with any other details that the member may choose to provide, for example, the timing and frequency of payments etc.

Provided the member has satisfied a condition of release in respect of access to their benefits, the trustee/s should minute that a request has been made and the date on which the pension is to commence. Before the fund is permitted to pay any benefits to a member, as sought in the request, the trustee should confirm that the trust deed allows for the benefits to be paid as requested. If the trust deed does not permit the payment of the benefit as sought, then action should be taken to amend the deed to enable the payment of benefits as sought, in accordance with the appropriate legislation.

The trustees must notify the member of the tax-free proportion of the benefit when this is paid.

Subject to certain exemptions, SMSF trustees are required to issue a Product Disclosure Statement (PDS) in accordance with the Regulation 7.1.04E of the Corporations Regulations 2001. This regulation states that the issuing of a PDS should occur at the earlier of:

- acknowledgement of receipt of the member’s election, or
- the making of the first benefit payment.
Exemption from PDS

The exemption that excludes the need to issue a PDS may be found under s1012D (2A) of the Corporations Act 2001.

Where the trustees of an SMSF believe that the member “has received, or has and knows that they have access to all of the information that the PDS would be required to contain” then they are exempt from this regulatory requirement.

PDS issues

If it is decided that the member should receive a PDS, it must contain sufficient information to allow the member to make informed decisions in respect of the benefits they intend to receive.

The following is a non-exhaustive list of the issues that the PDS may address:

- the characteristics of the pension and how it works
- whether it can be commuted
- whether a reversionary beneficiary can be nominated and the implications of this decision
- particular tax and legal constraints that may apply
- the market and longevity risks involved, and
- the implications for social security benefits of receiving the pension (if appropriate).

Other considerations

Since no further contributions or rollover amounts can be added to a member’s (account based) pension once it is commenced it is important to finalise certain details before the benefit is paid or the pension commenced. This may include:

- rolling in moneys from other funds if this is appropriate
- or not rolling in those monies if that could result in future tax issues
- making further concessional and/or non-concessional contributions if appropriate
- deciding whether there is to be a reversionary beneficiary and setting in place the necessary steps, and
- reviewing the tax implications of the receipt of benefits.

If it is necessary to make additional contributions to superannuation following the commencement of an account based pension, it is possible to set up a separate accumulation account within the same SMSF into which the additional contributions are received. This is necessary if a segregation of assets is required for transition to retirement pension for recipients who are still working or in receipt of income that they may wish for retirement savings.

The freedom to make superannuation contributions prior to age 65 and for older eligible members under the age of 75 may also call for the setting up of a separate accumulation account to segregate assets.
7.900 Splitting superannuation on marriage breakdown

When a marriage or de facto relationship breaks down property can be divided between the parties. Superannuation is treated as property under the Family Law Act 1975 but it differs from other types of property because it is held in a trust.

Superannuation splitting laws allow superannuation to be divided when a relationship breaks down. If there is a payment splitting agreement or order operating on a superannuation interest, the splitting laws may permit the creation of a new interest for the non-member spouse. They may also permit a transfer or roll-out of benefits for the non-member spouse to another fund.

These options are known as interest splitting, which lets the non-member spouse access entitlements independently of the member spouse.

- The superannuation assets that form part of any agreed or court imposed arrangement remain within the superannuation environment. Such assets remain subject to the conditions of release of benefits under superannuation law.

Trustees of superannuation funds must comply with superannuation agreements or court orders that provide for a division of a superannuation interest.

- Where splitting arrangements are put into place the proportioning rule will apply for the benefits. The interest that is transferred or split to the non-member spouse will retain the tax-free proportion of the member’s benefit at the time of splitting. If the superannuation interest is flagged the proportioning rule will then apply at the date of retirement or when the split is made.

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