Self Managed Super – Commencing an SMSF pension

Super legislation imposes strict conditions that regulate when super can be accessed. These are collectively known as 'conditions of release'. When certain conditions are met, it may be possible to receive ongoing and regular payments from your accumulated benefits by commencing an account based pension.

It is important that the pension is set up properly in line with not only legislative requirements, but also in accordance with any particular fund rules stipulated in your fund's trust deed. Following is a summary of the steps that may need to be taken.

Formally commencing a pension

When a member of an SMSF wishes to commence a pension, the member must provide the trustee with a written request confirming that a condition of release has been met and notifying of their intention to access benefits as an account-based pension. This request should specify how much to roll over to the pension phase.

Any additional relevant information regarding the proposed pension should also be stated and communicated to the trustee in writing. This may include:

- including the intended commencement date
- nominated pension payments
- frequency of pension payments, and
- where pension payments should be directed.

It is important to consult the trust deed to ensure that any specific fund rules in relation to pensions are reflected in the terms of the pension agreement.

It may be possible to commence a 'transition to retirement pension' (TTR). A TTR may be commenced when a member reaches preservation age, and is non-commutable. This means that lump sums cannot be drawn, and as well as meeting annual legislated minimum payments, there is also an upper limit on the value of annual pension payments.

Generally, when another full condition of release is met at a later time (for example, attaining age 65) it may be possible for the TTR pension to enter what is known as 'retirement phase'. While there is a lifetime limit on the total amount that can be transferred to 'retirement phase' pensions, a benefit of a pension entering retirement phase is that earnings in the pension are tax free.

NOTE: Please refer to the 'Retirement Income: Transition to Retirement Pension' and 'Retirement Income: Account-based Pension' Understanding Series for further information on these income streams.

Review trust deed

The trustee should check the fund's trust deed to determine if there are any restrictions. In particular, the trustee should check that the member's benefits can be released, that the fund is able to pay an account-based pension, and whether or not the fund can cater for the estate planning needs of the member.

Provide confirmation to member

The trustee should provide the member with a written confirmation that the fund can pay the requested pension.

Determine the member's entitlement

Trustees should verify the value of the member's superannuation account and the underlying tax components. This will require obtaining a current valuation of assets.

Determine whether to segregate assets or not

If the SMSF will have members in both accumulation and pension phases, trustees will need to decide whether pension assets should be segregated or not. If left unsegregated, the trustee will need to obtain an actuarial certificate each year to determine exempt current pension income to obtain tax exemptions.

In some cases, the fund is unable to use the segregated method where any member of the fund has a total super balance (as at the prior 30 June) of $1.6 million or more, where that person is also the recipient of an account based pension (regardless of whether or not the pension is paid from the SMSF or another fund).

Review investment strategy

The trustees should review the fund's investment strategy to determine if changes are necessary to facilitate the payment of the pension or whether the member's risk profile has changed. Strategies for liquidating investments to enable payment of the pension may need to be considered. The trustee should document the outcomes of this review by preparing a trustee minute and make any necessary changes to investments.

Set up pension and review death benefit nominations

The fund accounts should be adjusted to record the commencement of the pension and appropriate mechanisms put in place to make the regular pension payments. It is also important at this point to ensure that death benefit nominations remain valid and appropriate. For example, you should review whether or not a new and distinct death benefit nomination needs to be made directly in connection to the new pension account, or whether the rules of the fund provide that any valid nomination in connection with an accumulation interest also extend to a pension account of that member.

It may be possible upon the commencement of a pension for a member to establish a reversionary death benefit nomination. A reversionary nomination may provide for the member's pension to automatically revert to the nominated valid beneficiary upon the member's death. Before implementing a reversionary nomination, the trust deed should be reviewed to ensure that this type of nomination is acceptable under the rules of the fund.

Taxation obligations

If the member is under age 60, the fund will need to register as a PAYG payer and deduct tax (as applicable) from each payment. The member should provide the trustee with a TFN declaration form.

The trustee will have reporting obligations relating to the transfer balance cap. The transfer balance cap limits the amount that can be transferred into what is known as the 'retirement phase' of superannuation and receive the benefit of 0% earnings tax. An account based pension in retirement phase is assessed against the member's transfer balance cap. Once a TTR moves into retirement phase it is also reported for transfer balance cap purposes at that time.

Trustees of SMSFs who require specific advice on meeting tax obligations should seek advice from a registered tax agent specialising in SMSFs.

NOTE: Please refer to the 'Retirement Income: Transfer Balance Cap' Understanding Series for further information.

Calculate and pay pension payments to member

The trustee must ensure pension payments are paid at the requested frequency into the member's nominated bank account. The trustee should also ensure that at least the required minimum is paid each year. In the event that the legislated minimum annual pension payment is not paid, the fund may not qualify for the tax concessions applicable to earnings in retirement phase income streams (where a full condition of release has been met).

Ongoing review and maintenance

In addition to the usual trustee obligations, commencing a pension increases the fund's annual obligations, which may include arranging actuarial certificates, reviewing minimum pension payments, and issuing pension members with payment summaries (if appropriate) and Department of Human Services/Department of Veterans Affairs schedules (these may be needed only if the pension commenced before 1 January 2015).

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