MLC TechConnect

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Minimum pension requirements and implications

Super income stream providers must ensure the minimum pension payment requirements under the legislation are met. It's important to understand the rules and advice implications.

Background

The super legislation requires a super income stream to meet two requirements:

- pension payment occurs at least annually, and
- a minimum amount is paid to the member each year.

There are implications for the super fund and possibly the client if these requirements are not met.

In this article, we explain the minimum pension requirements for account based pensions, the implications if not met and important considerations.

Minimum pension requirements

The minimum pension payment is determined based on a legislative formula and depends on several factors, including the:

- client's age
- account balance, and
- start date of pension.

For account based pensions, the formula is:

Account balance x percentage factor

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The formula calculates the minimum annual payment amount by multiplying the client's pension account balance by a percentage factor (which correlates to their age at the time of commencement of the pension or at each subsequent 1 July). This amount is rounded to the nearest 10 whole dollars.

The percentage factors are:

Age of beneficiary (at commencement or 1 July)	Minimum percentage factor
Under 65	4%
65-74	5%
75-79	6%
80-84	7%
85-89	9%
90-94	11%
95 or more	14%

Advice tip

Fund product rules may require a minimum pension payment greater than the minimum pro-rated payment required by law.

If the pension commences:

- **on a day other than 1 July**, there is a requirement to pay the minimum amount for the first year in proportion to the number of days remaining in the financial year, including the start day, and
- **on or after 1 June in the financial year**, no payment needs to be made in that year of commencement.

For pensions in existence on 1 July, if the pension ceases part way through the year (other than on 30 June), the minimum amount is in proportion to the number of days the pension was in existence in that financial year. Pensions commenced during a financial year which cease before the end of the financial year must pay a minimum pension based on the number of days in existence.

Where a super provider, including an SMSF, pays more than one pension to one or more members, the minimum pension payment requirements must be met for each pension based on the formula.

The required minimum pension amount must be paid by 30 June for that financial year (or earlier when taking into account potential delays in electronic transfers of funds) and trustees cannot record any underpayment of the pension as an accrual in the fund's accounting records.

Example 1 – Calculation of minimum payment

Ben (66) purchases an ABP on 1 August 2024 for $100,000. Ben's minimum payment in that first year is calculated as follows:

<u>Annual payment</u>

$100,000 × 5% = $5,000

<u>Pro-rated payment</u>

$5,000 × 334 ÷ 365 = $4,580 (rounded to nearest $10)

Note: 334 is the number of days from commencement on 1 August 2024 until the end of the financial year (inclusive).

Commutations

While pension payments must be paid in cash and cannot be made using assets such as an in-specie benefit, lump sum super commutations can be paid using cash or assets (in-specie when the fund's trust deed permits).

Full or Partial commutation payments do not count towards minimum pension payments. This is regardless of whether the payment is made in cash or in-specie. Where the minimum payment has not yet been paid, before taking a partial commutation, ensure there is sufficient balance remaining in the pension to meet the minimum pension requirements (based on the original value of the pension at the start of the year or at commencement if the pension commenced during the year).

Receiving partial commutation payments, from a non-grandfathered account based pension, doesn't increase the income test for Centrelink purposes, as these are subject to deeming. However, partial commutations (and pension payment) may potentially reduce based on next year's 1 July balance. This may also reduce minimum pension payments and Centrelink's deemed income.

To meet the minimum annual pension requirements up to the time the pension ceases as a result of a full commutation, clients should ensure the required minimum annual pension amount has been paid as a separate payment (in cash) <u>prior to</u> the lump sum payment being made.

Clients with a transition to retirement pension are not entitled to access their capital as a lump sum, except for an unrestricted non preserved component. However, some product providers may limit access to a lump sum even in cases where unrestricted non preserved is held in the transition to retirement pension.

Example 2 – Commutation and pro-rata minimum required

On 1 July 2024, Jessica, 66, had an account based pension with a balance of $300,000. The minimum pension payment for the financial year is $15,000 ($300,000 x 5%). On 1 August 2024, she decides to change providers and rolls over the entire balance at that time. There are 32 days from 1 July to 1 August, so the pro-rata minimum amount is $15,000 x 32/365 = $1,320 (rounded to nearest $10). The pension payable period includes the day of the commutation. As at 1 August 2024, Jessica must take an income payment of $1,320 before commuting and rolling over.

In year of death

If a super income stream automatically transfers to a beneficiary on the death of a pensioner (ie a reversionary pension), the trustee must ensure that the minimum pension payments continue to be made to the reversionary beneficiary by 30 June in the year the primary member dies. This minimum continues to be based on the original determined for the deceased member. The minimum amount for the reversionary pensioner is recalculated on the following 1 July using the reversionary pensioner's age.

Advice tip

For reversionary pensions, in the year of death, the SMSF trustee may wish to ensure that the minimum pension payments are paid prior to the member's bank account being frozen when the bank is notified of the member's death.

If a member with a non-reversionary account-based pension dies, there is no requirement to meet the minimum pension payment in the year of their death. If the deceased member's benefits are subsequently used to commence a new pension to a beneficiary (a death benefit pension), the trustee is required to ensure the new minimum annual pension amount is paid in the relevant year, based on the recipient's details at when the death benefit pension starts. This may result in a pro-rata minimum pension payment if commenced during the financial year.

Consequences if minimum requirements aren't met

- If a trustee fails to meet the minimum pension payment requirements under the SIS Regulations, the superannuation income stream is taken to have ceased at the start of that income year for tax purposes. Accordingly, any payments made during that year are superannuation lump sums for both income tax and SIS Regulations purposes.
- The fund is not entitled to treat income or capital gains as exempt current pension income (ECPI) for the year. That is, tax becomes payable on both income and capital gains, as if the fund was in accumulation phase for the entire financial year. Often the underpayment is not discovered until after the end of the relevant financial year when the SMSF accounts are being prepared or audited.
- A transition to retirement pension does not receive ECPI (as it's not a retirement phase income stream) and if it fails to meet the minimum payment, it's not impacted by the loss of ECPI, but rather all payments are deemed as lump sum payments. However, where all benefits are from preserved components, this results in a breach of preservation standards and the payments are classified as illegal early access. This generally results in the payments being taxed at the top marginal tax rate regardless of the underlying tax components (ie tax-free component is taxed). In addition, trustee administration penalties may apply.
- The client's transfer balance account (TBA) receives a debit based on the market value of the assets that supported the pension at 30 June of the financial year in which the underpayment occurred[1] and the pension has ceased. A new pension will commence once the member commutes the original income stream and a new pension is commenced. At that time, a credit arises in the client's TBA based on the commencement value of the new pension. In most cases, this credit does not equal the original credit or the debit, due to payments and market movements made over time. The trustee must report to the ATO via Transfer Balance Account Reporting on a quarterly basis. This requirement is contained in the ATO's revised tax ruling TR 2013/5 which was issued on 26 June 2024.
- If the original pension commenced prior to 1 January 2015, it will lose its 'grandfathered' status for Centrelink income test purposes for the Age Pension or the Commonwealth Seniors Health Card. For more information, see our adviser article **Advice considerations for grandfathered ABPs**.

[1] ITAA97 s294-80(1) item 6

Maintaining ECPI status for small inadvertent errors (SMSFs)

For SMSF trustees, the Tax Commissioner may exercise their General Power of Administration to allow the superannuation fund to continue its use of the ECPI provisions, despite not having satisfied the minimum pension requirements. In these circumstances, all payments are considered income stream payments and the superannuation fund avoids having to re-start the pension and apply the proportioning rule again.

The Tax Commissioner is unlikely to exercise this power unless all of the following conditions are satisfied:

- the minimum payment was not paid due to an honest mistake or due to matters outside the control of the trustee
- the amount of the underpayment does not exceed 1/12th of the minimum annual payment
- access to the ECPI provision would have continued but for the trustee failing to pay the minimum payment amount
- the trustee makes a catch-up payment as soon as practicable (ie generally no later than 28 days of becoming aware of the underpayment), and
- the fund has not used the self-assessment exemption in a previous financial year.

Advice tip

This concession applies to the individual SMSF. Therefore, if in one year the exemption was used for member due to an underpayment, this concession cannot be used in any future year even if it relates to a different member of that fund.

Examples of allowable self assessment

The ATO provides a number of examples of where it may be appropriate for an SMSF trustee to self-assess including:

- being involved in an accident spending extended periods of time in hospital before the final catch up pension payment was later made
- needing to travel overseas at short notice to deal with a business related emergency situation, and
- financial institution error.

Requirements for self-assessment aren't met (SMSFs)

The trustee may apply in writing to the ATO if they don't meet the requirements for self-assessment but believe that the circumstances warrant the exercise of the Tax Commissioner's discretion.

In particular, the submission would need to outline how the underpayment occurred and any reasons why that was beyond the control of the trustee and any other special facts that may explain the underpayment.

The ATO also wants to ensure the fund's compliance and documentation is in order and the administration of the fund is appropriately managed.

Contact details

For further information, please contact TechConnect on **1800 645 597**.

Disclaimer and important information