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Technically Speaking…

Transition to Retirement Income Streams and Commutations

When the Australian Taxation Office (ATO) issued *Tax Ruling 2013/5: when a superannuation income stream commences and ceases* and *SMSFD 2013/2: does a payment made as a result of a commutation of an account based pension count towards the minimum annual amount required to be paid under paragraph 1.06(9A)(a) of the Superannuation Industry (Supervision) Regulations 1994 (SISR)?*, we were given some certainty regarding some key aspects of paying account based pensions from superannuation funds.

A key component of these rulings was that a partial commutation of an income stream would count towards the minimum pension payment requirements in the year that the partial commutation was made. However, SMSFD 2013/2 made it clear that its interpretation did not apply to a 'transition to retirement income stream' (TRIS) as defined in subregulation 6.01(2) of the SISR 1994.[1]

This has led to some questions as to why a partial commutation of an account based pension income stream counts toward the minimum annual payment amount but a similar partial commutation of a TRIS does not count towards the TRIS's minimum annual payment amount.

Recent commentary on the ATO website added in September 2014 regarding the partial commutation of an SMSF TRIS has clarified the issue on whether a partial commutation of a TRIS counts towards the TRIS's required annual minimum amount.

The ATO's updated guidance unequivocally states the partial commutation of a TRIS will count towards the TRIS's required minimum annual payment amount. The ATO commentary states:

> *"…when a member partially commutes their TRIS to receive a lump sum payment consisting of unrestricted non-preserved benefits…the payment counts towards their minimum annual pension payment amount, unless it is rolled over within the super system."*

This means that SMSF members can partially commute their TRIS to cash out unrestricted non-preserved benefits and have these amounts taxed as lump sums under the low rate cap,

[1] See paragraphs 1 and 11 of SMSFD 2013/2.

which stands at a lifetime limit of $185,000 in 2014-15. This is advantageous for SMSF members aged between 55 and 59 with unrestricted non-preserved amounts that have a taxable component. Rather than having the taxable component of their TRIS payments taxed at 17%, these amounts are tax free under the low rate cap up to the $185,000 life time limit.

Further, in relation to the partial commutation of a TRIS:

- it does not count towards the TRIS annual maximum payments;
- it can be made in the form of an in-specie payment;
- the tax-free and taxable components of the partial commutation will be have same proportions as calculated for the superannuation interest that supported the TRIS on its commencement;
- the account balance of the TRIS immediately after that partial commutation must be greater than or equal to the remaining required minimum payment for that financial year;
- a pro-rata proportion of the minimum annual pension payment amount is paid from the TRIS in the relevant year before the partial commutation is made; and
- the payment of a TRIS comes first from the unrestricted non-preserved component, then the restricted non-preserved component and last the preserved component. In some cases the unrestricted non-preserved component may have been exhausted due to the TRIS payments made to the time of the partial or full commutation.

It is important to remember that a partial commutation of a TRIS can only be made where the SMSF member has unrestricted non-preserved benefits that are able to be cashed. Also, a full commutation of a TRIS will not count towards the minimum annual pension payment amount (SMSFD 2013/2 and TR 2013/5 state that a full commutation causes the account based pension to cease, therefore, the payment is not part of the income stream).

TRIS Partial Commutation Examples

Example 1

Mary is an SMSF member, is 59 years old, has reached her preservation age and started a TRIS with her superannuation account balance.

Mary has met her minimum pension payments on a pro-rata basis for the 2014-15 year as she has received $8000 in TRIS payments as of 1 October 2014.

Her current superannuation account balance is $800,000 made up of $20,000 unrestricted non-preserved benefits, $30,000 restricted non-preserved benefits and $750,000 preserved benefits.

Mary requests that the SMSF trustee make a $20,000 partial commutation of her TRIS and elects for the payment to not be a superannuation income stream benefit under regulation 995-1.03 of *the Income Tax Assessment Regulations 1997*. This means the $20,000 partial commutation will be a lump sum superannuation benefit payment to her.

The $20,000 partial commutation counts towards the minimum annual amount required to be paid from the pension account under paragraph 1.06(9A)(a) of the SIS Regulations explained in the ATO commentary on TRIS.

The $20,000 does not count towards the maximum amount for the TRIS, meaning that Mary can still receive up to $72,000 in TRIS payments for 2014-15.

The $20,000 will count towards Mary's low rate cap of $185,000 and be tax free.

Mary will not pay the 2 per cent Temporary Budget Repair Levy on her income above $180,000, including the $20,000 lump sum from the TRIS partial commutation. This is because the amendments that implement the Temporary Budget Repair Levy effectively increase the tax offset provided under the low rate cap (see section 301-20 of the *Income tax Assessment Act 1997*) to ensure that the tax on the taxable components of the lump sum are taxed at zero percent, even where the Temporary Budget Repair Levy applies to taxable income over $180,000.

The Explanatory Memorandum to the Tax Laws Amendment (Temporary Budget Repair Levy) Bill 2014 explains:

> *1.39 While the levy applies to these payments to the extent that a taxpayer's taxable income (including the lump sum) exceeds $180,000, the tax offset mechanism will continue to apply to further reduce a taxpayer's basic income tax liability by the levy amount so that the effective overall income tax rate applying to the lump sum payment does not exceed the relevant cap.*

In effect, the larger tax offset provided under the low rate cap (a 49 per cent tax offset for Budget Repair Levy years where total taxable income exceeds $180,000) will cancel out any Temporary Budget Repair Levy that is required to be paid on the superannuation lump sum.[2]

Example 2

Amy is 59 and commenced a TRIS when she was 55. She wishes to partially commute $40,000 as a lump sum to buy a new car.

Unfortunately, Amy has only $10,000 of her unrestricted non-preserved benefits available to withdraw as a lump sum as the remainder of her balance is preserved. This means that

[2] This section regarding the Temporary Budget Repair Levy of this edition of Technically Speaking has been updated to reflect the correct interpretation of the Temporary Budget Repair Levy amendments and their effect on lump sums taxed under the low rate cap.

$10,000 of the $40,000 lump sum she was intending to receive can be paid to Amy without contravening the SIS cashing restrictions in regulation 6 of the SISR.

If Amy did withdraw the full $40,000 as a lump sum' $30,000 would come from her preserved benefits and her SMSF will have contravened the SIS operating standards. The breach would include a contravention of section 34(1) of the SIS Act and liable to an administrative penalty under section 166 of the SIS Act.

Further, Division 304 of the ITAA 1997 would likely apply to the $30,000 preserved benefits paid to Amy in view of the lump sum not being made in accordance with the payment standards in sub-section 31(1) of the SIS Act. This will mean the $30,000 will be included in Amy's assessable income and taxed at her marginal tax rate.

Key references:

- https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Contributions-and-benefits/SMSF---transition-to-retirement-income-streams/?page=3#Paying_the_minimum_annual_pension_payment_amount
- Tax Ruling 2013/5: when a superannuation income stream commences and ceases
- SMSFD 2013/2: does a payment made as a result of a commutation of an account based pension count towards the minimum annual amount required to be paid under paragraph 1.06(9A)(a) of the Superannuation Industry (Supervision) Regulations 1994?