Australian Government
Australian Taxation Office

SMSFs: starting and stopping a pension

This document provides information about issues that you, as a trustee of a self-managed super fund (SMSF), need to consider when commencing or stopping a superannuation income stream, or pension.

In this document, references to SMSFs include former SMSFs unless otherwise indicated.
This information applies to taxed, complying super funds which commence a super income stream in the form of an account-based pension, including a transition to retirement income stream (TRIS), on or after 1 July 2007.

Find out more
APRA funds - starting and stopping a superannuation income stream (pension) (/Super/APRA-regulated-funds/Member-benefits/APRA-funds---starting-and-stopping-a-super-income-stream-(pension)/).

Taxation Ruling 2013/5 (http://law.ato.gov.au/atolaw/view.htm?rank=find&

criteria=AND~2013%2F5~basic~exact&target=EA&style=java&sdocid=TXR/TR20135/NAT/ATO/00001&recStart=1&PiT=99991231235958&Archived=false&recnum=9&tot=17&pn=ALL:::ALL) : Income Tax: when a superannuation income stream commences and ceases (the Ruling) provides information you need to take into account when paying or considering paying an account-based pension to a member.

The Ruling focuses on when a super income stream commences and when it ceases and consequently when a super income stream is payable. These concepts are relevant for trustees in determining:

- whether the fund can apply the exempt current pension income (ECPI) provisions
- the income tax treatment applicable to payments from the fund, including the correct calculation of the tax free and taxable components.

Find out more
Self-managed super funds and tax exemptions on pension assets (/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/Self-managed-super-funds-and-tax-exemptions-on-pension-assets/)

Super income stream

A super income stream is an income stream that is a pension according to the Superannuation Industry (Supervision) Regulations (SIS Regulations).

We use:

- 'pension' when referring to the operation of the *Superannuation Industry (Supervision) Act 1993*

(SIS Act) or SIS Regulations.

- 'super income stream' when referring to the operation of the income tax laws.

An income stream cannot be a pension in accordance with the SIS Regulations unless it meets two fundamental requirements:

- payment occurs at least annually
- for an account-based pension, a minimum amount is paid to the member each year.

A super income stream exists when all of the following apply:

- a member is entitled to a series of payments that relate to each other
- the payments are periodic, whether paid annually or more frequently
- the payments are made over an identifiable period of time
- the pension standards of the SIS Regulations have been met.

A liability to make a single payment for one year is not a series of payments and will not satisfy the requirements of being a super income stream.

Creating a separate superannuation interest in an SMSF

Once a superannuation income stream commences you are required to treat the amount supporting the income stream as a separate interest in accordance with the income tax laws.

The value of the separate interest, including the amount of its tax free and taxable components, must be determined when the super income stream commences. The proportions of the tax components of this separate interest will be the same as the proportions for the tax components of the member's original non-pension interest just prior to the commencement of the income stream. This prevents members from choosing which tax components they wish to start a super income stream with.

The taxable and tax free components of any pension payment must have the same proportions as those determined for the tax components of the separate interest that supports the pension when the pension commenced.

Find out more

- Understanding super interests in an SMSF (/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/Understanding-super-interests-in-an-SMSF/)
- Superannuation benefit component calculator (http://calculators.ato.gov.au/scripts/axos/axos.asp?CONTEXT=&KBS=SBC_calculator.XR4&go=ok)

Determining the value of the assets supporting a pension

Before the commencement of a pension, you must establish the value of the superannuation benefits that are to support the pension. This means that the market value (/Super/Self-managed-super-funds/In-detail/SMSF-resources/Valuation-guidelines-for-self-managed-super-funds/?anchor=Market_value&anchor=Market_value#Market_value) of the assets that are to support the pension needs to be determined on the commencement day of the pension. Similar to valuing assets for the purpose of financial reports, the valuation needs to be based on objective and supportable data.

A reasonable estimate of the value of the account balance can be used when a pension is started part way through the year.

> **Find out more**
> Valuation guidelines for self-managed superannuation funds (/Super/Self-managed-super-funds/In-detail/SMSF-resources/Valuation-guidelines-for-self-managed-super-funds/)

Running a pension

Superannuation pension standards

Once an account-based pension commences you must ensure the pension standards in the SIS Regulations are met, this includes meeting the minimum pension payment requirements.

If the pension standards are not met in an income year both of the following apply:

- a super income stream ceases for income tax purposes
- we consider the trustee has not been paying an income stream at any time during the year.

You should also maintain appropriate records that reflect the value of the pension at commencement, any benefit (pension) payments made and the earnings from assets set aside to support the pension.

> **Find out more**
> Timing of a pension payment (/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/Timing-of-a-pension-payment/)

Minimum pension payment requirements

A general characteristic of an account-based pension is the need to pay an annual minimum pension amount.

The minimum amount that has to be paid from the pension account depends on several factors such as, the recipient's age, their account balance and the commencement date of the pension.

If the pension commences on a day other than 1 July, the minimum amount for the first year is to be worked out proportionately to the number of days remaining in the financial year, including the start day.

If the commencement day of the pension is on or after 1 June in the financial year, no payment is required to be made in that financial year.

A payment made from an account-based pension, which would otherwise satisfy the minimum annual pension payment requirements, will continue to be treated as such, even if a member elects to have the payment treated as a superannuation lump sum under s 995-1.03 of the income tax regulations.

> **Find out more**
> Minimum annual pension payments (/Super/Self-managed-super-funds/Paying-benefits/?amp;page=15#Minimum_annual_pension_payments) (including the percentages used to calculate the minimum annual pension payments)

Can a partial commutation payment counts towards the annual minimum pension payment?

Yes, a partial commutation payment that is not rolled over (that is, not transferred to another super fund) can count towards the annual minimum pension payment amount.

A partial commutation occurs when a member in receipt of a pension requests to withdraw a lump sum amount that is less than their total pension entitlement. As there still remains an obligation to continue to pay pension benefits, a partial commutation does not result in the cessation of the pension.

A partial commutation payment counts towards the minimum annual amount, unless it is rolled over within the superannuation system or paid directly to another superannuation fund.

The taxable and tax free components of any partial commutation payment must have the same proportions as those determined for the components of the separate interest that supported the pension when the pension commenced.

> **Failure to consider the commutation restrictions that apply to a TRIS may result in a breach of the payment standards with income tax consequences for the member and the fund.**

Can an in-specie partial commutation count towards the annual minimum pension payment?

Yes. The payment that results from a partial commutation is a lump sum for the purposes of the superannuation laws and a lump sum payment includes a payment made by way of an asset transfer, known as an in-specie payment.

This means that a partial commutation payment that is not rolled over counts towards the annual minimum pension amount regardless of whether the payment is made in cash or in specie.

Trustees need to be mindful of the governing rules of the fund and that the transfer of an asset of the SMSF will constitute a Capital Gains Tax (CGT) event with possible taxation implications for the fund.

Example: Partial commutation

Madeline, a member of the Spring SMSF, is receiving an account based pension. The balance of her pension account on 1 July 2011 was $400,000. Madeline is usually able to meet her living expenses from the minimum amount required to be paid from her pension account.

On 1 November 2011 Madeline advises the other trustees of the Spring SMSF and requests, in accordance with the governing rules of the fund, she would like to be paid a lump sum of $50,000. This amount is more than the minimum amount the fund is required to pay her for the year and Madeline indicates that she will not require any other payment of the pension for the year.

The partial commutation is paid on 15 November 2011 by the transfer of shares to the value of $50 000 from the fund.

As Madeline's pension did not cease as a result of the partial commutation and the amount was not rolled over, the $50,000 in-specie transfer counts towards the minimum annual amount she is required to be paid in that financial year.

This example does not address any CGT consequences for the fund.

Can a full commutation count towards the minimum pension payment?

No. A full commutation takes effect as soon as your liability as trustee to pay periodic pension payments to a member has been substituted in full with a liability to pay the member a lump sum instead. The account based pension therefore ceases at this time.

The liability to pay the lump sum arises as a consequence of the full commutation taking effect and therefore the superannuation income stream ceases before the time the lump sum payment to the member is made.

As the payment of the commutation lump sum is made after the cessation of the account based pension it cannot count towards the minimum annual pension amount.

In order to meet the minimum annual pension requirements up to the time the pension ceases as a result of a full commutation, you, as trustee, should ensure that the required minimum annual pension amount has been paid as a separate payment (or payments) prior to the lump sum payment resulting from the commutation being made.

> **Find out more**
> Self-managed Superannuation Funds Determination 2013/2 (http://law.ato.gov.au/atolaw/view.htm?rank=find&criteria=AND~SMSFD~basic~exact:::AND~2013%2F2~basic~exact&target=FF&style=java&sdocid=SFD/SMSFD20132/NAT/ATO/00001&recStart=1&PiT=99991231235958&Archived=false&recnum=2&tot=2&pn=ALL:::ALL)

What if a trustee fails to meet the minimum annual pension payment requirements?

If a fund fails to meet the minimum annual pension payment requirements for an account-based pension, in an income year, the super income stream will be taken to have ceased at the start of that income year for income tax purposes.

There are limited circumstances where the Commissioner will allow the income stream to continue even though the trustee fails to pay the minimum annual pension amount.

Find out more

SMSFs – Minimum pension payment requirements –FAQs (/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/SMSFs--Minimum-pension-payment-requirements---frequently-asked-questions/)

Maximum pension payment requirements for a TRIS

A TRIS needs to meet the standards of an ordinary account-based income stream.

Additionally, the SIS Regulations prohibit the total amount of payments, excluding partial commutation payments, made from a TRIS in a financial year to exceed 10% of the pension account balance unless the member has satisfied a condition of release that has a nil cashing restriction.

Where a fund exceeds the maximum annual payment limit for a TRIS in a financial year, the super income stream is taken to have ceased at the start of that year for income tax purposes.

Find out more

Transition to retirement pension (/Super/Self-managed-super-funds/Paying-benefits/?page=5#Transition_to_retirement_pension)

What are the tax implications for the fund once the trustee starts paying a super income stream to a member?

Once a complying super fund starts to pay a super income stream, it may be entitled to exempt a portion of the income earned from the fund's assets that are supporting the income stream until such time as the pension ceases. This is referred to as ECPI.

ECPI does not include assessable contributions or non-arm's length income.

> **Find out more**
> Self-managed super funds and tax exemptions on pension assets (/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/Self-managed-super-funds-and-tax-exemptions-on-pension-assets/).

There are two ways of working out the fund's ECPI. One method requires the trustee to segregate assets used to support the super income stream. The other enables the trustee to exempt a portion of the fund's total income that reflects the proportion of the fund's superannuation liabilities that are current pension liabilities. The value of the fund's superannuation liabilities and current pension liabilities must be certified by an actuary.

When starting a super income stream, the trustee will need to consider how the ECPI will be worked out. Should an actuarial certificate be required this must be obtained by the trustee before lodgment of the *Self-managed superannuation fund annual return* (SAR).

> **Find out more**
> Self-managed superannuation fund annual return instructions (/Forms/SMSF-annual-return-

> instructions/).

If the trustee has started paying a pension to a member and they receive a contribution for the same member, can they add it to the member's pension account?

A contribution received after a pension has started cannot be added to the capital supporting the pension. All contributions intended to form the capital of the pension must be made before the pension starts

Ceasing a super income stream

The most common circumstances for a pension ceasing are summarised as follows:

- When all pension capital is exhausted (?anchor=_Pension_capital_is#_Pension_capital_is).
- A failure to comply with the superannuation pension standards. (?anchor=_Failure_to_meet#_Failure_to_meet)
- The pension is fully commuted. (?anchor=_Pension_is_fully_1#_Pension_is_fully_1)
- The member has died. (?anchor=_Pension_Ceasing_upon#_Pension_Ceasing_upon)

Pension capital is exhausted

A super income stream ceases as no super income stream benefits are payable when the capital supporting the pension has been reduced to nil, and the member's right to have any other amounts applied (other than by way of contribution or roll over) to their superannuation interest has been exhausted.

For an account based pension, the pension ceases when the money funding the pension has run out.

Failure to meet the superannuation pension standards

If a fund fails to meet the required super pension standards for an account-based pension in an income year, the super income stream is taken to have ceased at the start of that income year for income tax purposes

From the start of the income year the member's account is no longer taken to be supporting a super income stream and any payments made during the year will be super lump sums for income tax purposes and lump sums for SIS Regulations purposes.

This also means the fund will not be entitled to treat income or capital gains as ECPI for the year.

> **When a new super income stream commences, you as trustee will be required to recalculate the tax-free and taxable components of the new pension.**

One of the most common reasons for not meeting the pension standards is failure by funds to meet the minimum annual pension payment requirements.

There are limited circumstances where the Commissioner will allow a fund to claim ECPI even though the income stream ceased because of the failure to pay the minimum amount of pension. We have published a Q&A on our website to highlight the conditions that would need to be satisfied to allow a fund to continue to claim ECPI, where a fund fails to meet the minimum pension payment requirements in an income year.

> **Find out more**
> SMSFs – Minimum pension payment requirements –FAQs (/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/SMSFs--Minimum-pension-payment-requirements---frequently-asked-questions/)

Pension is fully commuted

A superannuation income stream ceases when a request from a member or a dependant beneficiary to fully commute their entitlements to future super income stream benefits for an entitlement to a lump sum takes effect.

A payment resulting from a full commutation cannot count towards the required minimum annual pension payment amount.

The taxable and tax free components of the commutation payment will have the same proportions as those determined for the components of the separate interest that supported the pension when the pension commenced.

- Before fully commuting a member's pension, ensure that all minimum annual pension payments (?anchor=MPPR#MPPR) are made.
- You must also consider the more restrictive commutation rules that apply to TRIS.

Find out more
Transition to retirement pension (/Super/Self-managed-super-funds/Paying-benefits/?page=5#Transition_to_retirement_pension)

Example: Minimum payment prior to full commutation

Andre is a member of the Summa SMSF and is in receipt of an account based pension.

On 1 November 2011 Andre advises all trustees of the

Summa SMSF, in accordance with the governing rules of the fund that he wishes to fully commute his account based pension. The balance of his pension at the time is $60 000.

On 15 November, the trustees transfer assets to him to the value of $50 000 in satisfaction of the lump sum commutation. The trustees also proceed to liquidate the remaining $10 000 to fund the required minimum pension amount in cash. On 30 November, Andre is paid the minimum pension amount of $10 000 in cash.

As Andre's minimum pension payment was not made prior to the full commutation of his pension, the pension is taken not to have existed for that year of income and any benefits received will need to be treated as lump sums. The fund will not be entitled to treat income or capital gains from Andre's pension as ECPI in the year the commutation takes place.

- If a member fully commutes a pension and retains the amount of the commutation lump sum within the fund, you will be required to recalculate the tax-free and taxable components of any new benefit subsequently paid from the fund.

What are the tax implications for the fund associated with a full commutation?

As the super income stream ceases at the time the full commutation takes effect, eligibility for ECPI also ceases at this time. There may also be CGT consequences as a result of the disposal of assets after this time.

Can a full commutation be paid in-specie?

Yes. The payment that results from a full commutation is a lump sum for the purposes of the superannuation laws so if permitted under the fund's governing rules, the payment may be in the form of cash or in-specie.

Trustees will need to consider the governing rules of the fund and any CGT implications associated with the transfer of assets in lieu of cash.

Pension ceasing upon death

A pension ceases as soon as a member in receipt of the pension dies, unless a dependant beneficiary is automatically entitled to a reversionary pension.

Where a pensioner dies, is there a need to make a minimum pension payment to the deceased/beneficiary?

Where a super income stream automatically transfers to a beneficiary on the death of a pensioner (i.e. an auto reversionary pension) you must ensure that the minimum pension payments continue to be made, including in the year the member in receipt of the original pension dies.

Where a pensioner in receipt of a non reversionary account based pension dies, the ATO will not require a minimum pension payment to be made in the year of death. If the deceased member's benefits are subsequently used to commence a new pension to a beneficiary, you will be required to ensure the new minimum annual pension amount is paid in the relevant year.

Find out more

Taxation Ruling 2013/5 (http://law.ato.gov.au/atolaw/view.htm?rank=find&criteria=AND~2013%2F5~basic~exact&target=EA&style=java&sdocid=TXR/TR20135/NAT/ATO/00001&recStart=1&PiT=99991231235958&Archived=false&

recnum=9&tot=17&pn=ALL:::ALL) .

Where a pensioner dies, what else do you need to be aware of?

Upon the death of a member, a non-auto reversionary pension ceases

From 1 July 2012, Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013 ensure that, where a member who was receiving a non-auto reversionary super income stream dies, the fund will continue to be entitled to claim ECPI in the period from the member's death until their benefits are applied to commence a new super income stream or paid as a lump sum (subject to the benefits being cashed as soon as practicable).

You, are also responsible for the correct identification of the tax-free and taxable components of payments made from the superannuation interest that was supporting the deceased member's pension. Where a member in receipt of a non auto reversionary super income stream (the original income stream) dies on or after 4 June 2013 refer to the Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013 for an alternative method to determining the tax free and taxable components of the super interest.

Find out more
Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013 (http://www.comlaw.gov.au/Details/F2013L00894)

How we can help

If you have a general question about how the super laws operate for an SMSF, you can get written SMSF guidance.

SMSF guidance will not tell you how the law applies to your own SMSF's particular circumstances but will tell you how the super law applies generally.

Find out more

SMSF guidance (/Super/Self-managed-super-funds/Administering-and-reporting/How-we-help-and-regulate-SMSFs/)

If you need written advice about how the super law applies to your SMSF's particular circumstances, you can apply for self-managed super funds specific advice (SMSFSA).

A SMSFSA sets out the Commissioner's opinion about the way the super laws apply, or would apply, to your SMSF in relation to a specified arrangement or circumstance.

Find out more

How to apply for SMSF specific advice (/Forms/How-to-apply-for-SMSF-specific-advice/)

Last modified: 03 Apr 2014 QC 26864

Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.