ACCURIUM

Transition to retirement income streams… a comprehensive guide to the new rules

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The superannuation reforms applying from 1 July 2017 made a number of changes impacting transition to retirement income streams and their use by retirees.

A transition to retirement income stream (TRIS) is an income stream a retiree can access once they attain preservation age, but before they meet another condition of release like retiring.

Prior to 1 July 2017

Earnings on assets supporting the income stream were tax free as long as a minimum pension payment was paid in form and effect each financial year. There was also a maximum annual payment limit of 10% of the account balance at 1 July (or commencement).

Pension payments made from a TRIS are subject to the same tax treatment as payments from a normal account based pension (ABP). Namely they were generally tax free over age 60, and the taxable component was taxable at the individual's marginal tax rate with a 15% tax offset.

A TRIS was classed as a non-commutable income stream and, unless the interest contained any unrestricted-non preserved monies, lump sum payments or partial commutations could not be made. Despite this, it was still possible to elect to treat one or more payments from a TRIS as a super lump sum for tax purposes. This was used to take advantage of tax concessions available for members aged between preservation age and 60 years old by accessing the low rate cap. Super lump sums up to this cap ($195,000 in 2016/17) are tax-free. These payments were also allowed to count towards meeting the minimum pension standards.

When the pensioner 'retired' or met another relevant condition of release it was often the case that the TRIS was converted to an ABP. This was done to remove the commutation restrictions and maximum payment limits faced by a TRIS. It was also the view of some in the industry that the pension documentation could allow for this to happen without the need to commute and re-commence the income stream once a condition of release was met.

From 1 July 2017

From 1 July 2017 a TRIS will not be eligible for ECPI until the pensioner attains age 65 or reports a condition of release.

A TRIS will default to 'non-retirement phase' status from 1 July 2017. The main change being that earnings on assets supporting this non-retirement phase TRIS will not be tax free. A non-retirement phase TRIS will not be eligible to claim ECPI in the annual return.

The TRIS will be subject to the same payment and commutation restrictions as a pre-1 July 2017 TRIS. The non-retirement phase TRIS does however remain an income stream and must continue to make a minimum pension payment each year in order to meet the pension standards. The pension payments are still subject to the same tax treatment as previously.

A non-retirement phase TRIS will move to being in the retirement phase when a member attains age 65 or reports that they have met a nil cashing restriction condition of release to the Trustee. For those under age 60 this means retiring, and those between age 60 and 65 it means ceasing an employment arrangement.
rounded up at that time.

From this time the TRIS will be a retirement phase TRIS. The income stream does not cease and re-commence, but continues subject to the rules of a retirement phase TRIS. The Trustee will need to report this event as part of the fund's transfer balance account reporting (TBAR) requirements. The account balance at the time the income stream moves to retirement phase will be a credit against the member's transfer balance cap.

A retirement phase TRIS will be eligible to claim ECPI, meaning that the earnings on assets supporting the income stream will be tax free. The balance supporting the income stream will become unrestricted non-preserved and the ATO have confirmed the commutation restrictions and maximum payment limit of a non-retirement phase TRIS are removed.

With the cashing restriction removed, lump sum payments and partial commutations can be made from a retirement phase TRIS. However, the Fund's trust deed and pension documentation should be reviewed to ensure there are no clauses restricting the Trustee's ability to pay benefits, e.g. if the pension documents say 'maximum payment of 10% per annum' then the Trustee would need to abide by that rule.

The fine print

Effective 1 July 2017, the ability to elect to treat a pension payment as a lump sum for tax purposes has been removed. A non-retirement phase TRIS will not be eligible to make lump sum payments (unless the interest includes an unrestricted non-preserved amount). Instead, all payments will be income stream benefits and will be taxed accordingly. Under the PAYG rules, the Trustee may need to withhold tax from payments to members under age 60. These pension payments count towards meeting the minimum pension requirements and do not raise a TBAR event.

A retirement phase TRIS is eligible to make lump sum payments, but remember they won't count towards meeting minimum pension requirements.

However, it is possible to make a lump sum payment from a retirement phase TRIS because the cashing restrictions have been removed. Where the trustee decides to take a payment as a lump sum this will raise a TBAR event and a debit will apply to the member's TBA equal to the lump sum payment. A partial commutation will be treated like a lump sum for TBA purposes.

A lump sum payment made from a retirement phase TRIS will not count towards the minimum pension requirements. Where a payment is taken as an income stream benefit the pension payment will count towards the minimum pension requirements and will not raise a TBAR event.

A strategy being considered by many Trustees for a retirement phase TRIS is to take the minimum pension payment as an income stream benefit and then any additional payments as lump sums in order to reduce the member's TBA. This may be useful if the Member might want to transfer more into the tax free retirement phase in the future, for example if they receive a death benefit income stream.

When a TRIS moves from non-retirement phase to retirement phase it is important to note that in the ATO's view the income stream does not cease, and does not automatically convert to an ABP. It simply continues as the existing TRIS, but subject to the rules for a retirement phase TRIS. The minimum pension payment requirement must be met over the financial year based on the 1 July balance (or commencement) and does not reset at the time the income stream converts to retirement phase. For those who already had a TRIS at 1 July 2017 then it would become either a non-retirement phase or retirement phase TRIS effective 1 July 2017 depending on whether the member had attained age 65 or reported a relevant condition of release to the Trustee.

Review clients nearing age 65, or who intend to report a condition of release, to check they wont exceed their TBC when the TRIS moves to retirement phase.

Considerations for moving to retirement phase

A TRIS moving into retirement phase can have big implications for a member's TBA. Where a member is nearing age 65 or looking to report condition of release it will be important to review the potential impact on their transfer balance cap. If the balance of the income stream is close to or above $1.6million, or they have other retirement phase income streams that mean the transfer might take them near the cap, consider whether the Member will need to make a partial commutation or take a payment at the time the income stream converts to retirement phase in order to avoid an excess transfer balance.

For example, if a non-retirement phase TRIS has a balance of $1.8million and the Member is turning 65 on 31 August 2018, the Member will receive a TBA credit of $1.8million on that date. The Trustee will need to report this no later than 28 October 2018.

- When reported this event would raise a $200,000 excess transfer balance for the Member. The ATO would calculate notional earnings on that excess from 31 August and the Fund will become liable to pay excess transfer balance tax and must commute to accumulation phase or withdraw from the SMSF the excess transfer balance amount plus notional earnings incurred to the date of commutation.
- Instead, if the Trustee had reviewed the TRIS and realised the member was moving to retirement phase, they could complete a partial commutation of $200,000 on 31 August 2018. The Fund will not be liable to pay an excess transfer balance tax as the Member did not have an excess transfer balance at the end of that day.

For the majority of retirees, being paid a retirement phase TRIS will be just like having an ABP in terms of the taxation of earnings and the ability to make payments and lump sums.

However, if a TRIS is commuted in order to commence an ABP it is important to understand the implications of the ATO's view that a TRIS does not automatically convert to an ABP. Pension documentation will be required to establish the new ABP and TBAR transactions will need to be reported for the full commutation and new pension commencement. The Trustee will need to recalculate the tax free and taxable components for the new ABP and, if the Member has an accumulation interest, this is likely to change the tax components that will be set for the new income stream. The Trustee must also ensure that the TRIS has made a pro-rated minimum pension payment prior to full commutation. Another pro-rated pension payment will be required by 30 June for the new ABP (unless commenced in June) in order for that new income stream to also meet the pension standards.

Estate Planning

For a TRIS that has no automatic reversion provision in place, upon death of the primary pensioner the death benefit must be paid as a lump sum or/and income stream. If the death benefit is taken as an income stream in the SMSF by an eligible beneficiary then that will be a death benefit ABP and be in retirement phase irrespective of whether the original TRIS was in retirement phase or not. The Trustee will need to report a credit to the recipient's TBA equal to the account balance of the death benefit ABP at commencement. The new ABP must also make a pro-rated pension payment prior to 30 June to meet the pension standards.

Where an automatically reversionary TRIS is established then the intention is that upon the death of the primary pensioner the TRIS will not cease but continue to be paid to the nominated beneficiary (provided they are eligible). This will be a TBAR event and the account balance at the date of death will be reported as a credit against the beneficiary's TBA 12 months from the date of death.

From 1 July 2017 the Superannuation Industry (Supervision) Regulations require that a death benefit paid as an income stream must be in retirement phase. This means the beneficiary of an automatically reversionary TRIS must themselves meet the requirements for the income stream to be in retirement phase by either having attained age 65 or reported a condition of release to the Trustee. This is required irrespective of whether the TRIS was non-retirement phase or retirement phase prior to the pensioner's death. This means that where the beneficiary has not met a relevant condition of release they cannot be paid the reversionary TRIS and instead must take the death benefit as a lump sum or/ and death benefit income stream as for a non-reversionary TRIS noted above.

However, proposed legislation Treasury Laws Amendment (2018 Measures No. 4) Bill 2018 intends to resolve this issue by excluding reversionary beneficiaries from the requirement that, to be in the retirement phase, a TRIS must be paid to a beneficiary who has satisfied a condition of release. This proposed change is intended to apply retrospectively from 1 July 2017 and will mean that a TRIS can revert to an eligible beneficiary and the TRIS will be in retirement phase for that beneficiary.

Legislation has been proposed to apply retrospectively from 1 July 2017 to ensure a TRIS can revert to an eligible beneficiary and be in retirement phase.

This Bill is currently with the Senate and is expected to pass and become law however the Senate do not sit again until 13 August. The ATO is aware of the current 'gap' between the current law and the rules that will apply once the Bill is passed. During the interim, the ATO have informed us that they will not be applying compliance resources to review reversionary TRIS events as they expect the Bill to pass and become law. However, if the ATO has cause to review a fund which has a reversionary TRIS they will need to apply the current law and each situation will be assessed on a case by case basis.

Summary of TRIS characteristics

For an SMSF paying a TRIS post 1 July 2017 it is important to understand the impact of the reforms on the characteristics of these income streams. We summarise the key characteristics below.

Item	Pre 1 July 2017 TRIS	Non-retirement phase TRIS	Retirement phase TRIS	ABP post 1 July 2017
Eligible for ECPI (tax exempt income on earnings)	Yes	No	Yes	Yes
10% maximum payment limit	Yes	Yes	No	No
Commutation restrictions	Yes	Yes	No	No
Minimum pension payments required	Yes	Yes	Yes	Yes
Subject to TBC and TBAR	No	No	Yes	Yes
Can elect for pension payments to be lump sums for tax purposes	Yes	No	No	No
Tax components fixed at commencement	Yes	Yes	Yes	Yes

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