

>> PIS Tech Update 72

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Summary

In early September we released a Tech Update that addressed the topic of "Lifetime pension – it's time to review". The article had been generously supplied by DBA Butler Lawyers. As many aspects of superannuation are a moving feast, the original article has now been updated to reflect the current legal viewpoint. This Tech Update considers the latest developments.

Lifetime pensions — it's time to review!

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Complying lifetime pensions (ie, under s 1.06(2) of the Superannuation Industry (Supervision) Regulations 1994 (Cth)) (Lifetime Pensions) were commenced by members of SMSFs for various reasons. In particular, these include:

- being favourably valued for Reasonable Benefit Limit (RBL) purposes (RBL compression); and
- Centrelink Asset Test exemption (ATE) (100% ATE if commenced before 20 September 2004 and 50% ATE if commenced between 20 September 2004 and 31 December 2005)

Financial crisis

The recent financial crisis has resulted in many SMSF account balances being significantly reduced. This decline may also cause SMSFs to fail to meet the actuarial "high degree of probability" requirement.

For such members, this could result in the SMSF becoming insolvent and the ATE status of the Lifetime Pension being lost.

Once the ATE status is lost, a Centrelink debt is generally raised for all Age Pension payments received by the member from the commencement date (or within five years).

Also, as a minimum amount of a Lifetime Pension must still be paid each 12 months, some SMSFs may be finding it difficult if their investments are frozen or have lost considerable value. Note, the halving of the minimum pension payments for FY2009 and FY2010 generally only applies to account based pensions (ABPs).

Centrelink options and relief

Members who are placed in this position have various options available to them, including the following:

- If it involves 100% ATE pension, then commuting the Lifetime Pension and commencing a qualifying annuity with a life office or applicable financial institution — the ATE status is retained (there are disadvantages with this option and expert product advice should be obtained)
- If it involves 100% ATE pension in an SMSF that commenced prior to 30 September 2004, commuting and commencing a market-linked pension (MLP aka TAP) up to 30 June 2010 — the ATE status is lost and a debt liability arises. However, a specification has recently been made that waives the debt liability if the restructure arose from failing to satisfy the high probability test
- If it involves 100% ATE pension in an SMSF, that commenced prior to 20 September 2004 and related to the commutation of that pension which was rolled over to another ATE pension before 20 September 2007, then these can also be rolled over to an MLP without a debt liability arising

Note, there has not yet been any relief from the debt liability announced to date in respect of pensions that only satisfied the 50% ATE exemption. Thus there are no restructuring options without a debt liability arising.

Commutation

A Lifetime Pension can be commuted if the moneys supporting the Lifetime Pension are used to commence an MLP. Actuarial advice is required to determine the commuted amount.

As discussed above, the relief from a Centrelink debt liability only relates to pensions that originally commenced prior to 20 September 2004 that were 100% ATE. Lifetime Pensions that commenced on or after 20 September 2004 are generally not covered unless such pension was a restructure of a pre-20 September 2004 Lifetime Pension.

Expert advice should be obtained, as this area is quite complex and depends on the deed pension documents — especially if surplus reserves exist.

Reasons favouring commutation

Other reasons which favour commutation include:

- members may be eligible to receive some Age Pension under the new asset test rules, even if they do not have the ATE pension in place
- income from an MLP or ABP is income tax exempt (whereas income from any reserves related to the Lifetime Pension are assessed at 15%)
- from an estate planning perspective, reserves may be trapped in the SMSF and it provides greater access to capital
- MLPs and ABPs are easier to understand and their administration is less complex and less expensive

Please note that the above is not an exhaustive list.

Even if a Lifetime Pension is not ATE, some may still prefer to convert to obtain the lower minimum now on offer for ABPs.

Documentation

The following is required if a Lifetime Pension is to be commuted:

- the deed must allow the commutation and the commencement of the new pension to take place
- an actuarial report is obtained
- documents evidencing the commutation and commencement of the pension and allocation of reserves

Conclusion

The financial crisis has significantly impacted SMSFs paying a Lifetime Pension and therefore now is a good time to review the appropriateness or otherwise of such a pension for each member. Whether the Lifetime Pension should be commuted is a question of fact and should be considered in light of all of the circumstances of the particular member. Once commuted, a Lifetime Pension cannot be established.

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