SMSF technical - funds

Technical information about self-managed super funds.

QC 81460

Funds: starting and stopping a pension

Information to consider when commencing or stopping a superannuation income stream or pension from an SMSF.

Last updated 27 June 2024

If you're a trustee of a self-managed super fund (SMSF), there are some things to consider when starting or stopping a super income stream, or pension.

When we say SMSFs, we are including former SMSFs unless otherwise indicated.

This information applies to:

- taxed, complying super funds
- commencing 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.

Account-based pensions

You can find information about paying or considering paying an account-based pension to a member in Taxation Ruling 2013/5: *Income Tax: when a superannuation income stream commences and ceases*.

This ruling focuses on when a super income stream starts and ceases, and when a super income stream is payable. These are important for trustees when 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.

For more information see:

- Exempt current pension income

Super income stream

A super income stream is an income stream that's a pension according to the *Superannuation Industry (Supervision) Regulations 1994* (SISR).

We use the term:

- pension – when referring to the operation of the *Superannuation Industry (Supervision) Act 1993* (SISA) or SISR
- super income stream – when referring to the operation of the income tax laws.

An income stream can't be a pension in accordance with the regulations, unless it meets 2 fundamental requirements:

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

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 SISR have been met.

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

Creating a separate superannuation interest in a SMSF

Once a super income stream commences, you're required to treat the amount supporting the income stream as a separate interest in accordance with the income tax laws.

You must determine the value of the separate interest, including the amount of its tax free and taxable components, when the super income stream commences. The proportions of the tax components of this separate interest will be the same proportions of the member’s original non-pension interest just prior to the start of the income stream (proportioning rule).

The proportioning rule prevents members from selecting which tax components their super income stream will be paid from.

For more information see:

- Superannuation benefit component calculator

Value of the assets supporting a pension

Before the commencement of a pension, you must establish the value of the super benefits that are to support the pension. This means determining the market value of the assets supporting the pension on the commencement day of the pension. The valuation needs to be based on objective and supportable data. This is similar to valuing assets for the purpose of financial reports,

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

For more information see:

- Valuation guidelines for self-managed super funds

Running a pension

Super pension standards

Once an account-based pension starts, you must ensure you meet the pension standards in the SISR. 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 hasn't 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 the start
- any benefit (pension) payments made
- the account the payment was paid from
- the earnings from assets set aside to support the pension.

For more information see:

- Timing of a pension payment
- Record keeping requirements
- COVID-19 frequently asked questions – self-managed super funds – on our Legal database

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, including:

- the recipient's age
- their account balance
- the start date of the pension.

If the pension starts:

- on a day other than 1 July – work out the minimum amount for the first year in proportion to the number of days remaining in the financial year, including the start day
- on or after 1 June in the financial year – no payment is required to be made in that financial year.

For pensions in existence on 1 July; if the pension ceases on any day other than 30 June, work out the minimum amount in proportion to the number of days the pension was on foot in that financial year.

Note: Pension payments for 2019–20 above the reduced minimum withdrawal rate, taken before 25 March 2020, can't be re-categorised as a lump sum or commutation. This is even if a valid minute or election from the member was in place before the government announced the reduction.

For more information see:

- Pension standards for self-managed super funds
- Minimum annual payments for super income streams
- COVID-19 frequently asked questions – self-managed super funds – on our Legal database.

Partial commutation payments

A partial commutation payment that is not rolled over to another super fund, can only count towards the annual minimum pension payment amount if the payment was made before **1 July 2017.**

A partial commutation occurs when a member receiving a pension requests to withdraw a lump sum amount which is less than their total pension entitlement. As there's still an obligation to continue to pay pension benefits, a partial commutation doesn't result in the cessation of the pension.

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 started.

Remember, there are additional commutation restrictions if the pension from which the partial commutation is made is a transition to retirement income stream (TRIS). Failing to consider the commutation restrictions that apply to a TRIS may result in a breach of the payment standards. There may be income tax consequences for the member and the fund.

In-specie partial commutation

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

Partial commutation payments made from 1 July 2017 will not count towards minimum annual pension payments. This is regardless of whether the payment is made in cash or in-specie.

Trustees need to be mindful of the governing rules of the fund. 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 2019 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 2019, 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 won't require any other payment of the pension for the year.

The partial commutation is paid on 15 November 2019 by the transfer of shares to the value of $50,000 from the fund.

The in-specie payment won't count towards Madeline's minimum annual pension amount. The fund is still required to make the mandatory minimum annual pension amount as a separate payment (or payments) to ensure that the pension doesn't cease.

This example doesn't address any CGT consequences for the fund.

Note: If this scenario had occurred before 1 July 2017, 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 would have counted towards the minimum annual amount she is required to be paid in that financial year.

Full commutation

A full commutation doesn't count towards the minimum pension payment. It 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 them 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. Therefore, the super income stream ceases before the time you make the lump sum payment to the member.

The payment of the commutation lump sum is made after the cessation of the account-based pension. Therefore, it can't 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, as trustee, you should ensure the required minimum annual pension amount has been paid as a separate payment (or payments) prior to the lump sum payment being made.

Maximum pension payment requirements for a TRIS

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

Additionally, the SISR prohibits the total amount of payments, excluding partial commutation payments, made from a TRIS in a financial year from exceeding 10% of the pension account balance. This is 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.

For more information see:

- Ceasing a TRIS

Tax implications on the super income stream

Once a complying super fund starts to pay a retirement phase income stream to a member, it may be entitled to exempt a portion of the income earned from the fund's assets that are supporting the income stream.

This is referred to as exempt current pension income (ECPI) and applies until the pension ceases.

ECPI doesn't include assessable contributions or non-arm's length income.

From 1 July 2017, a TRIS where the member hasn't met a condition of release with a nil cashing restriction will not be considered in the retirement phase. Earnings from assets supporting a TRIS that is not in the retirement phase are not eligible for ECPI. They will be taxed at 15%. This will apply to all TRIS regardless of the date the TRIS started.

ECPI also applies to certain retirement phase products such as deferred lifetime annuities which are not currently paying a benefit.

For more information see:

- Exempt current pension income

Working out the ECPI

There are 2 ways to calculate the fund's ECPI:

- The trustee can exempt a portion of the fund’s total income that reflects the proportion of the fund’s super liabilities that are current pension liabilities in respect of retirement phase superannuation income stream benefits. The value of the fund’s super liabilities and current pension liabilities must be certified by an actuary.

- The trustee can segregate assets used to support the retirement phase income stream.

When starting a retirement phase income stream, the trustee will need to consider which method they should use to calculate the fund's ECPI. Should an actuarial certificate be required, it must be obtained by the trustee before lodging the *Self-managed superannuation fund annual return* (SAR).

For more information see:

- Methods for calculating ECPI
- Self-managed superannuation fund annual return instructions

Contributions received for a member after the pension has started

If a trustee has started paying a pension to a member and they receive a contribution for the same member, they can't 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.

For more information see:

- COVID-19 frequently asked questions – self-managed super funds – on our Legal database

Ceasing a pension

The most common circumstances for a pension ceasing include:

- When all pension capital is exhausted
- Failure to meet the superannuation pension standards
- The pension is fully commuted
- The member has died.

Pension capital is exhausted

A super income stream ceases as no super income stream benefits are payable when both the:

- capital supporting the pension has been reduced to nil
- 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 super 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. Any payments made during the year will be super lump sums for income tax purposes and lump sums for SISR purposes.

This is the case even if the member remains entitled to receive a payment from the fund for the pension under the governing rules or under general trust law concepts.

If income from assets supporting the income stream was eligible to be treated as ECPI because the income stream was in retirement phase, this also means the fund won't be entitled to treat the income or capital gains as ECPI for the income year.

For the member to receive a super income stream for income tax purposes in future years, the income stream must cease (for example by commutation) and a new superannuation income stream must start that meets all of the requirements of the SISR.

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

You will also need to revalue assets at market value and recalculate the minimum pension payment required at the start of that income year.

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 of Taxation will allow a pension to continue, even though the trustee has failed to pay the minimum amount of pension.

We have published a Q&A on our website (below). These highlight the conditions to satisfy to allow a pension to continue if a fund fails to meet the minimum pension payment requirements in an income year.

For more information see:

- SMSFs – Minimum pension payment requirements FAQs

Pension is fully commuted

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

A request to fully commute a superannuation income stream takes effect as soon as the trustee's liability to pay periodic superannuation income stream benefits is substituted with a liability to pay a superannuation lump sum to the member or dependant beneficiary.

A payment resulting from a full commutation can't 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 separate interest that supported the pension when the pension started.

Before fully commuting a member's pension, you should ensure all minimum annual pension payments are made.

You must also consider the more restrictive commutation rules that apply to TRIS.

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.

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 wasn't 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 won't be entitled to treat income or capital gains from Andre's pension as ECPI in the year the commutation takes place.

For more information see:

- SMSF – Transition to retirement income streams

Tax implications 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 if the pension was in retirement phase. There may also be CGT consequences as a result of the disposal of assets after this time.

Full commutation paid in-specie

A full commutation can be paid in-specie. The payment that results from a full commutation is a lump sum for the purposes of the superannuation laws. 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. That is unless a dependant beneficiary is automatically entitled to a reversionary pension.

Minimum pension payments

If a super income stream automatically transfers to a beneficiary on the death of a pensioner (a reversionary pension), you must ensure that the minimum pension payments continue to be made. This includes 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, we won't 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.

For more information see:

- TR 2013/5 *Income tax: when a superannuation income stream commences and ceases*.

When a pensioner dies

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

From 1 July 2012, *Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013* ensures that, where a member who was receiving a non-reversionary super income stream that was in the retirement phase dies, the fund will continue to be entitled to claim ECPI in the period from the member's death. This is 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).

The trustee is 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.

If a member in receipt of a non-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*. This describes an alternative method to determining the tax free and taxable components of the super interest.

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.

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.

For more information see:

- How to apply for SMSF-specific advice – getting started
- How we help and regulate SMSFs

QC 26864

Fund rules intended to prevent excess contributions tax

Issues concerning the rules in some funds, designed to prevent excess contributions tax (ECT).

Last updated 22 March 2017

In Taxpayer Alert TA 2010/2, we highlighted issues concerning the governing rules in some superannuation funds which are designed to prevent a member from becoming liable to excess contributions tax (ECT). Having reviewed these arrangements, we have withdrawn the taxpayer alert. This page explains our approach to fund rules of this kind.

Determining whether a payment is a contribution

If a trustee of a super fund receives a payment described as a contribution, the trustee must promptly consider whether the payment is in fact a contribution.

This involves considering whether the amount is paid to them to hold in their capacity as trustee of the fund. The trustee must consider whether, if they accept the payment, the amount would, under the terms of the fund's governing rules, form part of the capital of the fund.

Taxation Ruling TR 2010/1 explains our view on what a 'contribution' is for income tax and regulatory purposes. A 'contribution' is anything of value that increases the capital of a super fund where the purpose of the person who provides it is to benefit a particular member, a group of members or all the members generally.

In dealing with a payment received, trustees must act consistently with the super regulatory law and governing rules of the fund. If a payment is a contribution, it must be accounted for as such. Payments which are not to form part of the capital of the fund cannot be contributions and cannot be accounted for as such or intermingled with the assets of the fund.

It is therefore not open to trustees to deposit amounts received to the fund's bank account, and otherwise treat the amounts as contributions, without taking due care to determine whether the amounts in fact form part of the capital of the fund.

Trustees must consider whether a payment is a contribution as soon as, or shortly after, the payment is received.

A trustee who treats amounts as contributions without due care to determine whether the amounts are contributions, on the basis that any issues may be resolved by reference to the super fund's governing rules in the event of an audit, would not act consistently with the trustee's duties as trustee.

We expect trustees to be aware of their duties as trustee under the terms of the super fund's governing rules, the super regulatory law and trust law, and act in accordance with those duties.

If a trustee intermingles amounts with the fund's assets, without proper consideration of whether the amounts form part of the fund, we consider this when determining whether the person is a fit and proper person to be a trustee of a self-managed super fund.

A governing rule of the fund may be designed to prevent certain payments from being a contribution to the fund. For example, a rule may provide that a trustee is not to accept a payment as a contribution if doing so would cause a member to exceed the member's contributions cap for the purposes of ECT. Or a rule may provide that such amounts are to be held subject to a separate trust for the payer or returned to the payer.

Whether such a rule actually prevents a payment from being a contribution, and whether it applies to all or only some categories of such payments (for example, whether it applies to payments by a member's employer), depends on its effect as a matter of trust law. In particular, it depends on whether the rule prevents the payment from increasing the capital of the super fund.

The effect of such a rule must be assessed having regard to its particular terms, interpreted in the context of the surrounding provisions and the governing rules of the fund as a whole.

A governing rule will not prevent a payment from being a contribution where, on its proper construction, it merely empowers the trustee to return or otherwise deal with a payment which is already a contribution to the fund - that is, which has become part of the capital of the fund.

Trustees who are uncertain about the effect of the super fund's governing rules should seek independent advice.

Treatment of payments which are contributions

Where a payment to the trustee is a contribution, its character as a contribution is not affected by any subsequent actions taken by the trustee. The contribution will be preserved as a super benefit of the member.

A trustee will be in breach of the super law if they pay an amount received as a contribution for a member (or earnings attributable to it) to that member without a condition of release being satisfied.

If a trustee pays a member's super benefits to the member without ensuring the member has satisfied a condition of release, the super benefit will be assessable income of the member and taxed at their marginal rate of tax.

In considering whether a fund should be made non-complying for regulatory and tax purposes, the Commissioner will take into account whether the trustee has paid super benefits to members in contravention of the super law.

Treatment of payments which are not contributions

Any payment, or part of a payment, which the trustee of a super fund retains, despite the amount not forming part of the fund under the super fund's governing rules, will generally be an asset of a different trust, separate or distinct from the super fund. This will be so whether or not the fund's rules expressly provide for such amounts to be held under a separate trust and even if the trustee treats the payment as a contribution in the fund's records, contrary to the rules of the fund.

The trustee must keep the money and other assets of the super fund separate from the trustee's personal assets and the assets of any other trust.

The trustee should act promptly to either:

- return any amount described as a contribution but which, under the governing rules, does not form part of the fund to the person who paid it
- separate the relevant amount from the assets of the super fund.

A trustee who intermingles an amount that does not form part of the super fund with the money or assets of the fund will be in breach of their obligations under the super regulatory law and trust law.

The trustee must not treat any payment, or part of a payment, which does not form part of the super fund as a contribution for the purposes of the:

- income tax law
- operating standards of the super law–- in particular, the contributions and payment standards

- statement of contributions which the trustee is required to give to us.

The beneficiary of the separate trust must properly account for income tax on income from the separate trust. The payer cannot deduct a payment on the basis that it is a super contribution if the fund's governing rules prevent the amount from being a contribution.

Taxpayers who do not account for these obligations in accordance with the terms of the super fund's governing rules may be exposed to penalties and interest. Additionally, records which wrongly treat amounts as forming part of the super fund rather than a separate trust would not meet the record-keeping requirements of the income tax and super law.

Where a trustee holds any payment on a trust which is separate from the super fund, it must account to the payer for any income or expenses associated with that trust separately from those of the super fund. The assets of the super fund cannot be used to meet expenses of the separate trust.

Penalties can apply if a person:

- fails to disclose income earned from money held for them on a separate trust
- claims a tax deduction they are not entitled to claim
- fails to keep accurate records.

QC 25177

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.