DBA Butler Pty Ltd Lawyers

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New Draft Pension Regulations Released

The long awaited pension regulations proposed in the 2006 Budget were released in draft form on 21 December 2006.

Broadly, SMSFs will be able to pay two new types of pension: an account-based pension ('ABP') and a transition to retirement income stream ('TRIS'). Pensions may only revert to children in limited circumstances.

Account-based Pension

The new ABPs can commence to be paid from 1 July 2007. As the pension is account based, the pension continues while there is a remaining account balance.

The standards require a minimum pension payment be made annually. This is calculated as a percentage factor of the account balance at 1 July in the financial year the payment is made (or the commencement date). The factors increase with the age of the pensioner; this is aimed at 'drying-out' the pension during the life of the pensioner. These factors are shown in Table 1 below.

Item	Age of Beneficiary	Percentage Factor
1	Under 65	4
2	65-74	5
3	75-79	6
4	80-84	7
5	85-89	9
6	90-94	11
7	95 or more	14

Table 1: Percentage Factors

For example, the annual pension for a person aged 65 years with a pension account balance of $250,000 at 1 July of a particular year is $12,500.

There is no cap on the amount that can be withdrawn in a particular financial year. This provides flexibility for meeting unforseen expenses in a particular year without having to necessarily commute the pension.

The pension can be commuted at any time, subject to generally first paying the minimum amount of the yearly pension (or pro-rata minimum in the case of a full commutation). The pension may also be commuted, without first having to make a pension payment, on death, divorce or within 14 days of commencement.

Treasury's estimates show that provided the minimum amount of the pension is paid each year, the life of the ABP will generally exceed that for an allocated and market linked pension.

Transition to Retirement Income Stream

A TRIS is the same as an ABP, except that a cap of 10% is placed on the maximum amount of the pension account balance that can be withdrawn in any particular financial year.

Like the existing transition to retirement (aka non-commutable) pensions, the TRIS can be commenced once a person has reached their preservation age even though they do not satisfy a cashing restriction, namely, retirement. A person aged 55 could, eg, commence a TRIS while continuing to work and salary sacrifice to superannuation (keeping in mind that salary sacrifice contributions count towards the contributions cap).

Between 55 and 59 years of age, pension payments will be subject to tax at marginal tax rates less a 15% rebate (note the abolition of reasonable benefit limits from 1 July 2007). However, pension payments will become tax-free once the pensioner attains 60 years.

Non Account-based Pensions

Funds with at least 50 members will also be able to provide three types of non-ABPs (in addition to the ABP and the TRIS).

The first type of pension is similar to the ABP in that pension payments are calculated using the same percentage factors (see Table 1). However, the relevant factor is applied to the purchase price of the pension on commencement rather than the account balance determined on 1 July each year. Hence, any growth in pension assets is not taken into account in calculating the annual pension. This provides the pensioner with greater certainty of the pension payments they can expect to receive each year. Further, as the pension factors are low for pensioners under 80 years of age, it is likely that investment growth will out-strip draw-downs on the pension capital if only the minimum annual pension payment is taken.

The second type of pension is payable throughout the life of the pensioner or for a term of no greater than the difference between 100 years and the age of the pensioner on the commencement day. Annual pension payments are also fixed, and cannot vary by more than 5% from the total payments in the previous

year (except in the case of an indexation arrangement designed to maintain the purchasing power of the pension relative to the Consumer Price Index over time).

The third type of pension is the existing lifetime pension and is payable under the existing rules for same.

As the non-ABPs are defined benefit pensions, SMSFs will not be able to provide them.

Annuities

Life insurance companies and registered organisations will be able to provide annuities that are similar to the ABP, TRIS, and non-ABPs.

Status of Existing Pensions

Existing pensions, namely, market linked, allocated, non-commutable allocated and non-commutable market linked pensions can be commenced from SMSFs before 20 September 2007.

The rules governing these pensions will remain in the *Superannuation Industry (Supervision) Regulations 1994* (Cth), ie, these pensions will not automatically be governed under the new rules from 1 July 2007.

Pensions commenced on or after 20 September 2007 will be governed by the new rules. Existing allocated pensions can convert to the new ABP.

Reversion of pensions to children

If a member dies on or after 1 July 2007, their benefits can be paid as a pension or annuity to a child if the child is either under 18 years of age ***or*** is 18 years or more and is either financially dependent on the member and less than 25 years of age or is permanently disabled. If the pensioner dies and their pension reverts to an eligible child, the pension must be commuted on the child reaching 25 years of age unless they are permanently disabled.

Pension rules that provide for the transfer of the pension to adult children 25 years or over will not meet the minimum standards for the pension. This will be the case for both the new pensions and existing pensions commenced prior to 1 July 2007. This will have significant implications for people who have commenced pensions under the existing rules (in particular defined benefit pensions) where the pension is reversionary to children. These pensions will need to be reviewed in light of the proposed changes as from 1 July 2007 as they may not comply with the minimum standards for the pension.

Compulsory Cashing

The new regulations remove the existing compulsory cashing rules, thereby allowing accumulation of benefits up until death. A person's benefits must, however, still be paid out of the fund on death or used to pay a pension to a dependant.

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