

## Defined Benefit Pensions Update

As the 30 June 2005 defined benefit pensions ('DBP') deadline approaches, care must be taken in utilising the 30 June transitional relief, as its availability is quite restricted. Treasury should soon be providing its revised options in relation to the types of pensions that can be paid by small funds (funds with fewer than 50 members).

### Transitional Relief

The 30 June 2005 transitional relief applies to enable a small fund to pay a DBP to a person:

- who was a member of the fund on 11 May 2004;
- who, before 1 July 2005, retires (as defined in the *Superannuation Industry (Supervision) Regulations 1994* (Cth) ('SISR') on or after attaining age 55 or attains age 65; and
- who after 11 May 2004 and before 1 July 2005 becomes entitled to be paid a DBP where the first pension payment is made within 12 months of the person becoming entitled to the pension.

This transitional relief is somewhat problematic as:

- the requirement that a person be a member of the relevant fund on 11 May 2004 may cause difficulty in respect of reversionary beneficiaries ('RB') who were not members at that date; and
- the age requirement (55 years/65 years) may cause difficulty for RBs who have not attained the required age and those that have satisfied another condition of release (eg, total and permanent disablement).

### Treasury Response to Industry Feedback

Treasury issued a discussion paper in January 2005, with a view to releasing a final report in late April. Following industry feedback to the changes, the report outlines a number of possible alternative strategies, including:

- developing new rules for DBPs, including changing the RBL assessment of lifetime pensions (eg, making the assessment account based and/or updating the pension valuation factors), limiting the reversionary options for pensions, and requiring payout of residual amounts. This will have the impact of removing perceived abuses in respect of RBL compression where such practices can still be undertaken (eg, by members of large funds);
- modifying existing pensions – such as market linked pensions and allocated pensions – by amending pension valuation factors to provide for greater longevity and to allow some smoothing of pension payments; and
- introducing new pensions, such as lifetime pensions and term certain pensions with annual resetting.

### Documentation

Appropriate and quality documentation should be prepared to ensure compliance with the law. In particular, the following should be borne in mind:

- switching from accumulation to pension phase constitutes the issue of a new product. Therefore, a PDS must be issued. A generic PDS that covers superannuation within an SMSF would not, in our opinion, comply with the law as a comprehensive guide on the particular types of pensions available; and
- care must be taken in respect of the transitional relief in that while it enables the governing rules of a fund to be amended in order to facilitate the payment of a DBP, any such amendment may jeopardise the transitional relief provided for funds that were capable of paying DBPs on or before 11 May 2004. Please note that given its limited applicability, this other transitional relief is not discussed in this newsletter.

DBA Butler offers a comprehensive range of products and services in relation to all types of pensions. The next page shows a table summarising some of the main features of the various types of pensions.

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**PENSIONS<sup>1</sup> TABLE**  
as of April 2005

Allocated Pension	Market Linked Pension ('MLP')	Complying Lifetime Pension	Complying Term (Life Expectancy) Pension	Flexi Pension
<ul style="list-style-type: none"> <li>Account based, so lasts as long as there is an account balance.</li> <li>The size of the payments are required to be within a minimum and maximum level each year, calculated in accordance with Schedule 1A of the SISR.</li> <li>Can be commuted at any time.</li> <li>Counts toward lump sum RBL.</li> <li>No asset test exemption allowed.</li> <li>Considerable flexibility with estate planning as a lump sum and/or pension can be provided to dependants.</li> </ul>	<ul style="list-style-type: none"> <li>The term of the pension can be the life expectancy ('LE') of the member or if elected, his/her spouse's LE if greater. This term can assume he/she was up to 5 years younger. This is rounded up to the next whole number if it is not a whole number.</li> <li>Account based, so lasts as long as there is an account balance. However, must be paid out by the end of the term (as calculated above).</li> <li>The size of the payments are calculated with reference to Schedule 6 of the SISR.</li> <li>Cannot be commuted except in limited circumstances, eg, divorce, to pay surcharge, or to roll-over to another qualifying pension.</li> <li>Counts towards pension RBL<sup>2</sup>.</li> <li>Entitled to 50% asset test exemption.</li> </ul>	<ul style="list-style-type: none"> <li>Lasts for the life of the member, and if a reversionary was nominated at commencement, generally for their lifetime.</li> <li>The size of the payments are fixed but can be indexed.</li> <li>Upon the death of the member, any surplus remains in the fund for other beneficiaries.</li> <li>Allows a guaranteed minimum payment on the death of the member being the balance of the pension that would have been paid over the lesser of the primary beneficiary's LE (rounded up to the nearest whole number) or 20 years (this was 10 years prior to 20/9/2004).</li> <li>Cannot be commuted except in limited circumstances (similar to those applicable to MLP).</li> <li>Counts towards pension RBL<sup>2</sup>.</li> <li>Can be entitled to 50% asset test exemption.</li> </ul>	<ul style="list-style-type: none"> <li>The term is calculated the same as that for a MLP.</li> <li>The size of the payments are fixed but can be indexed.</li> <li>Surplus funds can be paid to the estate upon death if there is no reversionary beneficiary.</li> <li>Cannot be commuted except in limited circumstances (similar to those applicable to MLP).</li> <li>Counts towards pension RBL<sup>2</sup>.</li> <li>Can be entitled to 50% asset test exemption.</li> </ul>	<ul style="list-style-type: none"> <li>Lasts for the life of the member, or a fixed term (nominated upfront). Note, there are various types of flexi-pensions.</li> <li>The size of the payments are fixed but can be indexed.</li> <li>Can be commuted at any time, subject to limits imposed by actuarial tables. Also, may be commuted if exceptions similar to those applicable to MLP satisfied.</li> <li>Residual capital value can range from 0% to 100%. Thus repayment of capital at the end of the pension term can be specified.</li> <li>Counts toward lump sum RBL.</li> <li>Generally no asset test exemption allowed.</li> </ul>

<sup>1</sup> Pensions can only be paid when a condition of release under the SISR has been satisfied.

<sup>2</sup> Provided 50/50 test in section 140ZF of the *Income Tax Assessment Act 1936* (Cth) is satisfied.