

## Focus on Exempt Current Pension Income

The ATO has recently issued more information regarding how to calculate Exempt Current Pension Income (ECPI) as recent audit activity has indicated there is much confusion in this area. This SuperShot explains some of the typical errors and practical tips to consider regarding these calculations.

Firstly, the tax treatment of a self managed super fund's (SMSF) investment income and capital gains depends upon whether the fund is in accumulation or pension phase, or a combination of both.

Income earned from assets held to provide for pensions is generally exempt from income tax.

Typical errors in calculating ECPI include:

- Investment, management and administration expenses being calculated at ECPI label;
- Inclusion of contributions in the calculation of ECPI;
- ECPI amounts being claimed at the losses label;
- Offsetting deductions against ECPI;
- Incorrectly apportioning expenses;
- Failing to meet the minimum pension requirement;
- Failing to obtain an actuary certificate;
- Assets not being revalued to market value before the pension is commenced; and
- Not applying the actuarial certificate amount correctly.

## Calculating Exempt Current Pension Income

There are two methods available in calculating ECPI:

### 1. Segregated pension assets

Segregated assets are specifically identified as having the sole purpose of paying a pension, as opposed to 'pooled' assets, which are available to all members. Segregation involves applying specific assets to a specific member or allocating specific assets to either a pension and/or accumulation account. Where the asset is segregated to a pension, the income earned is tax free.

Important note: if an SMSF is 100% in pension phase, the ATO considers the fund to have 100% segregated assets.

### 2. Unsegregated pension assets

Assets not specifically separated to support a pension are considered unsegregated current pension assets (or 'pooled' assets). The unsegregated method allows a fund to claim the ECPI deduction based on the proportion of a fund's pension balances divided by its total balance. An actuary is required to do this calculation (see below).

## Deduction of expenses when a fund has ECPI

Generally, where an expense is incurred which relates to both accumulation and pension assets, the expense must be apportioned so that only the proportion of the expense relating to the accumulation balances is claimed as a deduction. These expenses are shown as a separate deduction in the superannuation fund tax return.

## Capital losses

Capital losses made where assets are unsegregated are able to be carried forward, while capital losses made where assets are segregated (or 100% in pension phase) are not able to be carried forward.

## Actuary certificate

An actuary's certificate is a statement provided by a qualified actuary that outlines the proportion of a super fund's income that should be exempt from income tax. If an SMSF does not obtain an actuary certificate when it is required to, it will not be eligible to claim a tax exemption for ECPI. The actuary certificate must be obtained prior to the date of lodgement of the SMSF annual return for the income year.

An actuary certificate is required where a fund has both accumulation and pension benefits, however, an actuary certificate is not required if all benefits are 100% in pension phase.

## Exempt Current Pension Income and death

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ATO draft ruling TR 2011/D3 indicates that unless the member's beneficiary is automatically entitled to receive an income stream upon the member's death, the account balance of the deceased reverts to accumulation upon death. Therefore, if the minimum pension standard has not been met prior to the date of death, the ECPI provisions will not be able to be applied that year. The ATO are still considering the impact of ECPI given this outcome.

### Other SMSF News

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#### **Pension drawdown relief extended for 2012/ 2013 year**

The ATO has confirmed the current 25% pension drawdown reduction will continue to apply during the 2012 /2013 financial year.

## Practical tips for calculating ECPI

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- Under the segregated asset method, assets must be identified as having the sole purpose of paying a pension and income must be split accordingly;
- If an actuary certificate is required, it must be obtained before lodging the annual return;
- All SMSF assets must be revalued to their current market value before the pension starts;
- If the minimum annual pension standard has not been met, the ECPI provisions do not apply. Therefore, ensure the minimum pension is paid early in the year if being paid annually;
- Deductions need to be apportioned and shown separately in the tax return; and
- The eligibility to carry forward capital losses needs to be determined based upon asset segregation.

Should you require assistance or additional information, please contact your PKF Tax adviser or:

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