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Retirement Phase Lump Sum Withdrawals

Proper planning should be undertaken and consideration given to how personal withdrawals are treated each year. Depending on your circumstances and available balances, personal withdrawals may either be categorised as pension payments or lump sum withdrawals for compliance and tax purposes.

An account-based pension has a minimum annual withdrawal requirement based on the member's pension balance and age as at 1 July of the financial year (or commencement date if the pension started during the financial year). To ensure the fund is entitled to tax concessions the minimum amount must be withdrawn. Some pension recipients may wish to withdraw more than the minimum required to meet their living expenses and their lifestyle needs. This fact sheet focuses on the treatment of any amount withdrawn in excess of the minimum annual pension withdrawal requirement.

In retirement phase, any amount withdrawn above the minimum can be nominated by the member in such a way to potentially produce better outcomes available to the SMSF/members than if they were simply allocated as pension withdrawals.

Eligibility and the different tax treatment of pensions and LSWs

If you're retired or over 65 years of age and have a retirement phase pension you are also eligible to take lump sum withdrawals. Transition to Retirement Income Streams (TRIS) in accumulation phase are non-commutable meaning you are not able to take lump sums as you have not met a condition of release with nil cashing restrictions.

Pension and lump sum payments to members aged 60 and over, from an SMSF, are tax free. Between preservation age, currently 58, and age 60 the taxable component of pension withdrawals are subject to tax at marginal tax rates less a 15% tax offset. In contrast for this age bracket, where a lump sum is taken, the taxable component is treated as tax free up to the low rate cap. The low rate cap is currently $215,000 (2020/21 Financial Year). Any taxable component above this cap is taxed at 15% plus Medicare.

Options for how excess payments are treated in the SMSF

For an SMSF the allocation decision can ultimately impact the income tax paid by the fund and for the member it can impact their Personal Transfer Balance Cap (PTBC).

There are two main alternatives for how any amount above the minimum pension can be accounted for by SMSF trustees, subject to whether the member has an additional accumulation interest or not:

1. **Lump Sum Withdrawal from Accumulation Phase interest**

If available, the excess amount may be withdrawn from an accumulation interest, potentially reducing the portion of the fund that is subject to tax on the earnings, for the current and subsequent years.

Withdrawing from an accumulation interest does not reduce the PTBC as this relates only to amounts held in a retirement phase pension account. However, it does reduce the amount of the fund that is held in a taxable environment meaning more of the income including capital gains will be exempt from tax. This is because exempt current pension income of the fund is determined based on the proportion of the fund assets in retirement/pension phase. An actuary will calculate these proportions to determine the exempt income percentage for tax purposes. Drawing down from the accumulation portion of the fund will generally increase the exempt percentage for the year. The higher the percentage, the higher the exempt current pension income deduction and this can result in lower income tax for the SMSF.

The actuarial calculation uses daily weighted average calculations and the size and timing of commutations during the year are factored in. On this basis, an lump sum taken earlier in the financial year will have a higher impact on the actuarial percentage than it would if taken later in the year as more of the fund would be in retirement phase over the year.

2. Lump Sum Withdrawal from Retirement Phase pension account

Where there are no accumulation accounts available, members may choose to withdraw the excess over their minimum pension requirement as a partial commutation lump sum withdrawal from their retirement phase pension account(s) to 'free-up' some of their PTBC space. A commutation creates a debit to the transfer balance account which can create additional room in the cap.

Space in the PTBC can enable future contributions or rollovers from other funds (in accumulation phase) to be included in a tax-free environment. Further it can provide greater capacity to transfer a spouses benefit via a reversionary or discretionary pension received on death. In contrast, pension withdrawals do not impact the transfer balance account. A commutation creating a debit to the transfer balance account can therefore be of future benefit to the SMSF.

The PTBC may be subject to indexation so by creating room in the cap a portion of the indexed amount will also be able to be utilised.

It is practical to consider allocating amounts over the minimum pension requirement as a lump sum withdrawal to maximise the tax-free environment of the fund.

NOTE: it is not a requirement to take the minimum before taking a lump sum, as long as the minimum is taken over the course of the year.

What happens if we leave the excess payments as pension payments?

Leaving any amount above the minimum as a pension payment, where an accumulation account exists, means the proportion of the fund in retirement phase is likely to be reducing relative to the accumulation phase balance (unless contributions are still being made). This will have a flow on effect to the actuary percentage and tax calculation. Additionally, treating any withdrawal above the minimum as a pension payment rather than a commutation from a retirement phase pension means you don't have the opportunity to create room in the transfer balance account that may be of use in the future.

If you want to elect to treat amounts as a lump sum what do you need to consider?

If any amount is to be treated as a lump sum rather than a pension payment, an election must be made in advance. This is important as transactions cannot be backdated and any commutation from a retirement phase pension must be reported via the Transfer Balance Account Report with the ATO. Payments need to be allocated as intended from the date of the withdrawal.

It is also important to consider how the allocation of withdrawals may affect any Centrelink entitlements, so we recommend checking with them in relation to the impact based on personal circumstances.

Where a pension recipient wants to make an election regarding the treatment of their withdrawals for the 2020/21 financial year and beyond, proper documentation should be put in place. This would include preparing a member request stipulating the allocation of the excess for the year and a resolution to confirm the trustee's acceptance of the request, prior to any excess being drawn.

Given the nature of these transactions they should not be applied or changed retrospectively, it is vital that proper planning and consideration is given at the start of each financial year.