Ability to claim ECPI when the Minimum Pension Standards have not been met

Another financial year has been and gone and you've only just realised that an Account Based Pension has not met the Minimum Pension Standards. Sound familiar? Well you still might be in luck.

The Commissioner of Taxation can exercise their General Powers of Administration (GPA) and allow a super income stream to still be entitled to claim Exempt Current Pension Income (ECPI) so long as the SMSF satisfies a list of requirements set out by the Commissioner.

Furthermore, the Commissioner of Taxation also allows Trustees of an SMSF to self-assess whether they are eligible to use the GPA concession or not based on whether the SMSF has satisfied another list of requirements.

To understand whether an SMSF is eligible to self-assess and how the self-assessment process works, we have broken it down into a step by step guide for you.

Step 1: Can the SMSF self-assess?

For the Trustees of an SMSF to be able to self-assess whether their fund is eligible to use the GPA concession, they must satisfy the following four conditions:

1. Failing to meet the minimum pension standards was an honest mistake by the Trustees or was outside of their control;

2. The shortfall of the minimum pension payment does not exceed 1/12th of the annual payment amount;

3. The Trustees have not previously applied the GPA concession; and
4. All of the other conditions to exercise the GPA concession have been met (this other list of conditions is covered shortly in Step 2). [1]

It is important to note that for super income streams that commence during the financial year, the ATO specify that the small underpayment of no more than 1/12th is determined from the annual payment amount and not the pro-rated amount. Furthermore, the Commissioner considers 'as soon as practicable' to be within 28 days of the Trustees becoming aware of the underpayment.

Not eligible to self-assess

For funds that are not eligible to self-assess, the Trustees can write to the ATO requesting the ability to use the GPA concession. The Commissioner will then determine whether to exercise their GPA if they believe the fund failed to meet the minimum pension standards due to either:

1. The shortfall was an honest mistake by the Trustees which resulted in a small underpayment of the minimum pension payment amount; or
2. The trustees demonstrated matters were outside of their control

It is important to highlight a speech that was made by the Assistant Commissioner, Kasey McFarlane, back in July 2015 where she highlighted what the term 'small underpayment' meant for funds that were not eligible to self-assess. Under these circumstances, McFarlane highlighted that the Commissioner did not view 1/12th has a hard and fast rule and that a small amount in absolute dollar terms may also be satisfactory. She then went on to explain that the Commissioner would consider the circumstances of each fund case by case on specific facts. [2]

Step 2: Self-assessing eligibility to use the GPA concession

For an SMSF that is eligible to self-assess, the Trustees must then determine if the following five requirements set out by the Commissioner have been satisfied:

1. The reason the Trustees failed to meet the minimum pension standards in the given income year was due to either;
   a. It was an honest mistake made by the Trustees which resulted in a small shortfall of the minimum payment amount required for the super income stream; or
   b. It was a matter that was outside of the control of the Trustees.
2. If the super income stream was in retirement phase, the income stream would have still been entitled to claim ECPI if it wasn't for the Trustees failing to meet the minimum pension standards.
3. Once the Trustees became aware of the underpayment, they made a catch-up payment as soon as practicable in the following financial year, or they have treated a payment that was made in the following financial year as if it was made in the previous financial year (i.e. the year where the minimum payment amount was not met).
4. If the Trustees were to have made the catch-up payment in the income year then the minimum pension standards would have been satisfied.
5. The Trustees have treated the catch-up payment as if it was made in the prior income year (i.e. the year that it fell short). [1]

For an SMSF that is eligible to self-assess and the Trustees are satisfied that the above five requirements have been met then the fund can take advantage of the one-off GPA concession.

Step 3: Eligibility to use the GPA concession

Eligible to use the GPA concession

If the SMSF is eligible to exercise the GPA concession then the super income stream will be considered to have continued and there will be no requirement for a new pension to commence in the following financial year. If the super income stream was in retirement phase then it will still be entitled to claim ECPI on the earnings that were received from the assets supporting that retirement phase income stream.

Not eligible to use the GPA concession

If the SMSF is not eligible to exercise the GPA concession or the Trustees decided not to use it, then the super income stream will not be able to satisfy the minimum pension standards. Where a fund has not satisfied the minimum pension standards, the income stream will be taken to have ceased at the start of the given financial year for income tax purposes. Any payments that were taken from the super income stream during the financial year will need to be treated as super lump sums for both income tax and SIS Regulation purposes. For super income streams that were in retirement phase, the SMSF will not be entitled to claim ECPI on that income stream. The earnings received from the assets supporting the retirement phase income stream will be fully taxable.

If the member wishes to continue to receive a super income stream in the following financial year then they will need to commence a brand new pension. This will include revaluating the assets at market value on the date the pension is commencing, calculating the new tax free and taxable components as well as calculating the minimum pension payment amount at the start of the new pension.

Conclusion

Where an income stream has not met the minimum pension standards, Trustees can self-assess and use the GPA concession if they are eligible to do so. However, it is important that Trustees are aware that the ability to self-assess and use the GPA concession is a one-off exception and should not be viewed as a get-out-jail free card for all pension underpayments.

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References

[1] Australian Taxation Office, SMSFs: Minimum pension payment requirements – frequently asked questions, last updated 28 May 2018, viewed 1 July 2019 https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/SMSF-technical/SMSFs--Minimum-pension-payment-requirements---frequently-asked-questions/

[2] Australian Taxation Office, What's ahead for SMSFs? The ATO perspective, Speech by Kasey McFarlane – Assistant Commissioner, last modified 28 July 2015, viewed 1 July 2019 https://www.ato.gov.au/Media-centre/Speeches/Other/Whats-ahead-for-SMSFs-The-ATO-perspective/

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