# What is ECPI Choice, and should we be using it?

Despite the excellent software we have developed over the years, I am still very hands-on with preparing some Actuarial Certificates. Roughly 5% of our certificates are requested using Excel application forms processed through Excel-based software that I originally developed back in 2007.

In addition, there are some circumstances with the online requests where the system flags me to run additional checks. These are rare situations where the software could make a mistake (e.g. multiple Internal Transfers on the same date, for the same member).

This hands-on approach helps me stay in touch with some client habits and get a feel for what is understood and misunderstood in our industry, especially around Exempt Current Pension Income (ECPI).

One of the most misunderstood aspects of ECPI is the question of whether a Fund has Disregarded Small Fund Assets (DSFA) and the impact that has on ECPI choice.

## Background

When the Transfer Balance Cap (TBC) was introduced in 2017, a handbrake was included around Funds ability to segregate assets. This handbrake came into effect when an SMSF had at least one member with a Total Super Balance (TSB) more than $1.6m – which was the TBC in 2017, and that same member was receiving a Retirement Phase Income Stream (inside or outside the SMSF). So if, at 30th June 20xx, a Fund had a member with this situation, that Fund was ineligible to use the Segregated Method in the next financial year (20xy) – and this Fund was said to have Disregarded Small Fund Assets (DSFA).

Essentially this was to prevent those with high balances from moving assets into and out of Segregation for the purpose of immunisation from income tax (and potentially also from CGT). There was a fear that with the TBC restricting some members to only a portion of their assets in Retirement Phase, they would seek to use segregation where possible, to minimise their tax.

Since then, the TBC has been indexed up to $2m, but the threshold for DSFA isn't indexed, so more Funds are becoming ineligible to use the Segregated Method. That said, if you consider your own SMSFs and what portion have members with TSB > $1.6m and receiving a RPIS as of 30/06/2025 – the majority of your SMSFs will most likely NOT have DSFA.

## Confusion

Another significant confusion around DSFA is the fact the double-negative nature of the test. It can be expressed as "If the Fund has a member with TSB > $1.6m AND receiving a RPIS as of 30th June, then it DOES have DSFA, and therefore is NOT eligible to use the Segregated Method in the subsequent FY." Or, we could also say "if the Fund DOESN'T have a member with TSB > $1.6m AND receiving a RPIS as of 30th June, then it DOESN'T have DSFA, and therefore IS eligible to use the Segregated Method in the subsequent FY." Confusing much?

This is easily the most misunderstood aspect of income-tax exemption and ECPI that I see, and unfortunately, I see it frequently.

## Simplification - maybe?

Trying to simplify it, let me put it this way: ALL Funds are **eligible** to use the Segregated Method in any given Financial Year, UNLESS they have DSFA.

The only way they can have DSFA is if they have a member with TSB > $1.6m who is receiving a RPIS at 30th June of the year prior.

So if a Fund doesn't have any members with TSB > $1.6m – it is eligible to use the Segregated Method.

Even if they do have a member (or two) with TSB > $1.6m, then unless any of those members were receiving a RPIS at 30th June of the prior year, the Fund is eligible to use the Segregated Method.

## Adding to the Confusion

In the same year that the TBC came about, it was decided that SMSF actuaries had been calculating the income-tax exemption incorrectly for the 20+ years prior. All actuaries were using the Unsegregated Method for the full Financial Year (unless the Fund had fully segregated Pension assets – in which case they didn't require an Actuarial Certificate).

The change introduced, was that those periods in the year where the Fund is entirely in Pension Phase (i.e. all balances were Pension Balances for at least one day) were deemed to be Segregated Periods (Deemed Segregated Periods – DSPs) and all earnings received in those periods are fully exempted from income tax, using the Segregated Method.

In order to be eligible to use the Segregated Method, they had to NOT have DSFA.

## Another change

Then a few years later Trustees were given the **choice** of whether they used Deemed Segregated Periods or the Unsegregated Method to calculate ECPI. With the DSP approach (Segregated Method) designated as being the default.

This potentially created legislative-change fatigue in the industry (shock!) and left many uncertain about what could, should and would be happening regarding ECPI.

## What is happening?

I can tell you with certainty, many clients are not exercising the choice.

What I consistently see is the answer to the question "Is the Fund **eligible** to use the Segregated Method?" comes back 'No' in at least 80% of certificate requests.

Do you think over 80% of SMSFs paying a pension have DSFA? Do you think so many have a member with TSB > $1.6m and receiving a RPIS? The statistics say otherwise.

By indicating the Fund is NOT eligible to use the Segregated Method, the next key question when requesting a certificate is already answered "Do you wish to use the Segregated Method for this calculation?" comes back as a 'No' since it has been indicated that the Fund is ineligible to do so.

## Outcome

For those Superannuation Funds where there are no periods of being entirely in Pension (Retirement) Phase, there is no impact. The income-tax exemption must be calculated using the Unsegregated (Proportionate) Method for the full FY, regardless of eligibility.

However, for those Funds where there is at least one period where the Fund is entirely in Pension Phase, it is **possible** (depending on the FY circumstances) the amount of income tax (and/or Capital Gains Tax) being paid is significantly more than necessary.

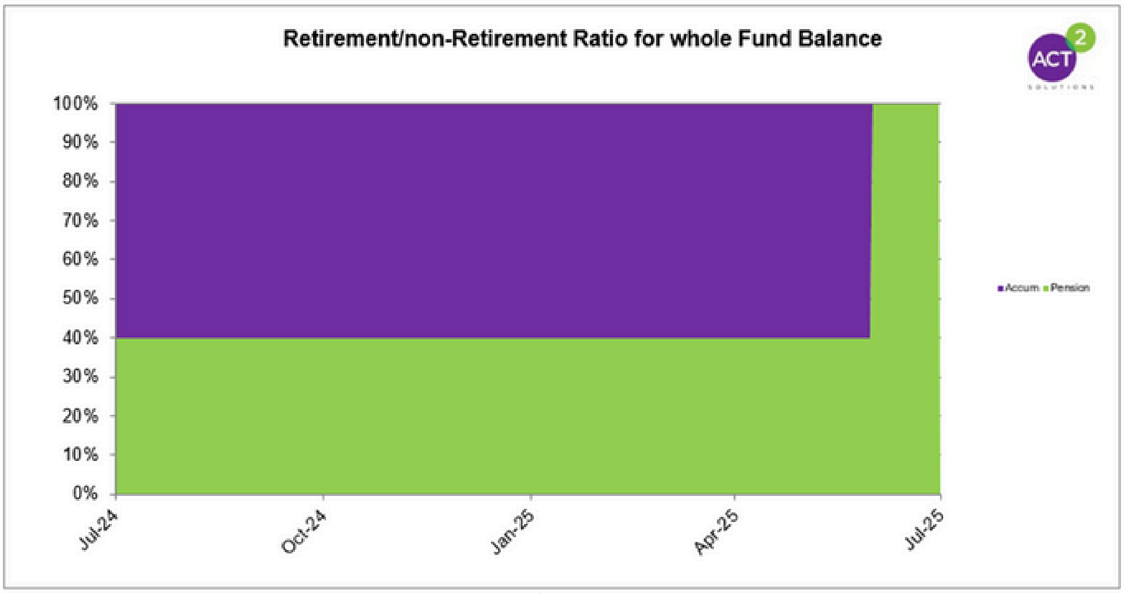
Saying the Trustees have a choice of ECPI is technically correct, but practically this is often not the case. In practice, it is often the administrators/accountants that are making this choice when requesting the Actuarial Certificate. If they aren't certain about how the legislation works, or how to be eligible to use the Segregated Method, then they will often choose the Unsegregated Method because they've (incorrectly) specified the Fund is not eligible to use the Segregated Method.

In many situations, the difference in the level of tax being paid (and the level of tax exempted), won't be appreciably different between the two methods. However, there are some circumstances, often with the medium to large SMSFs, where the level of tax exempted can be significantly higher if the Segregated Method is used.

In particular, if a Fund has periods of full pension, and receives large amounts of earnings or has CGT events occur during those periods, being in a position to use the Segregated Method, and treating those intervals as Deemed Segregated Periods is likely to have a profound effect on the tax outcome for the Fund.

## A Simple Example

Let's say a $2m SMSF is 40% Pension at the start of the FY (one member is fully retired and has roughly 40% of the total Fund balance) and the other member fully retires and converts their entire balance to pension at the start of June. Let's also say that the Fund has earned at roughly 10% pa and 80% of the earnings ($160,000) were received in June.




Using the Unsegregated Method, the tax-exempt percentage would be around 45% and so 55% of the earnings are taxable. Using the Unsegregated Method, the **tax payable would be $16,500** (15% of 55% of $200,000).

However, using the Segregated Method, 60% of the $40,000 received in the first 11 months (the Unsegregated Period) will be taxable. Anything received in June will be fully exempted using the Segregated Method (as it's a Deemed Segregated Period). The **tax payable would be $6,000.**

These members might then see you as their Super Tax Hero if you've saved more than $10K in tax, simply by knowing which ECPI method would give them the best tax outcome. You have effectively **increased the net return for the year by 5.7%**, simply by knowing that the Fund was eligible to use the Segregated Method and choosing to use that method.

## Final Outcome

So whilst ECPI isn't a silver bullet for all SMSFs, or even the majority of SMSFs, it is possible you will have a few SMSFs over the next few years, that could benefit from you having a better grasp of the concepts of DSFA and ECPI choice such that you can help improve their level of income-tax exemption.

To my mind, the Trustees are the most important individuals in our SMSF system and it's our job to help get their retirement savings to stretch as far as possible, within the bounds of the regulations and the legislation. This is why I wish to help you to help them!

As always, if you have any questions about this, or other ECPI matters, please contact Andy on 1800 230 737 or at andy@act2.com.au

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