When is **Deemed Segregation** the best choice for ECPI ?



I know some of our clients are not entirely across **ECPI choice** and I'm hoping to shed some light on where and how it can benefit your clients. This is of course only applicable to funds that are paying at least one pension during the financial year and can be in a position of having all balances in Retirement Phase for a period of time.

Requirements for Segregation

To make use of a Deemed Segregated Period (explained below), the fund needs to be eligible to use the Segregated Method. There is a simple test each year to determine if the Segregated Method is a possibility for the fund for that year. If just prior to the financial year in question, the SMSF had any member with a Total Super Balance more than $1.6 million and that same member was receiving a Retirement Phase income stream (from inside or outside the SMSF) then the fund has Disregarded Small Fund Assets (DSFA). If the fund has DSFA, then it is ***not eligible*** to use the Segregated Method. However, an SMSF that does not have DSFA is eligible to use the Segregated Method for that financial year. It is reasonable to assume that the majority of those SMSFs paying at least one income stream are eligible.

This doesn't mean there is an obligation to use the Segregated Method, or that the circumstances during the year will warrant the use of the Segregated Method, it simply means they're not prevented from doing so. In these circumstances, the fund can elect to segregate specific assets as 'pension only' assets, which is one way to make use of the Segregated Method.However, for simplicity in this article we will only be referring to funds where there are no elected segregated assets.

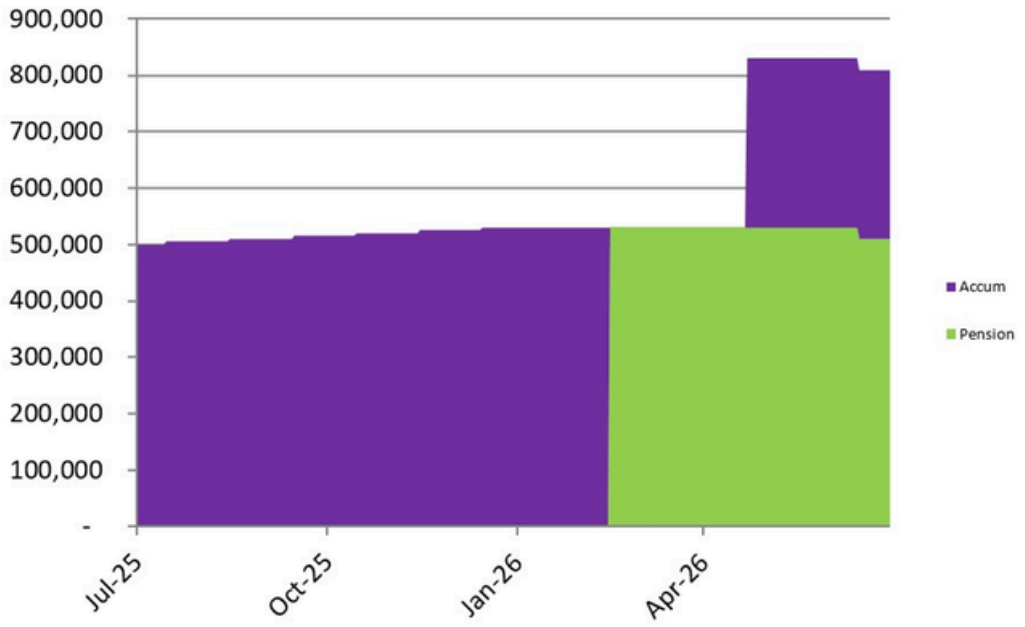
Segregated or Unsegregated (Proportionate) Method

When claiming income-tax exemption there are two methods that trustees can choose from in any given financial year – depending on the circumstances of the fund during that year.The traditional income-tax exemption approach is the Unsegregated Method, also known as the Proportionate Method.This involves a single calculation of the average pension balance as a proportion of the average fund balance over the whole financial year, regardless of periods of full pension or full accumulation.

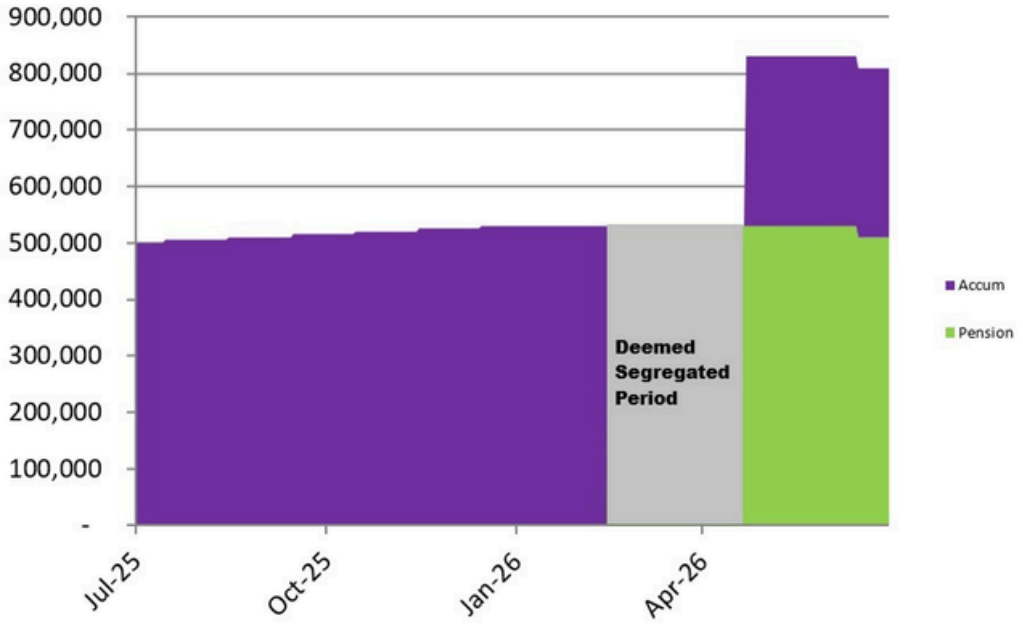
IMPORTANT NOTE: Under the Unsegregated Method, the timing of income and capital gains ***has no bearing on the tax outcome.*** If income is received or a property is sold during a period of all accumulation, or if the income is received or property is sold during a period of all pension, when using Unsegregated Method, the outcome will be exactly the same. The calculation of the tax-exempt percentage does not, and can not, consider these events, but the tax-exempt percentage calculated applies across the entire financial year.

However, if there is a period (or multiple periods) of at least one day where all balances of the fund are in Retirement Phase (pension) then if the Segregated Method is chosen, those periods are called Deemed Segregated Periods (DSPs). Any income received during a DSP is fully income-tax exempt and, more significantly, any capital gain realised during a DSP is fully immunised against CGT. This is where the ECPI choice becomes far more appealing and knowledge of such is extremely beneficial.

The remaining periods of the year where there is either a combination of Retirement Phase and Non-Retirement Phase (accumulation) balances, or only accumulation balances, are referred to as unsegregated periods. Those periods are subject to an actuarial calculation of the tax-exempt percentage that applies to earnings and capital gains across all unsegregated periods of the year.



In the above graph, a single member fund begins the year entirely in accumulation, making monthly contributions. The member then retires in February and converts their full balance to pension. The fund is in a period of full pension for a couple of months before the member makes a large non-concessional contribution that remains in accumulation for the rest of the financial year. If the Unsegregated Method is used, then the tax-exempt percentage of around 34% will apply to all income received and any capital gains realised throughout the year.



This is the same situation however the Segregated Method has been chosen meaning there is a Deemed Segregated Period [15/02/2026 – 22/04/2026] where all income and capital gains will be completely tax free.So if the contract of sale on a property is signed during the DSP, that capital gain is fully immunised from CGT.

So how does it work, what do you need to do?

Firstly, understand that this is only going to be beneficial if it's possible to ***align significant income or capital gains events with a Deemed Segregated Period***. Secondly, you need to ensure the fund has no DSFA (see above). Finally, and most importantly you need to share this information 'up-stream' and make sure that the financial advisers and planners you work with understand how this works. This is the only way to help ensure that alignment takes place with the DSP, getting the trustees and their advisers to be aware of and make use of this opportunity.

When is the alternative a better outcome?

Looking at the above examples, if a capital gain is realised outside of the 'all pension' period, then it will be around 21% exempt, as will any income received outside the DSP. However, if the Unsegregated Method is used, that gain will be around 34% exempt from CGT (in this example). Additionally, any capital losses realised during a DSP are completely wasted. They can't be offset against other gains or carried forward, whereas under the Unsegregated Method that same loss would count in full.

What is the ultimate decider? The tax outcome from applying the Actuarial Certificate result. The tax-exempt percentage is no help at all, no guide, until it is applied to the income received and any capital gains or losses that took place. Apply one method, then apply the other and the one that gives the best outcome is the one to choose. But more importantly, if the planners and advisers are aware and have helped guide the trustees to make better decisions during the financial year in question, then the right outcome should be self-evident.

If you have clients that are potentially commencing pensions and selling assets in the same financial year, then getting ahead of the decision-making process is vital to getting the best tax outcome for them. On the other hand, if the earnings for the year are reasonably 'uniform' and there are no significantly large gains or earnings, then neither ECPI method is likely to give a materially better tax outcome. Lastly, don't forget that a TRIS will only contribute to a DSP if it is a Retirement-Phase TRIS!

Feel free to call me and discuss if you have any questions or concerns about how this will apply to your clients.

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