



# CAVENDISH SUPERANNUATION PTY LTD

## SPECIALISTS IN SELF MANAGED SUPERANNUATION

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## TECHNICAL UPDATE

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### CGT & Pension Assets

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The taxation of SMSFs is often a complex area particularly when they pay pensions. There are varying tax requirements for a fund with segregated and/or non-segregated pension assets which are enhanced when a member needs to transfer out of their SMSF.

This bulletin examines the issues associated with calculating exempt pension income and the possible effects of electing to transfer assets that are supporting a SMSF pension.

#### WILL CGT APPLY

SMSFs member/trustee circumstances change and occasionally the end result is that a fund needs to be wound up or a member's benefit transferred to another complying superannuation fund.

In these situations the question often asked is whether the assets supporting the pension can be transferred to a new fund and if so is there any CGT to pay on the transfer if the member is receiving a pension.

Fund to fund asset transfers are possible however CGT may be payable.

There are a few issues that should be discussed with trustees/members:

- Pensions must be commuted before they can be rolled over
- Commuting a pension creates an accumulation account
- CGT applies on the sale/transfer of assets from an accumulation account

The only way to ensure that CGT will not apply is to sell pension assets prior to commuting a pension. The resulting cash can then be rolled over to a new fund and assets purchased at the new Trustees discretion.



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## **WHEN DOES CGT RELIEF APPLY**

CGT applies when a fund disposes of an asset unless a 'CGT Exemption' or 'CGT Rollover Relief' exists.

For a SMSF there is predominantly one CGT Exemption and one CGT Rollover Relief available.

A fund with segregated pension assets is exempt from CGT i.e. any capital gain or capital loss made on a segregated pension asset is disregarded.

Rollover relief is provided where assets of one Small Superannuation Fund (including SMSFs and Small APRA Funds) are transferred to another Small Superannuation Fund due to a marriage breakdown. In this situation the capital gains position of the asset is transferred to the new fund.

Rolling a pension interest from one fund to another (excluding marriage breakdown) does not satisfy any CGT relief provision.

## **TRANSFERRING ASSETS**

There may be very good reasons why trustees wish to transfer assets from a SMSF but unless they satisfy one of the relief options, as indicated above, there is a possibility any roll-over amount will be reduced to allow for any tax liability arising from selling assets.

A fund obtains significant tax advantages associated with the payment of a pension however those benefits only apply whilst a pension is being paid. Once a pension is stopped (commutation) the tax benefits are reduced.

This is a key to whether assets should be transferred or sold prior to rolling over a member's account.

## **EXEMPT CURRENT PENSION INCOME DEDUCTION**

In our March 2009 Technical Bulletin – "Opportunities in a Depressed Market", available at [www.cavendishsuper.com.au](http://www.cavendishsuper.com.au), we outlined how the Exempt Current Pension Income (ECPI) deduction is calculated for a fund paying a pension. The deduction is calculated based on whether a fund has segregated pension assets or unsegregated pension assets.

One of the messages of that bulletin, and the ATO's guide to calculating ECPI, is that capital gains (and losses) are disregarded if a fund has segregated pension assets. This may lead to the assumption that if a fund has segregated pension assets and transfers those assets to another fund any subsequent gains (or losses) will be disregarded for tax purposes.

An asset is not a segregated pension asset if there is no pension to pay and once a pension is commuted to roll over a member's account a funds liability to pay a pension ceases.

## SEGREGATED PENSION ASSETS

A fund has segregated assets if trustees identify specific assets for the sole purpose of supporting a pension. This can occur regardless of whether a fund has pension and accumulation members or just pension members.

To forgo the need for annual Actuarial Certificates, a fund that commences paying a pension with all of its assets commonly adopts the segregated method. However a fund may adopt the unsegregated asset method requiring an annual actuarial certificate each year indicating 100% of the fund income is exempt pension income.

Segregated assets that are transferred after a pension ceases (via commutation) are fully taxable as they are no longer "pension" assets. Any gains arising in this situation can be offset by any carried forward losses created prior to the pension commencing.

As segregated pension assets are disregarded for CGT purposes if sold whilst a pension is being paid, the most tax effective action trustees can take is to sell assets prior to commuting a pension and rolling the cash proceeds over.

## UNSEGREGATED PENSION ASSETS

Assets not specifically identified to support a pension are considered unsegregated current pension assets.

The unsegregated method allows a fund to claim a deduction based on the proportion of a fund's pension liabilities divided by its superannuation liability. This is determined by averaging out opening and closing pension balances and dividing that amount by the opening and closing fund balance over the applicable period, usually a Financial Year. In the instance where a fund closes down part way through a year the calculation is done for the period to closure.

### EXAMPLE

#### Unsegregated Pension ECPI Calculation (assets transferred at 31 December)

Average Pension Liability/Average Superannuation Liability x pension days/days in period

Average Pension liability = \$900,000 (Fund is 100% in pension mode)

Average Superannuation liability = \$900,000

Pension Days = 184 (days until commutation)

Total Days = 185

$$\$900,000/\$900,000 \times 184/185$$

= 99.5% Exempt Current Pension Income Deduction\*

\* Calculation is a guide only – for accurate calculations please see an Actuary

## SEGREGATED V UNSEGREGATED PENSION ASSETS

The unsegregated method is likely to produce a better tax result than the segregated method when a fund elects to transfer assets. It may produce a result close to 100% tax exemption if all assets are successfully transferred on one day (as above).

All income received after a pension is commuted will be taxable if the segregated method is selected.

Let's examine the different tax results based on the above example. The average liability of \$900,000 was based on an opening balance of \$800,000 and a closing balance of \$1,000,000. The member expects to roll-over \$1,000,000 to a new fund. Difference in balance, \$200,000, is net capital gains.

### Segregated Method – Assets sold prior to rollover (prior to commutation)

Capital Gains disregarded, nil tax liability - \$1,000,000 rolled over

### Segregated Method – Assets transferred

Entire gain is taxable, assets held less than 12months = \$200,000 @ 15% = \$30,000 tax - \$970,000 rolled over

### Unsegregated Method – Assets transferred (or sold prior to rollover)

\$200,000 Taxable Income less ECPI deduction of \$199,000 = \$1,000 @ 15% = \$150 tax - \$999,850 rolled over.

## CONCLUSION

Trustees can elect to transfer assets to another fund rather than sell the assets and rollover the cash.

There may be a tax impediment by electing to take this option and it is possible that the tax outweighs any benefits associated with transferring the assets. This needs to be taken into consideration when determining what options are best to take.

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