Navigate the ECPI rules with Apricot Actuaries

There has been a substantial increase in the complexity of the exempt current pension income calculation following the ATO's change in treatment of segregation. From 1 July 2017, if a fund finds itself eligible to use the segregated method and it was solely in retirement phase for even one day during a financial year, it may be required to use the segregated method when calculating the Exempt Current Pension Income (ECPI) for that day. This will create a move away from the previous actuarial calculation method of treating the full financial year as one unsegregated period, and results in more administrative work for actuaries, accountants and SMSF trustees alike.

Background

Prior to these changes, segregation was mostly a voluntary procedure, used by funds to separate a particular asset (such as a property) from the rest of their superannuation pool. Outside this scenario, the segregated method was rarely used.

New Terminology

Retirement Phase

Previously known as 'Pension phase'. The situation where an SMSF interest is a retirement phase income stream (that is, not an accumulation account). Also see the note below about transition to retirement.

It is now a concept that many SMSFs are having to familiarise themselves with quickly, as the rule changes have bought it to into the spotlight.

What's new?

Segregation – Deemed vs Elected

Now that the ATO have ratified the commissioner's view that an SMSF containing 100% retirement phase interests is segregated for tax purposes, there has been a slight change in the vocabulary of the industry. Income on retirement phase assets is still tax exempt, however there are now two types of segregation:

‘Elected segregated’	‘Deemed segregated’
Describes the situation where certain assets are deliberately set aside so that the income from these assets can be identified as having the sole purpose of paying a super income stream benefit. This situation must be clearly documented and kept separate from other unsegregated asset pools. Previously known as ‘segregated’ method.	Describes the situation where a fund’s interests are solely supporting retirement phase interests. The new ATO stance means that in this scenario, the fund is deemed to have segregated assets.

FAQ

Q: Can I avoid the additional admin that comes if the deemed segregated method applies for part of the year?

A: Potentially. By leaving a nominal amount (at least $10) in accumulation phase, the fund could have avoided periods where it was 100% in retirement phase.

Disregarded small fund asset rules

From 1 July 2017, each SMSF must first determine whether it is eligible to use the segregated method. The legislation has introduced the ‘disregarded small fund asset’ rule, as follows:

- In the selected financial year did the fund have at least one Superannuation Interest in Retirement Phase?
- At the end of 30 June of the previous financial year, did any fund member have a balance in Retirement Phase AND a Total Superannuation Balance of $1.6m or more (including their super outside the SMSF)?

If **both** these conditions are met, the fund meets the disregarded small fund asset rule and is ineligible to use the segregated method. **This test overrides the deemed segregation rule above.** It means the unsegregated method for claiming ECPI must be used for the full financial year and an actuarial certificate must be obtained.

FAQ

Q: What if a fund is entirely in retirement phase but meets both the disregarded small fund asset conditions?

A: The fund will be ineligible to use the segregated method.

Even if the fund has all interests in retirement phase and will receive a 100% tax exempt actuarial percentage – the unsegregated method must still be used to claim ECPI and an actuarial certificate must be obtained.

EXAMPLE – Eligibility and Deemed Segregation

IF	A fund is eligible to use the segregated method	**AND**	It contains periods of 100% retirement phase	**THEN**	The segregated method **must** be used when calculating ECPI

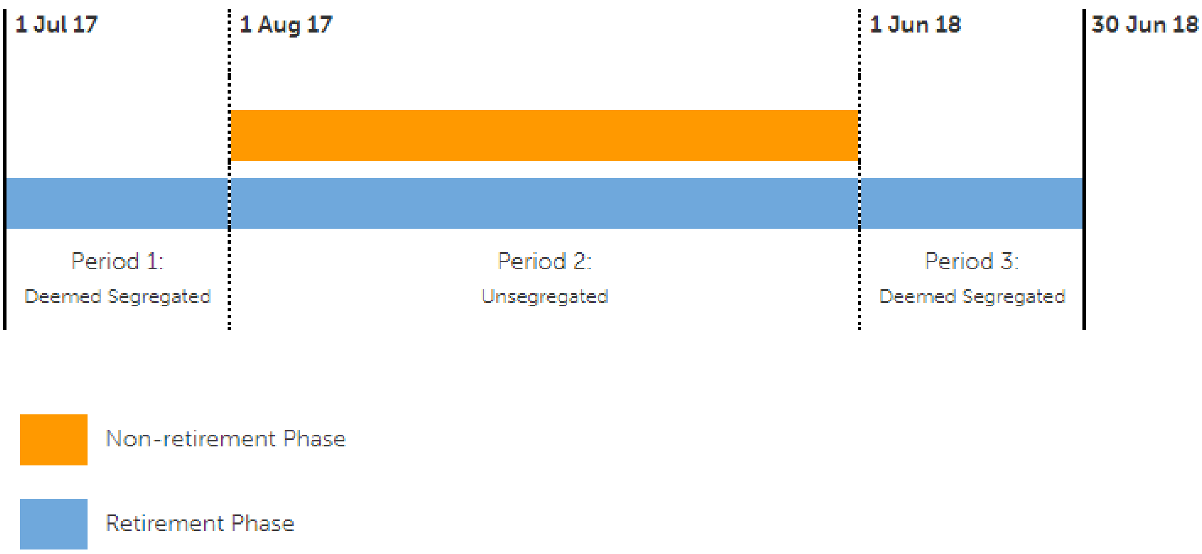
Consider an SMSF trustee Nick. At 30 June 2017 his entire superannuation balance of $900,000 is in retirement phase within his existing SMSF. He is the only member of the fund. He has no other superannuation assets outside the SMSF.

Is Nick eligible to use the segregated method?

Yes! Considering the disregarded small fund asset rules, we can see that whilst Nick's fund does hold a superannuation interest in retirement phase, his balance falls below the $1.6m threshold.

On 1 August 2017, Nick receives a rollover worth $200,000. This remains in accumulation phase until 1 June 2018, when he uses it to commence an additional account-based pension. This scenario is graphed below.

Deemed segregation periods



As you can see there are two periods during the year that solely support retirement phase – Period 1 (1 July to 31 July) and Period 3 (1 June to 30 June). Period 2 (1 August to 31 May) is unsegregated due to the presence of accumulation phase AND retirement phase assets.

**It is important to note that, regardless of how many deemed segregated periods occur during the financial year, only one actuarial certificate is required to cover all the unsegregated periods.*

How to use your tax-exempt percentage

In the past your tax exempt percentage generally applied across the whole tax year. Since 1 July 2017 the tax exempt percentage is only applied to income that is generated during unsegregated periods.

Accountants now need to ensure they account for the income from different periods separately. For periods where deemed segregation applies (and the disregarded small fund asset rule does not apply) the ATO requires you to add that income in your ECPI claim separately.

EXAMPLE – Applying the tax exempt percentage

Using the same example as above, let's say the actuarial certificate showed a 97.49% tax exempt percentage for the unsegregated period. This percentage should only be applied to income that was earned during the unsegregated period, that is 1 August until 31 May. Income from the periods that were deemed segregated are treated as 100% tax exempt. The total ECPI calculation should therefore take place as follows:

(1) Proportionate method (actuarial certificate)		
Income apportioned to the following periods: 01/08/2017 - 31/05/2018	$ 20000	x 97.49%
(2) Deemed segregated periods		
Income apportioned to the following periods: 01/07/2017 - 31/07/2017 01/06/2018 - 30/06/2018	$ 10000	x 100.00%
(3) Plus, income on Elected Segregated Assets		
(excluded from actuarial certificate order form)	$ 0	x 100.00%
Total Fund Income	**$ 30000**	
Total ECPI claim for the SMSF		**$ 29498**

This illustrates the additional work required by the accountant to determine the fund's ECPI. The segregated method requires tracking how much income was earned during each period and applying the actuarial percentage accordingly.

**SMSF accounting platforms may work out the income for each period for you, removing the need for manual calculations.*

Transition to Retirement Income Streams -

Non-retirement phase vs retirement phase

Prior to 1 July 2017, income from the assets supporting a transition to retirement income stream (TRIS) received the same tax exemption as account based pensions. From 1 July 2017, this treatment changed. For people under 65 who haven't yet met a condition of release, a TRIS will no longer be considered a retirement phase interest and thus will lose its ECPI status.

Non-Retirement Phase TRIS	Retirement Phase TRIS
• Income taxed at 15% • Must make minimum pension payments (and not exceed maximum) • Subject to commutation restrictions • Unable to pay lump sum pension payments for tax purposes	• Activates when member reaches age 65 or a condition of release • Income is tax free (eligible to claim ECPI) • Must make minimum pension payments (no maximum) • No commutation restrictions • Unable to pay lump sum pension payments for tax purposes

Confused? Navigate the new changes with Apricot's actuarial certificate wizard

Apricot's actuarial certificate wizard has been created to guide you through the new changes. In a short 3 minute questionnaire, the wizard tells you:

- whether an actuarial certificate is required
- whether your fund is eligible to use the segregated method for claiming ECPI
- guidance to help you understand the different components of your ECPI under the new rules, and
- tips on how to fill out the ECPI section of the 2017/18 SMSF annual return

Our Actuarial Certificate ordering process identifies any periods of deemed segregation for you and helps you to interpret and understand how the new rules apply to your SMSF.

Click here to access.

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Liam is Product Manager at A.S.A.P. and formerly worked for Australia's largest actuarial certificates provider supporting several thousand SMSF accountants with their certificate orders and retirement planning tools. Liam has a passion for making software intuitive, accurate and easy to use. He holds a combined Business/Economics degree from the University of Tasmania as well as an Advanced Diploma of Financial Planning including the SMSF specialisation. When not in the office, Liam is a keen AFL football player in Tasmania.