



Self-managed super funds and tax exemptions on pension assets

You may be able to claim a tax exemption in the SMSF annual return for certain income, once your SMSF commences paying super income stream benefits (commonly referred to as pensions).

When are you eligible to claim this tax exemption?

Ordinary income and statutory income that a complying SMSF earns from assets held to provide for super income stream benefits is exempt from income tax. This is referred to as exempt current pension income (ECPI).

The ECPI exemption can be claimed by all complying super funds (including SMSFs) currently paying super income stream benefits. However, an SMSF paying such a benefit is not automatically entitled to the exemption - it must meet certain other conditions.


To claim the ECPI exemption in the SMSF annual return, there are steps you must take prior to commencing the payment of the super income stream benefit, such as ensuring that all of the SMSF's assets are re-valued to their current market value. For further information, refer to [Running a self-managed super fund](#) (NAT 11032).

How much ECPI can you claim?

There are two methods for working out the amount of ECPI you can claim - the:

- segregated method
- unsegregated method.


The method you use will depend on whether the SMSF's assets are 'segregated' or 'unsegregated' or a combination of both when the super income stream commences.

 The amount claimed as ECPI must not be greater than the fund's assessable income.

What are the requirements for claiming the tax exemption?

Actuarial certificate


If you want to claim a tax exemption on the SMSF's income whilst paying a super income stream benefit, you may need an actuarial certificate. This will also help you to calculate the amount of ECPI you can claim.

 SMSFs using the **unsegregated** assets method will need an actuarial certificate for each year they claim ECPI, regardless of the type of super income stream benefit being paid.

Where all SMSF fund members are receiving a pension and the combined account balances of these pensions is equal to the market value of the fund's total assets, in effect all assets of the fund will meet the requirement of being 'segregated' as they have the sole purpose of paying super income stream benefits. In this situation, the ATO will accept that the SMSF is not required to identify individual assets as being dedicated to funding a super income stream benefit.

You will **not** need to obtain an actuarial certificate to claim ECPI if:

- you want to claim the tax exemption using the **segregated** assets method, and
- at all times that pensions were payable during the income year, the SMSF only paid allocated pensions, market-linked pensions or account-based pensions, and no other type of pension.

 If the market value of the assets supporting an income stream benefit exceeds the member account

balance supporting the benefit, the excess amount won't be considered to be segregated current pension assets.

If the SMSF pays other types of super income stream benefits and uses the segregated assets method to claim the tax exemption, you will need to obtain a certificate covering all super income stream benefits that the SMSF pays. This includes allocated pensions, market-linked pensions and account-based pensions.

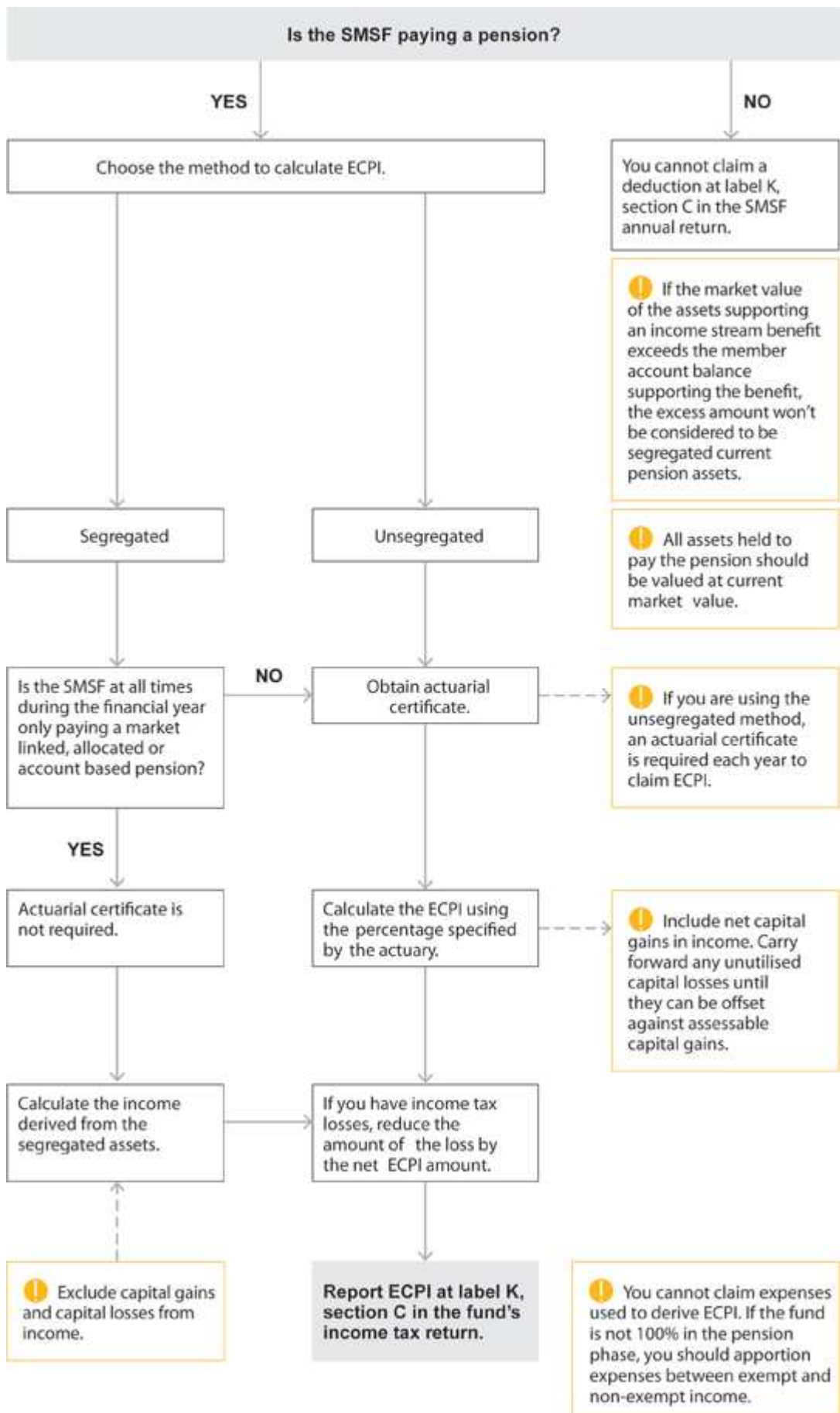
You **will** need to obtain an actuarial certificate to claim the ECPI using the segregated assets method if any of the following apply:

- your SMSF paid any super income stream benefit other than an allocated pension, market-linked pension or an account-based pension
- the market value of a benefit that is an allocated pension, market-linked pension or account-based pension exceeds the account balance supporting the benefit.
- your SMSF is paying an allocated pension, market-linked pension or account-based pension in addition to other types of super income stream benefits.

How to calculate the ECPI

We have prepared a flow chart to guide you through the basic process of calculating the ECPI - whether you choose the segregated method, the unsegregated method or both.

After the chart, we have further information about key items in the calculation process. Refer to these if you need more information.



Segregated method

Your SMSF has segregated assets if you have:

- set aside certain assets so that the income from these assets can be specifically identified as having the sole purpose of paying a super income stream benefit, and
- obtained an actuarial certificate (if needed)
 - before the date of lodgment of the SMSF annual return for the income year, and
 - which verifies that the assets and earnings that the actuary expects will be made from those assets are sufficient to pay, in part or in full, the benefit liabilities when they are due.

The ordinary income and statutory income that an SMSF earns from segregated current pension assets is tax exempt. For the purpose of working out the amount that is exempt from tax, ordinary income and statutory income of the SMSF is income other than assessable contributions and non-arm's length income of the SMSF.



For more information, see [How are assessable contributions and non-arm's length income treated when an SMSF has ECPI?](#)



Capital gains or capital losses from a capital gains tax event in relation to a segregated current pension asset are disregarded. For more information, see [What effect do capital gains and capital losses have on an SMSF's claim for ECPI?](#)

You must include the ordinary income and statutory income you receive from the segregated assets in the income section of the SMSF annual return. You can claim the tax exemption by filling in the ECPI label (label K) in the deductions section of the return.

If you intend to use the segregated method, you need to consider whether the SMSF's income stream assets meet the requirement of being 'segregated'. You need to determine whether:

- these assets are clearly identified as the assets dedicated to funding the super income stream benefit
- there is a clear relationship established between the relevant assets and the member's account.

Where all SMSF fund members are receiving a pension and the combined account balances of these pensions is equal to the market value of the fund's total assets, in effect all assets of the fund will meet the requirement of being 'segregated' as they have the sole purpose of paying super income stream benefits. In this situation the ATO will accept that the SMSF is not required to identify individual assets as being dedicated to funding a super income stream benefit.

As previously noted, assets of the SMSF that are supporting a super income stream benefit that is prescribed by the regulations (that is, allocated, market-linked or account based) are not segregated current pension assets to the extent that the market value of the assets exceeds the account balance supporting the benefit.

Example 1

The AXY SMSF has assets of \$2,000,000. Member A (who is receiving a super income stream benefit that is not an allocated, market-linked or account-based pension) has an account balance of \$1,200,000, and member B (who is still in the accumulation phase) has an account balance of \$800,000. The trustees have identified specific assets of the SMSF that total \$1,200,000 as having been set aside for member A (\$500,000 in shares, \$500,000 in property and \$200,000 in a bank deposit), and these SMSF assets are used to pay his income stream benefit. These assets are segregated current pension assets. The trustees of the SMSF must get an actuarial certificate to verify that those assets, and the earnings that the actuary expects will be made from them, are sufficient to pay, in part or in full, member A's income stream benefit.

The income that is earned from these assets is exempt from tax. For the above SMSF, if we assume that assets set aside for member A (\$1,200,000) earned \$100,000 in income and the other assets of the SMSF earned \$60,000 in income, then exempt current pension income is \$100,000. This would be shown on the SMSF annual return as follows:

Total assessable income	\$160,000 (included at item 10 label V of the SMSF annual return)
less ECPI	\$100,000 (the fund claims this exemption by including this amount at item 11 label K of the SMSF annual return)

<i>equals</i> Taxable income	\$60,000 (included at item 11 label O of the SMSF annual return)
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Unsegregated method

If an SMSF's assets are not specifically set aside for paying a super income stream benefit, the SMSF must determine the amount of exempt income using the unsegregated method.

An SMSF with unsegregated assets needs to obtain an actuarial certificate that certifies the proportion of income that is exempt.

In this case, the tax exemption is based on the proportion of the SMSF's **average value of current pension liabilities** compared to its **average value of super liabilities**.

The **average value of current pension liabilities** is the average value for the income year of the SMSF's current liabilities (contingent or not) for super income stream benefits that are payable by the SMSF in that year. This does not include liabilities that are to be met by segregated current pension assets.

The **average value of super liabilities** is the average value for the income year of the SMSF's current and future liabilities (contingent or not) for super income stream benefits for which contributions have, or were liable to have, been made. This does not include liabilities for segregated current pension assets.

Example 2

Using the same facts as in example 1, the AXY SMSF has assets of \$2,000,000. Member A (who is receiving a super income stream benefit) has an account balance of \$1,200,000, and member B (who is still in the accumulation phase) has an account balance of \$800,000. In this case, the trustees have obtained an actuarial certificate that shows that 60% of the SMSF's liabilities relate to the paying of the super income stream benefit. No assets are allocated to the member as in example 1. In this case, the exempt income is therefore 60% of the fund's assessable income of \$160,000 - that is, \$96,000.

Total assessable income	\$160,000 (included at item 10 label V of the SMSF annual return)
<i>less</i> ECPI	\$96,000 (the fund claims this exemption by including this amount at item 11 label K of the SMSF annual return)
<i>equals</i> Taxable income	\$64,000 (included at item 11 label O of the SMSF annual return)

How to complete the SMSF annual return when a fund is in both the pension and accumulation phase



Examples 3 to 6 below are scenarios where only some of the assets of an SMSF are held to provide for current pension liabilities.

The following scenarios may help you to understand how to complete the relevant labels in the SMSF annual return.

The examples below are based on the following background information:

- the SMSF has a range of investments, mainly Australian shares and managed funds. The portfolio is regularly revised to ensure that the fund is not overweight in any particular share or fund, due to uneven price movement on the ASX. This results in some capital gains and capital losses, and there are capital gain distributions from the managed funds themselves
- the SMSF has two members and, as at the start of the financial year, ownership of the assets was exactly 50:50
- the SMSF received \$35,000 in dividends, with franking credits of \$15,000, from each of the (four) companies invested in, for a total of \$200,000
- the SMSF also earned interest of \$200; ordinary trust income of \$20,000, with imputation credits of \$2,000 from their managed funds; foreign income of \$10,000, with a foreign tax credit of \$500; and capital gains, all discount, of \$4,000
- the total income of the fund was thus \$234,200
- the expenses are negligible and can be ignored
- the tax payable, prima facie, is \$35,130.

The following additional assumptions are made in relation to these examples:

- the fund has all necessary actuarial certificates where required - for example, where the assets are unsegregated. These certificates show a 50% split of income (if the percentage shown on the certificate was different, the calculations in the examples would need to be adjusted to reflect the percentage shown on the certificate)
- there was no non-arm's length income
- there were no contributions
- the pensions met all the requirements under the *Superannuation Industry (Supervision) Act 1993*.

Example 3

The fund has two members, both over 55 years old but not yet 60 years old. One draws a pension of \$36,000 from 1 July; the other is still in accumulation phase within the fund. The assets are not segregated.

The fund would show the following amounts at the specified labels on the SMSF annual return 2009.

Item 10 Income	
Net capital gain (label A)	\$4,000
Gross interest (label C)	\$200
Net foreign income (label D)	\$10,000
Franked dividend amount (label K)	\$140,000
Dividend franking credit (label L)	\$60,000
Gross trust distributions (label M)	\$20,000
Total assessable income (label V)	\$234,200
Item 11 Deductions	
Exempt current pension income (label K)	\$117,100
Taxable income or loss (label O)	\$117,100
Income tax calculation statement	
Taxable income (label A)	\$117,100
Gross tax (label B)	\$17,565
Rebates, offsets, foreign credits (label C)	\$500
Subtotal (label D)	\$17,065
Eligible credits (label F)	\$62,000
Supervisory levy (label H)	\$150
Total amount due or refundable (label I)	\$44,785 (refund)

Example 4

The fund has two members, both over 55 years old but not yet 60 years old. One draws a pension of \$36,000 from 1 July, the other is still in accumulation phase within the fund.

The assets are segregated. The pensioner is assigned all the shares, and the non-pensioner has all the other assets (as the pension member has all share assets segregated to provide for his benefit, it is assumed that the value of the remaining assets is equal to this amount).

The fund would show the following amounts at the specified labels on the SMSF annual return 2009.

Item 10 Income	
Net capital gain (label A)	\$4,000
Gross interest (label C)	\$200
Net foreign income (label D)	\$10,000
Franked dividend amount (label K)	\$140,000
Dividend franking credit (label L)	\$60,000
Gross trust distributions (label M)	\$20,000
Total assessable income (label V)	\$234,200
Item 11 Deductions	
Exempt current pension income (label K)	\$200,000
Taxable income or loss (label O)	\$34,200
Income tax calculation statement	
Taxable income (label A)	\$34,200
Gross tax (label B)	\$5,130
Rebates, offsets, foreign credits (label C)	\$500
Subtotal (label D)	\$4,630
Eligible credits (label F)	\$62,000
Supervisory levy (label H)	\$150
Total amount due or refundable (label I)	\$57,220 (refund)

Example 5

This example uses the same two members as examples 3 and 4. However, in this case the pension started on 1 October. We assume the two dividend payments are for equal amounts (\$100,000 before 30 September and \$100,000 after this date).

The assets are not segregated. Some shares were sold in November to provide cash for the pension, and a capital gain of

\$10,000, discountable, was made. The managed fund, after much questioning, conceded that its capital gains were all made in the last month of the reporting period - that is, June.

The income for this example will be different to that in examples 3 and 4, due to the additional \$10,000 capital gain realised.

The SMSF will show the following amounts at the specified labels on the SMSF annual return 2009.

Item 10 Income	
Net capital gain (label A)	\$14,000
Gross interest (label C)	\$200
Net foreign income (label D)	\$10,000
Franked dividend amount (label K)	\$140,000
Dividend franking credit (label L)	\$60,000
Gross trust distributions (label M)	\$20,000
Total assessable income (label V)	\$244,200
Item 11 Deductions	
Exempt current pension income (label K)	\$91,575#
Taxable income or loss (label O)	\$152,625
Income tax calculation statement	
Taxable income (label A)	\$152,625
Gross tax (label B)	\$22,894
Rebates, offsets, foreign credits (label C)	\$500
Subtotal (label D)	\$22,394
Eligible credits (label F)	\$62,000
Supervisory levy (label H)	\$150
Total amount due or refundable (label I)	\$39,456 (refund)

As the assets are not segregated, the amount shown here is 75% of the ECPI that would be calculated for the pensioner if the pension had been payable for the full year.

Where assets in a fund are not segregated and a member commences an income stream, the ECPI deduction for that year is the amount of income attributable to the pensioner apportioned from the commencement date of the pension - that is, if the pension commenced on 1 March, the ECPI deduction would be 25% of the income attributed to the member (assuming no contributions or special income was received).

Example 6

This example is the same as example 5, except that the assets are segregated (as in example 4).

The fund would show the following amounts at the specified labels on the SMSF annual return 2009.

Item 10 Income	
Net capital gain (label A)	\$4,000
Gross interest (label C)	\$200
Net foreign income (label D)	\$10,000
Franked dividend amount (label K)	\$140,000
Dividend franking credit (label L)	\$60,000
Gross trust distributions (label M)	\$20,000
Total assessable income (label V)	\$234,200
Item 11 Deductions	
Exempt current pension income (label K)	\$100,000*
Taxable income or loss (label O)	\$134,200
Income tax calculation statement	
Taxable income (label A)	\$134,200
Gross tax (label B)	\$20,130
Rebates, offsets, foreign credits (label C)	\$500
Subtotal (label D)	\$19,630
Eligible credits (label F)	\$62,000
Supervisory levy (label H)	\$150
Total amount due or refundable (label I)	\$42,220 (refund)

*Where a pension is commenced with segregated assets, the ECPI deduction is equal to all income attributed to the assets funding the pension.

Where the above pension is commenced part-way through a year, no apportioning of income occurs if the assets are segregated and the income is all received after the commencement date.

Where income is received prior to the commencement of the pension the income received does not form part of the ECPI deduction.

Losses

If an SMSF has income tax losses (not capital losses), reduce the amount of the loss by the net ECPI amount. The net ECPI amount is ECPI less any expenses that were incurred in deriving ECPI (such expenses cannot be claimed as a deduction). Then, any remaining tax losses can be offset against assessable income of the SMSF. Once the assessable income is reduced to zero, any further losses can be carried forward to the next financial year.

Example 7

AXY SMSF earned \$30,000 in interest and paid \$200 in bank fees, while 30% of the SMSF's assets were held to provide for the SMSF's current pension liabilities. It has \$10,000 in tax losses carried forward from the previous year. This would be shown on the SMSF annual return as follows:

Gross interest	\$30,000 (included at item 10 label C)
ECPI	\$9,000 (30% of \$30,000) (included at item 11 label K)
Interest expenses that can be deducted	\$140 * (70% of \$200) (included at item 11 label A)
Net ECPI	\$8,940 (ECPI less bank fees incurred in earning exempt income)
Tax losses to be deducted from income**	\$1,060 (\$10,000 less \$8,940) (included at section C label M)
Taxable income	\$19,800 (income less ECPI less interest expenses less loss) (included at item 11 label O)
Losses to be carried forward to later years	\$0 (included at item 13 label U)

The losses used in this example refer to tax losses as opposed to capital losses.

*The remaining bank fees of \$60 (30% of \$200) cannot be claimed as a deduction because they were incurred in earning the exempt current pension income.

** Tax losses carried forward must be reduced by net ECPI before they can be offset against assessable income.



For more information, see [What effect do capital gains and capital losses have on an SMSF's claim for ECPI?](#)

How are expenses treated when an SMSF has ECPI?

Generally, expenses which an SMSF incurs in deriving ECPI cannot be claimed anywhere on the SMSF annual return. This means that these expenses must not be included as part of the deductions claimed in the SMSF annual return.

Expenses incurred in gaining or producing exempt or non-assessable non-exempt income, or expenses of a capital, private or domestic nature are not allowable deductions. Generally, where an expense is incurred which relates to both accumulation and super income stream based income, the expense must be apportioned so that only the proportion of the expense relating to the production of assessable income is claimed. Taxation Ruling TR 93/17 *Income tax: income tax deductions available to superannuation funds* provides further advice regarding the method for apportioning the expense. Certain specific deductions can be claimed in full, whether they provide exempt or assessable income - for example, tax-related expenses such as the supervisory levy and death and disability premiums.



For more information, refer to [Taxation Ruling TR93/17 Income tax: income tax deductions available to superannuation funds](#).

You should not include management and administration expenses in the amount claimed at the ECPI label or investment expenses label. In addition, you must ensure expenses are apportioned correctly between accumulation and pension-based income to avoid incorrectly claiming the total expense in the SMSF annual return.

Example 8

AXY SMSF earned \$100,000 in interest and paid \$1,000 in bank fees. One hundred per cent of the fund's assets were held to provide for current pension liabilities. This would be shown on the SMSF annual return as follows:

Gross interest	\$100,000 (included at item 10 label C)
less ECPI	\$100,000 (included at item 11 label K)
<i>equals</i> Taxable income	\$0 (included at item 11 label O)

The \$1,000 bank fees cannot be claimed as a deduction, because they were incurred in earning the ECPI.

Example 9

AXY SMSF earned \$60,000 in interest and paid \$500 in bank fees. Eighty percent of the fund's assets were held to provide for current pension liabilities. This would be shown on the SMSF annual return as follows:

Gross interest	\$60,000 (included at item 10 label C)
less ECPI	\$48,000 (80% of \$60,000) (included at item 11 label K)
less Interest expenses that can be deducted	\$100 * (20% of \$500) (bank fees - included at item 11 label A)
<i>equals</i> Taxable income	\$11,900 (include at item 11 label O)

* The remaining bank fees of \$400 (80% of \$500) cannot be claimed as a deduction, because they were incurred in earning the ECPI.

What effect do capital gains and capital losses have on an SMSF's claim for ECPI?

The effects of capital gains and capital losses are different for segregated and unsegregated assets.

If your SMSF only has segregated current pension assets, you should ignore any capital gains or capital losses resulting from the disposal of these assets. If the disposal of a segregated current pension asset results in a capital loss, this loss must not be offset against any other capital gain earned by the SMSF.

If your SMSF has unsegregated current pension assets, you need to factor in capital gains and capital losses. For unsegregated current pension assets, capital losses that arise are not included as deductions when you calculate assessable income. If your SMSF has a net capital loss, it can be carried forward each year until it can be offset against an assessable capital gain. The SMSF's capital gain less any capital losses equals the net capital gain. The net capital gain is added to the SMSF's assessable income before working out how much of income is tax exempt, as per the actuarial calculation for the relevant year.

Example 10

Note: This example uses the same facts as [example 1](#).

AXY SMSF has two members. It has segregated assets set aside for member A that resulted in a capital gain of \$10,000 and derived \$50,000 of ordinary income. The other assets set aside for member B derived ordinary income of \$25,000 and resulted in a capital loss of \$15,000. Therefore, the ECPI is the \$50,000 for member A. The \$10,000 capital gain from these segregated assets is ignored. The \$15,000 capital loss from the other assets is carried forward to future years until it can be set off against an assessable capital gain. This would be shown on the SMSF annual return as follows:

Net capital gains	\$0 (included at item 10 label A)
Other income	\$75,000 (included at item 10 label S - it is assumed it is 'other assessable income')
Total assessable income	\$75,000 (included at item 10 label V)

less ECPI	\$50,000 (included at item 11 label K)
equals Taxable income	\$25,000 (included at item 11 label O)
Capital loss carried forward	\$15,000 (included at item 13 label V)

You will need to complete a [Capital gains tax \(CGT\) schedule 2009](#) (NAT 3423) if your SMSF has one or more CGT events that happen during the income year and:

- a CGT event happens in relation to a forestry managed investment scheme interest that is held other than as an initial participant, or
- the total current year capital gain or capital loss is greater than \$10,000.



For more information about SMSF CGT obligations, refer to the [Guide to capital gains tax 2009](#) (NAT 4151).

How are assessable contributions and non-arm's length income treated when an SMSF has ECPI?

When calculating the amount of ordinary income and statutory income of the SMSF that is exempt from income tax, non-arm's length income and assessable contributions are excluded from the calculation. You should record these income types in the SMSF annual return under the relevant income labels but not include them when you calculate the SMSF's ECPI.

Generally, assessable contributions are contributions paid to an SMSF:

- on behalf of a member (such as super paid by an employer on behalf of an employee), or
- where a member has claimed a personal deduction for those contributions.

Income is non-arm's length income if the:

- parties to a transaction or a series of transactions are not dealing at arm's length
- income derived from the transaction is greater than might have been expected had the parties been dealing at arm's length in relation to the transaction.

Non-arm's length income includes income such as private company dividends (including non-share dividends) and certain distributions from trusts.



For more information, refer to [Taxation Ruling TR 2006/7 Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income](#).

More information

For more information refer to:

- [Taxation Ruling TR 2006/7 Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income](#)
- [Self managed superannuation fund annual return 2009](#) (NAT 71226).

Last Modified: Thursday, 25 February 2010

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