Case Study

Pension
Underpayment
Compliance



Scenario:

Imagine John, a retiree, has an SMSF and receives a pension from it. According to the regulations, John must receive a minimum annual pension payment to comply with the Superannuation Industry (Supervision) (SIS) Regulations. However, due to an honest mistake, John receives less than the required minimum payment for the financial year.

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What action does ATO Takes?

In this case, the Australian Taxation Office (ATO) considers the pension to have ceased at the beginning of the financial year for income tax purposes. This means that the SMSF cannot claim Exempt Current Pension Income (ECPI) for that year, and any payments made are treated as lump sum withdrawals

However, if the underpayment is not rectified within the specified time frame, the pension must be commuted, and a new pension must be started. This means that the trustee must be able to evidence that John has exchanged his rights in relation to the failed pension for income stream benefits from a new pension.

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Solution:

To rectify the situation, the trustee of John's SMSF must make a catch-up payment as soon as practicable in the following income year. If the underpayment is less than **one-twelfth** of the minimum payment amount and the catch-up payment is made within **28 days** of becoming aware of the underpayment, the ATO may allow the SMSF to continue to claim ECPI.

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Bonus Tip:

If a pension in an SMSF commences in June, the minimum pension payment requirement for that financial year is prorated based on the number of days the pension was in force. Here's how it works:

Yes, it is necessary to meet the minimum pension payment requirement even if a pension commences in June. When a pension starts in the middle of the financial year, including in June, the minimum pension payment is prorated based on the number of days the pension was in force during the year.

1. Calculate the Pro-Rata Minimum Payment: Determine the number of days the pension was in force during the financial year. Divide the annual minimum payment by the number of days in the year (365 or 366 for leap years) and multiply by the number of days the pension was in force.
2. Example Calculation:
    - Assume the minimum annual pension payment is $10,000.
    - The pension commenced on June 1st and the financial year ends on June 30th.
    - The number of days the pension was in force: 30 days (June 1st to June 30th).
    - Pro-rata minimum payment = ($10,000 / 365) * 30 ≈ $821.92

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Compliance Requirements

The SMSF trustee must ensure that the prorated minimum payment is made by June 30th.

If the prorated minimum payment is not met, the ATO will consider the pension to have ceased for tax purposes, and the fund cannot claim Exempt Current Pension Income (ECPI) for that year.

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