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SuperNews

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Significant changes to Superannuation from the 2016 Federal Budget now law

On 23 November 2016 legislation was passed by Parliament to implement the superannuation changes originally announced in the May 2016 Federal Budget. This legislation has received Royal Assent and is now law.

The final legislation passed incorporated the introduction of a transfer balance cap of $1.6 million on retirement balances but omitted the controversial $500,000 lifetime non-concessional cap which was scrapped by the Government in September and October 2016 after consultation. The lifetime limit was replaced by changes to the non-concessional contribution caps.

The significant changes legislated are outlined below.

$1.6 million 'Transfer Balance Cap'

From 1 July 2017, a $1.6 million general transfer balance cap will limit the amount of capital that can be transferred to the pension or retirement phase of superannuation. This cap is intended to limit the extent to which the tax-free income earned on retirement phase accounts can be used by high wealth individuals.

A new concept of a personal transfer balance cap / account will apply to transfers to the retirement phase and is not impacted by earnings, losses or pension payments that occur within the retirement phase.

Individuals at 1 July 2017 with over $1.6 million in retirement phase (where a nil tax rate on earnings applies) will be required to move the excess back into accumulation phase (where a 15% tax rate applies). The amount remaining on 1 July in pension will establish their personal transfer balance account.

For example an individual with $2.2m in pension phase at 20 June 2017 would need to commute $600,000 back to accumulation or alternatively take a lump sum withdrawal before 1 July 2017.

A transition to retirement income stream (TRIS) is not a pension for the purposes of the transfer balance cap whilst it remains a TRIS (See further comments regarding the changes for a TRIS on page 2).

Special rules apply to market linked and lifetime pensions.

The general transfer balance cap will be indexed in $100,000 increments in line with CPI. Indexation will be applied proportionally to a member's personal transfer balance cap where a member is a retirement phase income stream recipient, but has not, at any time, met or exceeded their cap.

Death benefit pensions

Reversionary pensions will count towards the beneficiary personal transfer balance cap based on the value of the pension at reversion.

However, a 12 month period will apply to deal with the reversionary pension before a credit arises and counts towards their cap.

This deferral also applies to individuals who are receiving a reversionary pension on 30 June 2017.

Non-reversionary pensions count towards the beneficiary's personal transfer balance cap on the date that they begin being paid to the beneficiary.

Depending on the reversionary beneficiary's personal transfer balance cap some reversionary pension benefits may need to be paid out as a lump sum if caps are exceeded. For individuals with high superannuation balances this change may result in a need to review estate planning requirements.

Breaches of the transfer balance cap

If an individual exceeds their transfer balance cap, the Australian Taxation Office will direct an individual's superannuation income stream provider to commute (reduce) their retirement phase interests by the amount of the excess (including excess transfer balance earnings) to rectify the breach. The individual will be liable for excess transfer balance tax on their excess transfer balance.

Breaches in the 2017-18 financial year attract a single tax rate of 15%. The tax rate on excess transfer balance earnings increases for second and subsequent breaches occurring in the 2018-19 financial year or a later financial year increases to 30%.

Reduction in concessional contributions cap

The Government is reducing the concessional contributions cap to $25,000 from 1 July 2017. The concessional cap is currently $30,000, for those aged under 49 at the end of the previous financial year and $35,000 otherwise.

The concessional contributions cap will also be indexed, to AWOTE, in $2,500 increments, instead of the current $5,000.

Changes to non-concessional contribution cap

From 1 July 2017, a new standard annual non-concessional contribution cap of $100,000 will apply down from the current cap of $180,000.

This has been legislated by making the standard non-concessional contribution cap equal to four times the standard concessional contribution cap of $25,000. This means that until the concessional contribution cap is indexed by AWOTE by $2,500 then the non-concessional contribution cap will be unchanged.

The ability to make non-concessional contributions will be subject to the aggregate amount a person has in the superannuation system. If a person's total superannuation balance is greater than the general transfer balance cap, then no non-concessional contributions are permitted.

The general transfer balance cap is equal to the pension balance transfer cap of $1.6 million. This means individuals with a total superannuation balance above $1.6 million at 30 June 2017 would not be eligible to make non-concessional contributions.

A 'bring forward' rule will continue to be available for those persons under age 65 at the commencement of the financial year in which they trigger the rule. The rule is triggered if a contribution greater than the standard annual non-concessional cap is made, subject to a maximum of three times that amount. The size of a person's total superannuation balance will restrict the extent to which they can use the 'bring forward' rule especially where close to the $1.6 million general transfer balance cap.

Transitional rules will apply for those persons who triggered the 'bring forward' rule prior to 1 July 2017. If the current bring forward amount of $540,000 is not fully utilised prior to 30 June 2017, then an adjusted three-year cap will apply after 1 July 2017.

For example, where an individual triggered the bring forward rule in 2015-16 financial year, the maximum would be $460,000 (being $180,000 + $180,000 + $100,000) unless they exceed this amount before 30 June 2017. For those who triggered the bring forward rule in 2016-17 financial year, the maximum would be $380,000 (being $180,000 + $100,000 + $100,000) unless they exceed this amount before 30 June 2017.

Removal of Exempt Current Pension Income for Transition to Retirement Income Streams

From 1 July 2017, the tax exemption of earnings from assets that support a transition to retirement income stream (TRIS) will be removed. Earnings will be subject to the standard 15% tax regardless of the date the TRIS commenced. In other words super funds would start to pay tax on income relating to a TRIS at the same rate as if the balance was in accumulation phase and there would be no Exempt Current Pension Income (ECPI).

A TRIS is currently available to assist an individual to gradually move to retirement by accessing a limited amount of super. Currently, where a member receives a TRIS, the fund receives tax free earnings on the super assets that support it.

The intent of these changes is to ensure that a TRIS is not accessed primarily for tax purposes but for the purpose of supporting individuals who remain in the workforce.

Additionally, individuals will no longer be able to treat certain income stream payments as lump sums for tax purposes, which currently makes them tax-free up to the low rate cap of $195,000.

Pension withdrawals made from a TRIS account by those 60 and over will retain their tax free status.

While a TRIS remains in the 'transition' phase the transfer balance cap is not relevant. However, as soon as the transition phase ceases (because the taxpayer has attained age 65 or has retired) and the pension is now an ordinary account-based pension, the trustee paying the pension will have to report to the ATO the date the transition phase ceased and the then pension account balance for recording in the member's personal transfer balance account. From that point, the earnings tax exemption will apply.

If the balance of the TRIS on changing to an account based pension exceeds the member's transfer balance cap, the excess will need to be moved back to accumulation or paid as a lump sum.

Reduction in Division 293 threshold

Currently individuals with income and concessional super contributions in excess of $300,000 trigger a Division 293 assessment.

From 1 July 2017, the government will lower the Division 293 income threshold to $250,000. An individual with income and concessional super contributions, exceeding the $250,000 threshold, will have an additional 15% tax imposed on their contributions over the threshold up to the total amount of concessional contributions not exceeding their concessional contributions cap.

End of 10% rule for tax-deductible personal contributions

Currently, an individual (primarily self-employed) can claim a deduction for personal super contributions where they meet certain conditions. One of these conditions is that less than 10% of their income is from salary and wages.

From 1 July 2017, this condition will be removed. The remaining conditions stay the same.

Carry-forward concessional contributions of unused caps over five years

From 1 July 2018, individuals will be able to make 'carry-forward' concessional super contributions if they have a total superannuation balance of less than $500,000. They will be able to access their unused concessional contributions cap space on a rolling basis for five years. Amounts carried forward that have not been used after five years will expire.

The first year in which you can access unused concessional contributions is the 2019–20 financial year.

Capital Gains Tax (CGT) Relief

Under current law, any capital gains realised on the disposal of assets that support pension accounts are exempt from tax. This applies regardless of purchase date, including gains accrued before the pension started.

As the new rules for the $1.6m pension transfer cap and the restrictions for TRIS will disadvantage funds that might previously have benefited significantly from this provision, special CGT relief has been included in the new law for gains accrued before the changes commence.

Before the lodgement of the 2016/17 SMSF Annual Return Trustees can choose to elect to 'reset' the cost base of any assets that were purchased before 9 November 2016 (being the date the legislation was tabled in Parliament) and still held on 1 July 2017 to the market price of that asset on 1 July 2017.

For tax purposes this effectively means that the asset has deemed to have been sold at the market price on 1 July 2017 and re-purchased on the same date. The CGT purchase date of any assets for which an election is made would also reset to 1 July 2017.

There are a number of complex tax outcomes that need to be worked through depending on whether an asset has been held on a segregated or unsegregated basis.

Segregated

A segregated pension asset is one that has been set aside to solely support a pension balance either because the fund:

- is entirely in pension phase (other than defined benefit pensions) and so all of the assets of the fund are effectively segregated by default; or
- has a combination of pension and accumulation balances and maintains specific and separate assets to support them.

This basis only applies where a fund asset was a "segregated" pension asset on 9 November 2016 and stops being segregated at any point before 1 July 2017.

The major points for this basis are:

- Trustees can choose to deem to have sold an asset at 1 July 2017 and re-bought it at market value;
- The cost base is then reset to 1 July 2017 value;
- The capital gain made while still in pension phase so potentially exempt current pension income (ECPI).

Unsegregated

The unsegregated basis is proportionate and applies to funds which obtain an actuarial certificate to claim a tax exemption for investment income on pension assets.

To be eligible for CGT relief for a particular asset:

- the fund must have a 2016/17 actuarial certificate with a tax exempt % of more than 0%; and
- must not have been a segregated pension asset or a segregated accumulation asset at any time between 9 November 2016 and 30 June 2017.

The major points for this basis are:

- Trustees can choose to deem to have sold an asset at 1 July 2017 and re-bought it at market value;
- Part of the capital gain is ECPI;
- Trustees can choose to defer the capital gain until the asset is sold with the capital gain then included the Fund's income;
- It may be better not to apply if likely have larger percentage of the fund in pension phase when selling.

For either approach an election would need to be in a form accepted by the Australian Taxation Office and is irrevocable once made.

Any election made for 'CGT relief' is optional and trustees are able to select which assets (if any) that they will include in an election.

There is more detail to come on this particular change once the Regulations to the new law are issued.

Removal of the segregated method in certain circumstances for SMSFs

A further requirement of the new law is from 1 July 2017 some SMSFs may not be able to use a segregated approach to calculate their ECPI.

A small fund cannot use the segregated method for ECPI if:

- A member of the fund has total superannuation balance over transfer balance cap (initially $1.6 million); and
- That member is drawing a pension from any fund

These funds will be required to use the unsegregated method to calculate the tax their fund must pay on earnings. This change is designed to stop small funds cherry picking assets for CGT exemption.

An approach where segregation is required is to consider two separate SMSFs.

Other Superannuation measures

Expand spouse tax offset

Currently an individual can claim a tax offset up to a maximum of $540 for contributions they make to their spouse's eligible super fund where if the total of the spouse's assessable income, total reportable fringe benefits and reportable employer super contributions is under $13,800.

From 1 July 2017, the spouse's income threshold will be increased to $40,000. The current 18% tax offset of up to $540 will remain as is and will be available for any individual, whether married or de facto, contributing to a recipient spouse whose income is up to $37,000. As currently, the offset is gradually reduced for income above this level and completely phases out at income above $40,000.

Individuals will not be entitled to the tax offset when their spouse receiving the contribution has exceeded their non-concessional contributions cap for the relevant year, or has a total superannuation balance equal to or exceeding the transfer balance cap immediately before the start of the financial year in which the contribution was made.

Low Income Superannuation Tax Offset

The Government will introduce a Low Income Superannuation Tax Offset (LISTO), which will replace the Low Income Superannuation Contribution (LISC) policy that has been repealed from 1 July 2017.

LISTO will provide continued support for low-income earners and ensure that generally they do not pay more tax on their super contributions than on their take-home pay.

From 1 July 2017, eligible individuals with an adjusted taxable income up to $37,000 will receive a LISTO contribution to their super fund. The LISTO contribution will be equal to 15% of their total concessional (pre-tax) super contributions for an income year, capped at $500.

Abolition of anti-detriment payments

Currently, the anti-detriment provision enables a fund to claim a deduction in their tax return for a top-up payment made as part of a death benefit payment where the beneficiary is the dependant of the person. The top-up amount represents a refund of a member's lifetime super contribution tax payments into an estate.

From 1 July 2017, the government is removing this provision and super funds will no longer be able to claim this deduction.

Super funds may claim a deduction for an anti-detriment payment as part of a death benefit if a fund member dies on or before 30 June 2017. The fund has until 30 June 2019 to pay the benefit. Funds cannot include anti-detriment payments as part of a death benefit if the member dies on or after 1 July 2017.

Anti-detriment payments are not common with SMSFs as generally a reserve needs to be maintained to fund the top-up payment.

Removing contributions restrictions for people aged 65-74 not legislated

The Government announced, in the 2016 Budget, a policy of removing the ‘work test’, which restricted some older people from contributing to super, from 1 July 2017. However this policy was not proceeded with in order to offset the cost of dropping the lifetime $500,000 non-concessional contributions cap policy.

How can we help?

For clients near or over the $1.6 million threshold their arrangements will need to be reviewed and assistance required in identifying how these proposals may impact their super entitlements.

There may be one off costs from undertaking reviews and for initial compliance with the new laws such as administration costs required to move pension accounts back to an accumulation account.

For future administration increased administration costs may apply as SMSFs that were 100% pension may be required to once again become a mix of pension and accumulation.

If you would like some assistance with identifying how these proposals may impact your own superannuation fund, please feel free to give our office a call or contact your financial adviser.

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