SUPERANNUATION REFORMS

We Need to Make the Most of What is Bad Policy, Badly Executed!

The **2016 Federal Budget** contained a controversial and unexpected attack on superannuation planning for high net worth and high income individuals. The end result following passing of a very large volume of legislation late in November, is a system that heavily reduces the ability to build large super balances, and additional tax for those who have already done so in good faith.

Layer upon layer of complexity and administration has been added reversing with interest the simplifications occurring in 2007. The government appear to have sacrificed efficiency to hide the tax within a fund rather than adopt a simpler but more visible 'new' tax on the recipients of super pensions.

This is an example of the bad policy our political system is currently producing. All of the tenets of good tax policy have gone out the window. Unfortunately there is more of this rubbish to come due to an un-balanced Federal Budget and a dysfunctional parliament. High end taxpayers and tax fairness and efficiency are collateral damage in the Turnbull / Morrison quest for survival.

We thank you for your patience in relation to information about these changes. As you will see they are very involved and far reaching. Treasury and the ATO are still working on the detail and the superannuation industry to digest it all and work through the necessary changes to their systems. Our summary is much simplified and designed mainly to give you heads up on the issues that will have to be worked through in detail. Everybody's situation is unique in some way and there is no generic solution. Given the 30th June timeframe for most changes we all need to get on with it.

Finally, with all of the wisdom enshrined in the Future of Financial Advice (FOFA) reforms superannuation is deemed to be a financial product similar to an investment when it is actually a structure that holds investments. Please refer to our disclaimer outlining limitation of our advice to tax related issues.

A RECAP ON THE BASICS: WHAT IS CHANGING?

The reforms have changed markedly since first announced in the **May 16 Budget** and there is confusion due to various public proposals and counter-proposals, and the fact that in the final version there are now two $1.6m caps for completely different purposes. The context of the changes is the fact that the current system has allowed some people to accumulate very large amounts in superannuation on which earnings are completely tax free in pension phase.

Where relevant we have compared the new system with the old rules currently in place. The details outlined here are greatly simplified to assist your overall understanding.

Tax Exempt Super Balances In "Retirement / Pension" Phase Of Super Subject To A New Cap Of $1.6m Per Member From 1/7/2017 (Transfer Balance Cap – TBC)

NEW	OLD
From 1/7/17 there is a 'Transfer Balance Cap' (TBC) of $1.6m per member for the amount of super that can be held in retirement phase (pension phase) where earnings and gains are tax free to the fund. The excess over this cap must be commuted back to 'accumulation phase' within super, or withdrawn from super.	Previously there was no limit to the amount qualifying for the exemption. Earnings on 'accumulation balances' in funds will continue to be taxed at 15% with a 1/3 discount applying to capital gains on assets held >12 months.
Comment: *Fund members will be required to maintain a 'Transfer Balance Account' which is a separate record of movement of benefits in and out of pension phase along with indexation of the cap itself in order to know over their lifetime, how much 'cap' they have left available to transfer further benefits into pension phase. Importantly, earnings and gains on the 'exempt' $1.6m pension account, once set, can accumulate without restriction. Conversely, losses from your pension fund do not result in a reset of the cap. Note that on death your spouse or dependant does not benefit from your cap. If at any time you exceed your cap and have an 'excess transfer balance' then you are required to roll the excess back to 'accumulation phase' within super or withdraw the excess amount from super. There is a penalty tax applicable to notional earnings whilst in excess.*	
From 1/7/17 'taxed' 'Defined Benefit' pension payments will be assessable to recipients based on 50% of the excess over a notional cap which is the TBC, currently $1.6m, divided by 16 or $100k p.a.	Superannuation income stream benefits (member benefits) from taxed sources are non-assessable non-exempt income to recipients aged 60 or over. The same treatment applies to dependant death benefit payments where the deceased was 60 or over.
Comment: *Defined benefits schemes are common for government workers and some high level employees of large companies. Benefits are determined by a formula rather than an account balance.*	
From 1/7/17 'untaxed' 'Defined Benefit' income streams will be entitled to a 10% tax offset on the first $100k p.a. of annual pension payments.	Member benefits from untaxed sources are assessable income to recipients. Recipients aged 60 or over are entitled to a 10% tax offset on the whole pension withdrawal.
Comment: *Other superannuation income stream member benefits and dependant death benefits remain subject to their existing tax treatment. However, if the other benefits are defined benefit income, the defined benefit income cap is reduced by the amount of that income.*	
Complying superannuation funds are able to reset the cost base of fund assets to their market value where those assets are reallocated or re-apportioned from the retirement phase to the accumulation phase prior to 1/7/17 in order to comply with the TBC or new TRIS arrangements. Where these assets are already partially supporting interests in the accumulation phase, tax will be paid on this proportion of the capital gain made to 1/7/17. This capital gain may be deferred until the asset is sold.	Where fund assets are segregated, movements between the pension and accumulation pool have no bearing on the cost base of the asset. For funds that are not segregated, gains on assets used to support accounts in the accumulation phase are included in the assessable income of the fund on realisation under the CGT provisions and tax liability is determined using a proportionate method.
Comment: *Because the changes potentially expose funds retrospectively to tax on capital gains that have been accruing, the government have allowed this concession. Care needs to be taken as eligibility for the CGT concession has limitations.*	

Changes re: Concessional Superannuation Contributions

NEW	OLD
From 1/7/17, the threshold at which high income earners pay additional contributions tax (Division 293) will be lowered from $300,000 to $250,000.	A $300,000 threshold has applied since this measure was introduced in 2012/2013.
Comment: *This tax is levied on the member and effectively doubles the rate of tax on their deductible contributions from 15% to 30%. This tax is very administratively inefficient and exposing more people to it won't help that.*	
From 1/7/17 the annual cap for concessional contributions is reduced to $25,000.	The cap for 2016/2017 is $30,000 for members <50 and $35,000 members 50 and over.
Comment: *There are still other factors impacting your ability to maximise super contributions under these caps.*	
From 1/7/17 deductions for personal superannuation contributions are no longer dependent on whether the member earns 10% or more of their income from employment or related activities.	Up to 30/6/17 individuals are not able to deduct personal contributions if 10% or more of their total income is from employment or related activities.
Comment: *Abandoning the 10% rule allows more flexibility to make deductible personal contributions. For example, individuals under 18 will be able to offset trust income with deductible super contributions provided they have earned at least $1.00 of employment or business income for themselves.*	
Individuals with a total superannuation balance of less than $500,000 just before the start of a financial year can increase their concessional contributions cap in the financial year by applying previously unapplied unused concessional contributions cap amounts from one or more of the previous five financial years. Unused cap amounts can accrue from 1/7/18.	Presently, If an individual does not use the entire amount of their concessional contributions cap in a financial year they are not able to carry forward unused amounts.
Comment: *This is a significant opportunity for members with lower balances for whom cash flow may restrict contributions in particular years or where a higher deduction is beneficial in a particular year.*	

Changes re: Non - Concessional Superannuation Contributions

NEW	OLD
From 1/7/17, the annual 'Non-Concessional Contributions Cap' is reduced to $100,000 with potential bring forward of up to two years' worth of cap see below.	The cap for the 2016/2017 year is $180,000 with potential bring forward of up to two years' worth of cap see below.
From 1/7/17 an individual must have a total superannuation balance of less than the general TBC (currently $1.6m) on 30 June of the previous financial year to be eligible for the non-concessional contributions cap in the relevant financial year.	Up until 30/6/17 there is no total superannuation balance test to determine whether an individual is eligible for the non-concessional contributions cap.
In the 2017-18 financial year, the amount of the cap an individual may bring forward is three times the annual cap over three years if their total superannuation balance is less than $1.4 million, two times the annual cap over two years if their superannuation balance is above $1.4 million, and nil if their superannuation balance is $1.5 million or above. An individual's total superannuation balance is determined on 30 June of the previous financial year. Transitional arrangements apply to individuals who brought forward their non-concessional contributions cap in the 2015-16 or 2016-17 financial years.	Up until 30/6/17 individuals can access a three year bring forward period for their non-concessional contributions cap of three times the annual cap. The maximum cap where eligible is $540,000.
Comment: *This is a very significant restriction on how much a member can contribute as non-concessional over their lifetime. Previously that could be around $15,000,000 or more. There are some exemptions relating to legal settlements and business sale proceeds eligible for Small Business CGT Concessions.*	

Other Measures

NEW	OLD
From 1/7/2017 the Low Income Superannuation Contribution (LISC) is replaced with the Low Income Superannuation Tax Offset (LISTO). The LISTO effectively refunds the tax paid on concessional contributions by individuals with an adjusted taxable income of up to $37,000 – up to a cap of $500	The original low income super contribution (LISC) is a government superannuation payment of up to $500 direct into an individual's fund provided adjusted taxable income is <$37,000.
From 1/7/17 eligibility for the Spouse Superannuation Contribution Offset (maximum of $540) is based on, among other things, the total of the spouse's assessable income, reportable fringe benefits amounts and reportable employer superannuation contributions for the income year being less than $40,000.	The threshold for 2016/2017 is $13,800
From 1/7/17 the tax exempt status of income of assets supporting Transition to Retirement Income Streams (TRIS) will be removed.	Up until 30/6/17 earnings on assets supporting TRIS pensions was tax free.

ISSUES AND OPPORTUNITIES ARISING FROM THE CHANGES

Dealing with the $1.6m Transfer Balance Cap

1. Individuals in receipt of Account Based Pensions (ABPs) at 30 June 2017 with balances totalling more than $1.6m will be required to 'roll back' the excess to 'accumulation phase', or alternatively withdraw these amounts from superannuation as a pension payment or lump sum commutation, by 30 June 2017. A 'roll back' is a paper transaction within the fund whereas a withdrawal will require physical movement of funds or assets.

2. Whilst members with balances in pension phase are required to withdraw between 4%-14% of their balance annually as a pension depending on age, accumulation balances can remain in a superannuation environment until death. **Tip!** After 1/7/17 the minimum pension withdrawal for many account based pensions will be based on a much reduced amount.

3. **Tip!** Depending on personal circumstances holding investments outside of superannuation can be tax efficient. For instance the threshold before which no income tax is payable for a resident individual is $20,500 after allowing for the 'Low Income Offset'. Individuals of at least age pension age who qualify for the Seniors & Pensioners Tax Offset (SAPTO) can earn up to $32,279 of 'income' in the 2017 financial year before paying tax (or $28,974 each for couples). The level of income at which a resident individual generally reaches an average tax rate of 15% is about $45,000. On that basis an individual could in theory invest up to around $1,800,000 at 2.5% and still pay lower tax than the 15% applicable to superannuation in an accumulation account. Everybody's situation varies and that is an extreme example.

4. In considering the impact of earning income outside of superannuation eligibility for the Commonwealth Seniors Health Card will be a factor. To qualify for the Commonwealth Seniors Health Card a person's annual income must be less than: $52,796 if they are single; $84,472 (combined) if they are a member of a couple; and $105,592 (combined) for couples separated by illness or respite care. Importantly the income threshold includes deemed income of up to 3.25% from superannuation account based pensions that have been commenced or changed since 1/1/15.

5. **Trap!** If a fund is currently 100% in pension phase and the excess monies are taken as a lump sum commutation from superannuation without first rolling an amount back to accumulation, the fund may not be eligible for transitional CGT relief.

6. As the balances currently held in pension phase generate tax free earnings inside the fund, the optimal time for any 'rollback' or commutation will be as close as possible to 30 June 2017 but no later than 30 June 2017. In the case of SMSFs no money changes hands so a 'rollback' can be documented as at 30th June. **Trap!** Depending on the fund, reasonable lead time before 30/6/17 will be required to execute changes particularly for members of retail funds and platforms.

7. **Trap!** Before making any alteration to an account based pension it is necessary to ensure that the minimum pension for the year has been paid. Otherwise the pension may lose tax exemption for the year. **Tip!** Up until 1/7/17 amounts paid out as a lump sum commutation or partial commutation of a pension qualify toward minimum

pension payments. Amounts drawn in this way are tax free for members <60 if within their lifetime cap of $195k whereas pension payments to those under 60 are taxable.

8. **Tip!** Relief in relation to the $1.6m cap allowable for transfer into tax free pension phase is available where the member has contributed certain personal injury settlements. The cap is replenished where the member has lost money from a pension account due to fraud or transferred part of their pension account to a spouse as a result of a Family Law Payment Split.

9. The unused portion of an individual's $1.6m transfer cap is indexed.

10. Certain types of pensions are non-commutable or in other words can't be changed. Most Market Linked or Life Expectancy pensions fall into this category. For these pensions the amount of $1.6m TBC they use up is calculated by a formula. After 1/7/17 payments from these pensions are subject to a 'defined benefit income cap' of initially $100k p.a. with the excess of the pension payment partly assessable to income tax in the hands of the member.

11. Some other strategies that could assist in minimising the impact of the TBC include:
    a) Steps to equalize balances of couples where one is above the $1.6m could involve withdrawal and re-contribution if scope exists.

    b) Subject to cost benefit considerations, use of multiple funds to isolate certain assets or preserve estate planning attributes of individual pension accounts.

    c) Members wishing to draw more than the minimum pension from their pension account may prefer to partially commute their pension for the excess which will increase available unused TBC.

DEATH AND THE $1.6M TRANSFER BALANCE CAP

1. The introduction of the $1.6m TBC limits the amount of death benefit which can be paid in pension form. This is because the commencement of a death benefit pension to a dependant (reversionary or otherwise) will count towards the TBC of the recipient.

2. **Trap!** Death benefits in excess of the recipient's TBC cannot remain in a superannuation environment. The requirement to withdraw potentially large amounts from superannuation on death of a member will necessitate the review of estate planning and may be reason to consider trust or testamentary trust structures.

3. **Trap!** In situations where death benefit pensions are or were to be funded by illiquid assets such as property the introduction of the TBC is likely to force realisation of those assets sooner than would otherwise be the case.

4. **Trap!** After 30th June it will not be possible to 'roll back' an existing death benefit pension to accumulation phase. For widows and widowers in excess of their TBC that means there will be no option to keep the excess in a superannuation environment. In this situation it may be advisable to 'roll back' the death benefit pension prior to 30th June 2017.

5. **Trap!** Where a surviving spouse's 'retirement phase' pension balance is less than the deceased's, they will be faced with having a portion of their wealth outside superannuation after their partner's death. This is because they will be unable to 'rollback' a sufficient amount of their own 'retirement phase' pension to accumulation to permit payment of the majority of the death benefit in pension form.

6. Where the deceased had a pension in place and had nominated it as reversionary to their spouse then the value of the pension at date of death is not credited against the spouse's TBC until 12 months following death. During that period the spouse's tax free pension can be well in excess of the cap without penalty.

7. Whenever it is likely that monies will need to be held in accumulation phase after the death of an individual's spouse, it may be important to ensure, where possible, that the fund qualifies for and elects to utilise the transitional CGT relief provisions in anticipation.

Transitional CGT Relief

1. The introduction of the $1.6m TBC and the removal of the tax exemption for earnings on balances paying TRIS pensions exposes unrealised capital gains on superannuation assets to the prospect of becoming taxable upon realisation where prior to the changes the gains could have been tax free. For this reason and because trustees may have been encouraged to sell assets or reset CGT cost bases using 'wash sales', limited transitional relief has been granted. The basic intent of this concession is to allow capital gains that are accrued up to 1/7/17 to continue to be exempt or partly exempt. Some specifics in relation to the relief are as follows:

    a) Only assets held by the fund on 9 November 2016 and retained by the fund until 30 June 2017 qualify. That was the day the measures were first tabled in the House of Representatives.

    b) The relief applies on an asset by asset basis on a voluntary basis. Securities such as shares can be broken down into parcels within one security for this.

    c) Eligible funds will need to lodge with the ATO an irrevocable election in the approved form (not yet available), before the due date for lodgement of the fund's 2017 income tax return (in most cases May 2018). Whilst decisions regarding CGT on particular assets can wait until this time important steps are necessary before 30th June to determine or trigger eligibility.

    d) **Trap!** Making an election in relation to an asset with an unrealised loss will reset the costbase of that asset and eliminate that loss where it might otherwise have been available to offset future gains.

    e) For funds that have only Account Based Pensions (ABPs), only those funds which are required to, and in fact, reduce the balance held in pension phase by 30 June 2017 will be eligible for CGT relief. **Trap!** If action to reduce APB balances does not occur until after 1/7/17 CGT relief will not be available.

    f) For funds that have only TRIS Pensions only those funds where the TRIS is stopped or the TRIS balance reduced by 30 June 2017 are eligible for relief.

    g) For funds that have only Market Linked Pensions, those funds will not be eligible for CGT relief. Because these pensions are non-commutable any excess over the TBC is taxed via pension payments.

    h) For funds that have only Defined Benefit Pensions that are non-commutable, those funds will not be eligible for CGT relief. Because these pensions are non-commutable any excess over the TBC is taxed via pension payments.

    i) For funds paying a combination of pensions, CGT relief is generally available provided other conditions are met.

2. The resetting of cost bases is achieved by a deemed sale and immediate reacquisition of the chosen asset/s at market value on the reset date which in most cases will be 30th June 2017. This triggers a capital gain at that date. The capital gain is taxable at that time on the proportional basis. That is, for a fund with 100% Pensions there is no tax. For funds with pension and accumulation balances proportional tax is triggered but it can be deferred until the relevant asset is actually sold. **Trap!** Where CGT relief is chosen tax may be payable even if by the time the asset is actually sold the position reverts to a loss.

3. **Trap!** When resetting the cost base of an asset the acquisition date is also reset meaning a further 12 months will be required before a sale of the asset qualifies for the existing 1/3 CGT Discount.

Transition To Retirement Income Streams (TRIS)

1. TRIS pensions were designed to allow a limited pension draw of up to 10% p.a. for those people who had reached 55 but not necessarily retired. As with other pensions earnings on assets supporting TRIS pensions have been exempt. Salary sacrificing super contributions in conjunction with a TRIS became popular but outside the real purpose of funding a transition to retirement. Accordingly, from 1/7/17 earnings on assets supporting TRIS pensions are no longer exempt from tax.

2. Most people with TRIS pensions will switch them off unless they currently need the funds, because without the tax exemption there is little or no tax advantage and draining their fund is counterproductive in terms of maximising long term tax benefits of superannuation.

3. **Trap!** Failing to stop or reduce a TRIS by 30th June may cause the fund to be ineligible for CGT relief.

Contribution Opportunities

1. **Tip!** Fund members with balances currently approaching or exceeding $1.6m have a once off opportunity to make maximum non-concessional contributions where eligible before 30th June. After that date members with balances over $1.6m will be prevented from making further non-concessional contributions other than in limited circumstances such as where Small Business CGT Concessions have been applied or where a personal injuries settlement has been received.

2. **Tip!** Your superannuation balance will not impact your ability to make concessional contributions into superannuation under the new rules. To maximise the taxation benefits of superannuation overall every available opportunity should be taken each year to maximise concessional contributions.

3. In addition to the general non-concessional contribution cap being reduced to $100k p.a. and subject to 'total superannuation balance' being < $1.6m the ability to bring forward future year's contributions where eligible is modified as follows:

Bring Forward Amount & Period – 2018 Financial Year

Total Superannuation Balance on 30 June 2017	Non-Concessional Cap	Bring Forward Period
Less than $1.4m	$300,000	3 years
≥ $1.4m but less than $1.5m	$200,000	2 years
≥ $1.5m but less than $1.6m	$100,000	N/A
$1.6m or more	NIL	N/A

THE BIGGER PICTURE

The changes outlined above are a major blow to the use of superannuation as a tax efficient intergenerational investment vehicle. Superannuation remains a tax effective investment structure. The problem is now how to accumulate, grow and retain reasonable amounts in a superannuation environment. Starting early and taking advantage of opportunities to make concessional contributions is one way. Intergenerational funding of contributions may be worth considering, especially if you think there is a prospect of estate or wealth transfer taxes down the track.

WHAT TO DO NOW

This information is general. You should not act without specific advice. Please let us know if you would like us to investigate your particular circumstances. Be aware that we are only allowed to provide general or tax advice and cannot make a direct recommendation to transfer funds in or out of superannuation, or to start or stop a pension. In most cases we can assist with these direct recommendations in conjunction with your licensed financial advisor or our preferred licensed superannuation specialist.

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