Super Reforms 1 July 2017- Transfer Balance Cap

Key Advice Issues

Content

The background

- The transfer balance was introduced to:
  - Limit the amount of capital that can support retirement income streams.
  - Limits the amount of earnings that are exempt from income tax.
  - $1.6 million from 2017/18 financial year.
- New concept of superannuation income streams
  - Super income streams will need to be in ‘retirement phase’ to qualify for tax exemption on the earnings on the pension.
  - All super income streams for the income year will be in retirement phase unless
    - The pension is a Transitional to Retirement (TtR) Pension, or
    - A super income stream provider has failed to comply with a commutation authority in respect of a member’s transfer balance cap.

Key terminology

- The general transfer balance cap is $1.6m for the 2017-18 year and will be indexed to CPI (in $100,000 increments)
- The personal transfer balance cap is the amount that an individual is able to transfer to the tax-free retirement income/pension phase and is linked to the general transfer balance cap.
- The transfer balance account tracks how much a person has transferred into and out of the retirement income phase, and broadly operates on a system of credits and debits.
- A person who is already receiving a retirement income stream/pension on 1 July 2017 will have a personal transfer balance cap of $1.6m established at that time.

Personal transfer balance cap

- The person has a transfer balance account when they first transfer an amount from accumulation to retirement income stream phase. In that financial year, their personal transfer balance cap will be the same as the general transfer balance cap at that time (e.g. $1.6m for 2017-18).
- Proportional indexation – is intended to hold constant the proportion of an individual's used and used cap space as the general cap increases.
- In future years, the personal transfer balance cap will depend on:
  - If indexation is available – their unused cap percentage, and
  - Debits (decreases) and credits (increases) to their transfer balance a/c
  - Once an individual has used up their cap, they will not have their personal transfer balance cap indexed.

Transfer balance account

- The purpose of the transfer balance account is to track the net amounts transferred to retirement income phase. The transfer balance account allows a client to determine whether they have exceeded their transfer balance cap on any given day.
- Amounts credited to a person's transfer balance account include:
    - The value of all super interests supporting super income stream in the retiring phase on 30 June 2017.
    - The commencement value of new super income streams commenced on or after 1 July 2017
    - The value of revisionary income streams (but, broadly, with a 12 month delay from the time the individual becomes entitled to them, and
    - Notional earnings amounts – that will accrue on excess transfer balance amounts.

Transfer balance account - continued

- An individual’s transfer balance account will be debited (reduced) when:
  - They commute (in part or full) capital from the retirement income phrase. The amount of the debit will be equivalent to the amount that is removed from the retirement income phase regardless of whether the amount is returned to the accumulation phase or is withdrawn completely from the super system.
  - A debit also broadly arises where the retirement income stream is commenced using the proceeds from a personal injury structured settlement.

Transfer Balance Cap Case Studies - 1 July Start Date for New Transfer Balance Cap

- Example 1
- Dave had an SMSF a/c balance of $1.45m when he commenced his pension on 1 July 2015. Despite drawing down a pension since then, his a/c balance at 1 July 2017 has increased and he now has a balance of $1.82m.
- Dave will need to transfer $220,000 back to accumulation phase or pay it as a lump sum benefit by 1 July 2017 to avoid being liable for excess transfer balance cap tax.

Transfer Balance Cap Case Studies - 1 July Start Date for New Transfer Balance Cap

- Example 2
- Dave has an a/c balance of $1.45m at 1 July 2017 which supports a pension which commenced prior to that date. Dave is within the new Transfer Balance Cap limits and so can continue his pension without modification.
- By 1 July 2019, despite drawing down his pension, Dave’s a/c balance supporting his pension has increased due to good investment performance of his portfolio to $1.82m. The increase in his SMSF a/c is not treated as a Transfer Balance Credit. Dave does not have to transfer any part of his SMSF pension a/c to accumulation phrase.

Reversionary pensions versus Pensions commenced under a Binding Death Benefit Nomination

- Death benefit pensions what options do you have
  - Reversionary
  - Binding death nominations.

Breaching personal transfer balance cap

- If an individual’s transfer balance account exceeds their personal transfer balance cap, there is a breach of the transfer balance cap. Where this occurs, an excess transfer balance will arise. The two main consequences of this are:
- A person who exceeds their personal transfer balance cap will be required to commute (in full or part) their retirement income stream to remove the excess (including a notional earnings amount), and
- Excess transfer balance tax will be payable on the notional earnings.

Example: Breach of transfer balance cap

- On 1 July 2017, Rebecca commences a superannuation retirement income stream of $1m from the superannuation fund her employer contributed to. On 1 October 2017, Rebecca also commences a $1m superannuation retirement income stream in her SMSF.
- On 1 July 2017, Rebecca's transfer balance account is $1m. On 1 October 2017, Rebecca's transfer balance is credited with a further $1m bringing her transfer balance account to $2m. This means that Rebecca has an excess transfer balance of $400,000.
- On 15 October 2017, Rebecca sees her financial adviser and commutes $401,414 (excess of $400,000 plus 14 days of notional earnings) back into the accumulation phase to rectify the breach.
- Because of Rebecca rectifying the breach so quickly, the Commissioner does not issue a determination. Despite this, Rebecca is still required to 15% tax on the $1,414.

Transitional provisions

- The transitional provisions provide that an individual will not have an excess transfer balance in the transitional period from 1 July to 31 December 2017 if:
  - The only credits in their transfer balance account are from existing super income streams as at end of 30 June 2017,
  - Their transfer balance is in excess of their transfer balance cap ($1.6m on 1 July 2017) only by an amount equal to or less than $100,000, and
  - Their transfer balance is reduced below their transfer balance cap within the six months (by the 31st of December 2017).