Nexia Australia

Super Update

Superannuation Changes from 1 July 2017

December 2016

Are we throwing the baby out with the bathwater?

What happened?

- 15% Tax on retirement phase balances > $1.6 million
- Lower contribution caps

Legislation was recently enacted[1] that will make drastic changes to the way our Superannuation System will operate from 1 July 2017.

Although these changes are aimed to discourage the use of superannuation as a tax minimisation or estate planning vehicle, the changes also severely limit an individual's ability to build up a substantial superannuation balance (e.g. by lowering the contribution caps and in some instances reducing the capacity to make non-concessional superannuation contributions). Therefore, due to these new rules, individuals may not be able to accumulate enough capital in superannuation to fund their own retirement without having to rely on the aged pension.

Some of the main changes as well as potential opportunities that will be discussed in this alert include the following:

1. A $1.6 million superannuation transfer balance cap (i.e. can only have a maximum starting balance of $1.6 million of superannuation savings in the tax-free retirement phase on 1 July 2017); and
2. Lowering the non-concessional contributions cap to $100,000 per year (currently $180,000 per year);
3. Lowering the concessional contributions cap to $25,000 per year (for everyone under 75);
4. An extra 15% contribution tax on concessional contributions made by individuals earning more than $250,000 a year (currently more than $300,000 a year); and
5. All but abolishing the effectiveness of TRIS (transition to retirement income streams).

Please don't act on any of the information or issues that are raised in this alert without talking to your authorised Nexia adviser first so that you can proceed with advice specific to your circumstances.

Because we have about 7 months before the changes take effect on 1 July 2017, we look forward to working with you in this time to ensure you are in a position to make an informed decision on how to manage your superannuation assets and implement any strategies that may be applicable to your individual circumstances.

What do these changes mean for you?

- Tax-free treatment limited to returns on $1.6 million in retirement phase

1. $1.6 million superannuation transfer balance cap

From 1 July 2017 there will be a $1.6 million cap on the amount of capital that can be held in or transferred into the tax-free retirement phase of superannuation (e.g. superannuation pensions and annuities to members aged 60 or above). This means that, unlike the current position where all income on capital earned in retirement phase is tax exempt, only the earnings on $1.6 million of capital in the retirement phase will be tax exempt from 1 July 2017.

Assuming the amount in the retirement phase is $1.6 million at 1 July 2017 – if the value of the investments rise (for example to $2 million at the end of 2018) or decline (for example to $1 million at the end of 2018), there is no requirement to remove the excess of $400,000 in 2018 nor is there any possibility to top up the balance by $600,000 in 2018 (although the Government may provide relief in the case of a major economic downturn).

What to do before 1 July 2017: $1.6 million superannuation transfer balance cap

If a balance in the retirement phase will be more than $1.6 million by 1 July 2017, the excess must be commuted before 1 July 2017 to either:

- accumulation phase (where earnings on the excess will no longer be tax-free, but will be taxed at 15%); or
- outside Superannuation (where earnings will no longer be tax-free, but will be taxed at the individual's marginal tax rate – where the first $18,200 of earnings will be tax-free and where senior's and pensioner's tax offsets may be available).

Fortunately **capital gains tax relief**[2] would be available for such transfer[3] of assets between the retirement and accumulation phases of the superannuation fund. The cost base of CGT assets reallocated (for industry superfunds) or re-apportioned[4] (for SMSFs) from the retirement phase to the accumulation phase will be reset to their market value.

For SMSFs this resetting of the cost base to market value broadly means that the tax-free capital gains that have been accumulated up until the date of transferring the excess to the accumulation phase will remain tax-free and therefore tax will only be payable on the increments in the value of the assets held in the accumulation phase since the cost base was reset. Such treatment therefore effectively preserves the tax-free capital gains that have been accrued up until the date the excess was transferred from the tax-free retirement phase to the accumulation phase.

Please note that, due to the one-third discount on the usual 15% tax rate, the effective tax rate on capital gains made on the disposal of assets held by a superannuation fund for longer than 12 months is 10%.

If an individual breaches this $1.6 million cap (i.e. if the balance in the retirement phase is more than $1.6 million), the excess will be subject to excess transfer balance tax on the notional earnings on the excess to negate the benefit received from having the excess in the tax-free retirement phase. The tax will accrue daily until the excess is removed and increases for second and subsequent breaches.

If before 1 July 2017 an individual has a balance of more than $1.6 million in retirement phase, the individual will be unable to segregate assets that remain in retirement phase. That is, the $1.6 million will be apportioned between different asset classes to arrive at the total $1.6 million cap. This means that individuals will not be permitted to select which assets comprise the $1.6 million retirement phase balance. For example, some individuals may have been tempted to place either high yielding or high capital growth assets in the $1.6 million retirement phase account; such an attempt will not be permitted.

A possible method of segregating assets might be to establish a new SMSF and then transfer particular assets to that SMSF to be held in either accumulation or retirement phase.

How can couples maximise the $1.6 million cap?

If couples are still in the accumulation phase, they may want to consider contribution-splitting strategies to ensure they take full advantage of each of their $1.6 million cap.

Likewise, if such a couple is in retirement phase, they may want to consider taking capital out of any account exceeding $1.6 million and transferring that capital to into the lower balance account held by the person's spouse.

Retirement phase from 1 July 2017	Issues to think about
Cap of $1.6 million of balance that can be in tax-free retirement phase	Need to transfer excess to accumulation phase (taxed at 15%) or outside superannuation

2. Changes to non-concessional contribution rules

Currently no cap applies to the total non-concessional contributions (i.e. contributions from after-tax income that have already been taxed at the individual's marginal tax rate) that an individual can have in his/her superannuation fund. However, such contributions are limited to $180,000 a year (or $540,000 under the '3 year bring-forward' rule).

From 1 July 2017, an individual can only make non-concessional contributions of $100,000 per year (or $300,000 under the '3 year bring-forward' rule) - provided that their total superannuation balance at 30 June 2017 is less than $1.6 million.

If this $1.6 million superannuation balance cap is reached, superannuation balances can only be increased through investment growth or by making concessional contributions (limited to $25,000 a year from 1 July 2017) – i.e. in such a case an individual would not be able to make any more non-concessional contributions.

However, please note that the additional CGT cap of $1.415 million derived from capital gains made from the sale of eligible small businesses will remain and will not be counted towards the $1.6 million superannuation balance cap.

Bearing this in mind, once in the accumulation account, if the individual has fully utilised their transfer balance cap of $1.6 million as well, then the CGT exempt amount must remain in an accumulation account.

What to do before 1 July 2017: consider maximising non-concessional contributions

An individual who has surplus savings (e.g. through selling assets outside of superannuation, transferring business premises to a SMSF or through using funds in a home loan offset account) may wish to contribute $540,000 (a couple can contribute $1.08 million - $540,000 x 2) to superannuation before 30 June 2017 to maximise the existing higher non-concessional contributions cap. If this approach is taken, no further non-concessional contributions would then be able to be made in 2018 and in 2019.

Note that if the total amount in superannuation at 30 June 2017 is $1.6 million or more, no non-concessional contributions can be made after that date.

Non-concessional contributions from 1 July 2017	Issues to think about
Cap lowered to $100,000 a year if total superannuation balance is less than $1.6 million cap	Time when is best to reach the $1.6 million cap
Operation of the bring forward rule depends on the $1.6 million cap	Have to calculate proximity to the $1.6 million cap
The lifetime small business CGT cap ($1.415m in 2017) does not count towards the non-concessional $1.6 million cap	Sell small business and contribute proceeds to super up to the life-time small business CGT cap
Tax offset for spouse contribution if spouse earns less than $40,000	Now possible to contribute more on behalf of your spouse (current qualifying contribution limited to $13,800)

3. Changes to concessional contribution rules

From 1 July 2017, the maximum amount that can be contributed from pre-tax dollars (e.g. 9.5% compulsory superannuation guarantee and voluntary salary-sacrifice) will be limited to $25,000 per year for all ages (currently individuals under age 49 at 30 June 2016 can contribute up to $30,000 to superannuation and $35,000 if 49 years or over).

Furthermore, the high income threshold will also be lowered from $300,000 to $250,000 – which means that from 1 July 2017, concessional contributions made by individuals earning more than $250,000 will be subject to Division 293 contributions tax of 30% (as opposed to the normal 15%).

However, from 1 July 2017, any individual (up to the age of 75) will be allowed a tax deduction for personal concessional contributions with the removal of the so-called 10% rule. Currently this rule provides that a deduction is only allowed for contributions if the individual earns less than 10% of their income from employment (i.e. currently personal superannuation contributions are tax deductible for individuals substantially self-employed or who are under 65 years and have investment income). Please note that an individual still must satisfy a work test where they are over the age of 65.

What to do before 1 July 2017: consider maximising concessional contributions

An individual with sufficient funds may consider maximising concessional superannuation contributions (currently either $35,000 or $30,000 depending on age) before 30 June 2017.

Concessional contributions from 1 July 2017	Issues to think about
Cap lowered to $25,000 per year (for all individuals under the age of 75)	Max out concessional contributions (e.g. $30,000 or $35,000) before 1 July 2017
15% tax on contributions if earn less than $250,000 30% tax on contributions if you earn more than $250,000	Consider ways to decrease income to below $250,000
Everyone entitled to a tax deduction whenever they make a personal contribution – no 10% rule	Consider making a personal contribution to obtain the tax deduction
Catch-up contributions from 1 July 2018 (for up to 5 years) if superannuation balance at 30 June of previous year is less than $500,000	Allow people with interrupted work patterns to catch up on super
Can't make contributions if 65 years or older and not working	Same as before

4. (All but) abolishing the effectiveness of TRIS

From 1 July 2017, having a TRIS may no longer be as attractive as is currently the case, mainly because earnings from assets supporting a TRIS will no longer be tax-free but taxed at 15%. Further, TRIS payments as lump sums (and thereby receive $195,000 tax-free) will not be available.

Also bear in mind that any re-contributions of TRIS pensions will be subject to the new $1.6 million superannuation balance cap (i.e. once the superannuation balance reaches $1.6 million, the previous re-contribution strategy of making non-concessional contributions cannot be made).

Therefore, if an individual over age 60 is considering converting their TRIS to a full pension, they may have to cease working (i.e. meet a condition of release).

TRIS from 1 July 2017	Issues to think about
Fund earnings taxed at up to 15% (currently exempt)	Not much incentive to continue a TRIS
Non-concessional recontributions may breach $1.6 million cap	Watch out for recontributions of pension drawdowns that may breach the $1.6 million cap

5. How do these changes affect properties held in SMSFs?

Will the $1.6 million transfer balance cap affect your decision to sell property?

This $1.6 million transfer balance cap poses a conundrum for SMSFs that own property – especially if the property is likely to exceed the $1.6 million cap.

If an SMSF in the retirement phase holds property with a value of $1.6 million, consideration might be given to selling the property before 1 July 2017 because any capital gain arising will be tax-free (of course, any rental income earned before 1 July 2017 will also be exempt).

If such a property is sold after 1 July 2017 the gain above market value since the date of transfer of the asset into the accumulation phase will be subject to CGT at a rate of 10% (provided the property has been held for at least 12 months before sale (of course, any rental income earned in accumulation phase before the sale will be subject to tax at 15%).

This tax of 10% or 15% can be a considerable impost, especially on property which has high capital growth post 1 July 2017. Therefore, SMSFs should manage cash flow to fund these tax imposts.

Personal circumstances will affect a decision on whether to sell or retain a property before 1 July 2017. If the property is to remain in an SMSF, consideration must be given on how the SMSF will fund the CGT liability on eventual sale of the property. Tax should not be the sole consideration when deciding whether to sell property in an SMSF before or after 1 July 2017.

Please note, that if you had the property in your own name (i.e. not in the name of the SMSF), you would pay CGT at your marginal tax rate on any capital gain on the eventual sale of the asset.

This illustrates that holding property in a SMSF still remains very tax-effective with earnings being taxed at 15% instead of potentially 49%. Advice should be sought on the best way to structure an SMSF's investments.

Changes to the non-concessional contribution rules may affect an SMSF's decision to sell

An SMSF which owns properties and which funds mortgage payments from non-concessional contributions may become financially stressed if superannuation balances exceed $1.6 million (because no more non-concessional contributions will be allowed once each member's superannuation balance exceeds $1.6 million).

Please seek our advice if the $1.6 million cap is being approached or is already exceeded so that potential strategies can be developed (e.g. if possible, allow more members into the SMSF that have less than $1.6 million in superannuation so that more non-concessional contributions can be made – and the mortgage therefore can continue to be serviced).

How can Nexia help you?

These significant changes that will apply from 1 July 2017 will cause everyone to reconsider their retirement plan – **action should be taken well in advance of 30 June 2017.**

This alert provides a brief overview of the impending superannuation changes as well as some of the challenges and potential opportunities available to maximise your retirement nest egg.

We would also be delighted to discuss other potential investment opportunities that may be available outside of superannuation (e.g. the innovation incentive where you can access a tax offset for investment in innovative "start-up" companies, please see our recent Nexia Tax Alert - Innovation Incentive: How can you benefit?).

We will be conducting client presentations about the impact of the new Superannuation measures early in the new year. In the meantime, if you have any questions about any issues raised in this alert or about Superannuation in general, please contact your Nexia adviser.

Lastly, our plan is to keep you abreast of strategies that will be developed as a consequence of the new superannuation changes.

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1 - The Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016 received Royal Assent on 29 November 2016. This Act is the result of the Government Superannuation Reform Package originally announced in the May 2016 Budget (and updated by subsequent amendments e.g. removing the proposed $500,000 cap on non-concessional contributions).

2 - This CGT relief is also available for transfers of assets from retirement phase to accumulation phase due to impending changes to TRIS from 1 July 2017.

3 - There will generally be no CGT consequences on this deemed disposal and reacquisition transactions since both transactions are deemed to occur on the same day.

4 - SMSFs are not able to physically separate the assets held in retirement and accumulation phase – instead they will have to account for a "notional split" between these phases and pay tax accordingly (i.e. an actuary will certify what proportion of the returns will be tax exempt).