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SURVIVING THE PROPOSED SUPERANNUATION CHANGES

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Licensing regime

- We now have LAW.
- Draft legislation was presented to the house on 9/11/2016.
- This legislation was passed by both houses without amendment on 24/11/2016.
- ASIC, now that the licensing regime for accountants has been introduced, will definitely be doing some shadow shopping exercises.
- It will have the support of CPA Australia Advice given they now run a dealer group.

Disclaimer

The purpose of this presentation is to provide you general advice and assist you in understanding how engaging Morrows for advice might benefit you.

Where we provide you preliminary general advice, we must explain that this advice has been prepared at this time without taking into account your individual personal needs, objectives, or financial situation, and or any personal information we may already have obtained from you.

Therefore you should not act on any advice that has not been tailored or considered in light of your full individual personal circumstances, as there is a risk such actions may not be appropriate for you.

Where we provide personal advice and investment recommendations, these will be presented in a Statement of Advice (SoA) which will explain the basis of your personal advice recommendations, and any considerations or risks so that you can make an informed decision.

No representation is given, warranty made or responsibility taken about the accuracy, timeliness or completeness of information sourced from third parties.

Agenda

- General/Personal Transfer Balance Cap
- CGT Relief
- TRIS
- Condition of Release
- Reversionary Pensions & Estate Planning
- Contribution Rules
- SOA’s and licencing
- Action Items before 30 June 2017

New definitions

- General transfer balance cap

  The cap that everyone receives;

  $1.6 million in 2017-2018;

  Indexed to the CPI in $100,000 increments.

- Personal transfer balance cap

  The maximum amount of capital an individual can transfer to their superannuation retirement phase (1.6 million for 2017/2018);

  Indexed proportionally to the general transfer balance cap.

- Personal transfer balance account

  Tracks the net amounts the individual has transferred to the retirement phase.

  Tracks debits (increases) and credits(decreases) to the account.

New definitions

- Excess transfer balance

  The amount by which an individual's transfer balance exceeds their personal transfer balance cap.

- Cap space

  The difference between the general transfer balance cap and an

  individuals balance cap.

Earnings and capital growth on assets supporting pension liabilities are ignored when applying the personal transfer balance cap.

What does that mean?

What credits and debits and account?

General Transfer Balance Cap

- The following are regarded as a <u>credit</u> to the transfer balance:
  - the value of all assets supporting pension liabilities of a member on 30/06/17
  - the capital value of a new pension commenced from 1/7/2017
  - the capital value of a reversionary pension
  - notional earnings that accrue on excess transfer balance amounts.
- The following are regarded as a <u>debit</u> to the transfer balance:
  - partially or fully commuted pensions
  - indexation (where applicable and proportionally applied)
  - relief for certain events where an individual loses some or all of the value of assets that are held in pension phase (e.g. family law splits, bankruptcy)

Case Study

- Murray is 63 has an account based pension (ABP) balance at 30 June 2017 of $1.25 million.
- Murray's roof requires repair and he commutes $200,000 on 31 December 2017.
- Murray receives an inheritance of $250,000 on 1 February 2018. Murray would like to contribute this amount to his SMSF and begin a pension.
- Murray has not made any NCC in the past 2 years.
- In 2018/19 the cap is indexed by $100,000.

Amounts in excess of the minimum pension should be transacted as a commutation, thereby increasing the cap space.

Personal transfer balance cap

Transaction	Debit Entries	Credit Entries	Cap Space
1/07/2017 Individual Cap			$1,600,000
30/8/2017 Commences ABP		$1,250,000	$350,000
31/12/2017 Commutes for repairs	$200,000		$550,000
1/02/2018 ABP with inheritance		$250,000	$300,000
Indexation 2019 $100,000 (used 79% of cap)	1-($1.250m/$1.6m) x 100= 21%	Unused cap 21%*$100,000 = $21,000	$321,000

An individual that has exhausted or exceeded their transfer balance cap will not have their personal cap indexed.

CGT Relief

1. What Method

9/11/2016 – 30/06/2017	01/07/2016 – 30/06/2017
Segregated	**Proportional**
⇩	⇩
2. Reset/Retain Cost base	2. Reset/Retain Cost base
⇩	⇩
3. What Assets	3. What Assets
	⇩
	4. Pay tax or Defer Tax

CGT Relief Arrangements

- The CGT relief arrangements will allow complying superannuation funds to reset the cost base on CGT assets that are moved or reapportioned from a tax free to taxable regime before 1 July 2017.
- CGT relief applies differently depending on whether the fund uses the segregated or the proportional method.
- Where the fund is 100% in pension mode, it is automatically a segregated fund.
- Where assets support both accumulation and pension accounts, tax will be paid on the proportion of the capital gain made to 1 July 2017. The tax may be deferred until the asset is sold.
- The CGT relief includes assets that support a TRIS.
- When these assets are sold after 1 July 2017, tax is only paid on the capital gains accrued after this date.
- The CGT relief arrangements are only intended to support movements of assets and balances necessary to support the transfer balance cap and changes to the TRIS.
- An irrevocable election must be made in the ITR for 2016/17 year before lodgement.

CGT relief on segregated assets

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- Segregated assets of $2 million support Helen's Account Based Pension.
- Helen does a partial commutation of $1 million to meet the transfer cap balance requirement.
- The historical cost base of the assets moved back to the accumulation phase is $750,000.
- An unrealised gain of $250,000 exists.
- This transfer occurs prior to 30 June 2017.
- By making an irrevocable election with the ATO, the cost base of those assets **is reset** to $1 million.
- Only gains accruing on the accumulation balance from 1 July 2017 will be subject to tax within the super fund.

To qualify for CGT relief under this method, the relevant asset must be a segregated current pension asset at 9/11/2016, and must cease to be segregated by 30 June 2017.

New contributions will have to be maintained in a separate bank account.

CGT relief of Unsegregated pension assets

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- Lisa and Yeok have an SMSF.
- The only asset is a commercial property valued at $3 million.
- The historical cost base of the property is $2,820,000, resulting in an unrealised gain of $180,000.
- Lisa's super interest supports an account based pension of $2 million.
- Yeok is in accumulation with a balance of $1 million. (1/3 of the fund)
- Lisa commutes $400,000 to comply with the pension cap.
- Only the notional gain attributable to the accumulation phase is taxable.

1/3 of $180,000	= $60,000
1/3 Discount	= $20,000
Taxable Gain	= $40,000

- The fund has the option of including the notional gain in the 2016/17 tax return or deferring the gain until the asset is sold.

CGT relief of Unsegregated pension assets

- The trustees make the election to defer paying this capital gain until the asset is sold.
- The property is sold in the 2019/20 year for $4 million.
- The total gain is $1 million.
- The asset has been held for more than 12 months and the fund applies the 1/3 discount.
- <u>Capital gain calculation</u>
- The fund is now 40% in pension ($1.6m/$4.0m = 40%)
- Capital Gain $1,000,000
- <u>Less</u> 1/3 discount ($333,333)
- Less exempt pension income ($266,667)
- Plus deferred gain <u>$ 40,000</u> (from previous slide)
- **Amount included in tax return $440,000**
- **What happens for carry forward losses?**

Should I make the CGT relief election?

Should I make the election?

- Where assets have reset their cost bases, the 1/3 capital gain discount will not be available for 12 months.
- The fund may be in 100% pension phase at disposal of the selected assets.
- Where the election has been made the deferred capital gain tax will still need to be included in the tax return.
- The election should not be made on assets that are currently in a loss position.
- Individual assets can be selected for CGT relief.
- Record keeping will be crucial in keeping new cost bases and deferred capital gains tax.

There is a lot of planning required around the CGT relief option.

TRIS

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- The the pension asset exemption from 1 July 2017 with respect to any superannuation supporting a TRIS has been removed. A TRIS will now be taxable.
- Members aged between 55 – 65 years who have not met a condition of release will now have their pension accounts (TRIS) in the SMSF taxed.
- A TRIS **does not count** towards a members transfer balance cap.
- Re-contribution strategies to increase the member’s tax free percentage may still be beneficial, where the maximum pension can be withdrawn.
- A TRIS may be able to cover unexpected expense or reduce debt for a member by having limited access to their superannuation.
- Capital gains relief is available for a TRIS that converts to accumulation phase at 30 June 2017.
- Do members need to take advantage of the CGT relief options?
- A member may inadvertently trigger a condition of release converting a TRIS into an Account Based Pension.

Retirement a Condition of Release

- What is the definition of retirement for superannuation purposes?
- Member is under 60 years of age:
  - They have reached preservation age; and
  - An arrangement under which they were gainfully employed has come to an end; and
  - The member intends never again to become gainfully employed for at least 10 hours a week, in the future.
- Member is over 60 years but less than 65 years of age
  - An arrangement under which the member is gainfully employed ceases.
- Where a member has been in two or more employment arrangements at the same time, the cessation of one of the employment arrangements is satisfactory to meet the retirement condition of release.
- If a member age 60 or more commences a new employment arrangement after satisfying a condition of release, benefits in respect of the new employment are preserved.

Case Study

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- Mary is 61 and has a TRIS balance at 30 June 2017 of $1.95 million.
- Mary's assets only have a small unrealised capital gain and she decides not to apply the CGT relief option.
- Mary works full time but also works for the electoral commission during elections.
- Mary's work with the electoral commission finishes 30 August 2018.
- Mary's fund is now an Account Based Pension and the value at 30 August 2018 must be recorded against the transfer balance cap.
- On 30 August 2018 Mary's fund is valued at $2 million.
- Mary has triggered a condition of release and now has an excess transfer balance of $400,000.
- Unless Mary commutes $400,000 she may be liable for an excess transfer balance tax.

Excess transfer balance.

Mary's account

Balance of Transfer Balance account $2.0M	Transfer Balance Cap $1.6m	Excess Transfer Balance $400,000

The Commissioner makes an excess transfer balance determination, advising Mary to commute the interest in excess of the cap including notional earnings on the excess.

Notional earnings are calculated on a daily rate worked out as follows:

$$\frac{\text{90 day bank accepted bill yield + 7 percentage points}}{\text{The number of days in the year}}$$

Notional earnings are taxable at 15% (30% for the second offence) to the individual regardless of whether they have rectified their breach and removed the notional earnings amount from their pension interest

Reversionary pensions -Estate Planning Issues

- From 1 July 2017, reversionary pensions will be retested against the surviving spouse's cap.
- A credit will arise in the spouse's cap in respect of the income stream based upon the market value at the time of the member's death.
- A deferral period of 12 months will apply prior to the credit being applied to the new beneficiary's transfer balance account.
- Amounts over $1.6 million must be withdrawn as lump sums.
- In specie transfers can accommodate lump sum payments if required, however capital gain issues will need to be considered.
- Succession planning where reversionary pensions have been included will need to be revisited.
- What happens with lumpy assets? E.g. commercial building

Reversionary Pension Example

The following example is taken from the proposed legislation that seems to indicate the amounts in excess of the cap must be withdrawn as lump sums.

- John has a reversionary pension worth $1 million at the time of his death on 1 August 2017.
- The pension reverts to John's wife, Heather.
- Heather already has her own pension and a transfer balance account with a balance of $800,000.
- The combined pensions cause her to breach her transfer balance cap.
- Heather can either commute either pension or she can undertake a partial commutation for the amount of the potential excess $200,000.
- Heather makes a partial commutation of her pension and received a superannuation lump sum of $200,000.

Heather's Transfer Balance Account

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Transaction	Debit Entries	Credit Entries	Balance
1/07/2017 Individual Cap			$1,600,000
01/07/2017 Commences ABP		$800,000	$800,000
01/08/2017 John's death			$0.00
01/12/2017 Commutes	$200,000		$600,000
01/08/2018 Reversionary pension (12 months) Value at time of death		$1,000,000	$1,600,000

Contribution Rules - 3 Year Averaging

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- The Government has not gone ahead with the proposed $500,000 lifetime cap for non concessional contributions announced in the budget.
- From 1 July 2017 the government will lower the annual non concessional cap to $100,000 ($300,000 for averaging).
- Individuals with a balance of more than $1.6 million will no longer be eligible to make non-concessional contributions.
- Old rules remain in force until 1 July 2017. This is the last opportunity to take advantage of the $540,000 averaging amount.
- Transitional arrangements apply where averaging is started in the 2015 or 2016 year and the full $540,000 has not been used.
- If the bring forward rule is triggered this year or in the previous year and the full $540,000 is not used by the 30 June 2017, care must be taken in calculating the remaining amount that can be contributed, as the cap is reset on 1 July 2017.
- Where an individual is over the $1.6m cap, they won’t be able to use the unused portion of the non-concessional cap.

Case Study - Bring forward transitional rules

- Maureen is 40 and has a super balance of $200K.
- In September 2016 she receives an inheritance of $250K which contributes to her superannuation as a non-concessional contribution.
- What NCC can she make for the period 1 July 2017 – 30 June 2019.

	Annual NCC Cap
2016/2017	$180k
2017/2018	$100k
2018/2019	$100k
Total NCCs allowed during bring forward period	$380k
NCC made during 2016/17	$250k
NCC available for the period 1 July 2017 – 30 June 2019	$130k

Averaging going forward

Total Superannuation balance 30 June 2017	Non-Concessional cont. cap for the first year	Bring forward period.
Less than $1.4 million	$300,000	3 years
$1.4 m < $1.5m	$200,000	2 years
$1.5m , $1.6 m	$100,000	No bring forward period.
1.6m	Nil	N/A

- The total balance of a member's account at 30 June of the previous year determines whether you can contribute NCC. The balance may not be known until the accounts are prepared.
- Where investments fall and an ABP account falls below the cap, NCC contributions can be made to the member's accumulation account.

Contribution rules

- The 10% test for claiming personal superannuation contributions has been removed.
- An individual will broadly pass the 10% test where less than 10% of the individual’s assessable income, reportable fringe benefits and reportable employer superannuation contributions are from the employment activity.
- The removal of the 10% test from 1 July 2017 will be advantageous for part-time employees and some contractors.
- Individuals aged between 65-74 (inclusive) are still required to satisfy the “work test’ (40 hours in 30 days) before contributions (other than mandated contributions) can be accepted by the fund.
- There are no changes proposed to the lifetime CGT cap ($1,415,000 for 2016/17).This cap allows certain contributions to be made under the small business 15 year exemption or the small business retirement exemption, without those contributions being counted towards the standard NCC cap.

Catch up Contributions

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- The catch-up provisions allow individuals with superannuation entitlements of up to $500,000 to make catch-up Concessional Contributions in respect of any unused cap amounts accrued from 1 July 2018.
- The $500,000 is measured on 30 June of the previous financial year.
- Only amounts of unused concessional cap space from 1 July 2018 will be carried forward.
- Carried forward amounts expire if they remain unused for 5 years.
- Unused contributions could reduce capital gains in a particular year.
- Catch-up contribution can be split to eligible spouse.
- Contribution splitting is not available where a condition of release has been met between the ages of 60 – 65 years.

Case study: Making catch-up contributions

- Joe's employer makes a SG contribution of $10,000.
- No additional concessional contributions are made for the next four years.
- Joe is able to accrue any unused concessional contribution cap amounts and may carry forward each amount to be used in subsequent financial years.
- To offset a capital gain in 2024/25 Joe decides to contribute an extra $30,000 in 2023/24 and $35,000 in 2024/25.

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
SG Contribution	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Personal DC	Nil	Nil	Nil	Nil	Nil	$30,000	$35,000
Total CCs	$10,000	$10,000	$10,000	$10,000	$10,000	$40,000	$45,000
Annual Cap	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000
Unused cap accumulated for this year	$15,000	$15,000	$15,000	$15,000	$15,000	$0	$0

Balancing Super Strategies

- Contribution splitting with a spouse.
- 85% of the previous years concessional contributions.
- At the time of the contribution the spouse must be:
  - under 65; or
  - aged between preservation age and 65 and not retired.
- Catch up contribution can be split to eligible spouse.
- Re-contribution strategies should be optimised this year where there is unrestricted non preserved amounts.
- Reserving accounts may be an option where the Deed permits and a reserving strategy is in place.

Equalising Balances

SMSF
2 million

Harry (55)
$1.2 million

Mary (54)
$800,000

Harry splits 85% of his 25k concessional contributions over 10 years.

Total amount added to Mary's account (25k * 85% * 10years) = $212,500

Deed Upgrade

- Current Morrows Deed provides for:
  - Rollback of pensions to accumulation within the fund;
  - Division of assets between accumulation and pension;
  - Provide for income streams and ABP (Grandfathered);
  - Attend to excess transfer balance tax and excess NCC;
  - Remove pensions with flexible timing without melding with accumulation account;
  - Reimburse contributions;
  - Repudiate contributions;
  - Assign the Power of Attorney when living overseas from > 2 years.
  - Deal with separated and unseparated assets;

Deed Upgrade

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- Stipulate guardians for incapacity and death;
- Provide for reversionary beneficiary nominations;
- Allow for CGT relief;
- Discontinue to keep Transition to retirement Income Streams
- Determine member balances, across different funds; and
- Measure internal pension rollbacks to accumulation.