SUPERANNUATION REFORMS LEGISLATED

FirstTech Superannuation Reform Update

Legislation[1] implementing the superannuation reform package announced in the 2016 Federal Budget received Royal Assent on 29 November 2016. The reform package will implement the largest changes to the superannuation system since the Simpler Super changes in 2007.

This update provides a detailed summary of the key reforms including worked examples. In the near future, FirstTech will release a range of support materials, including fact sheets on each reform, which will provide a full analysis of the rules, strategies and future advice opportunities relating to these changes.

Superannuation reforms

To learn more about an individual reform, select from the list below:

Note: All reforms commence on 1 July 2017 unless otherwise indicated.

1 *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* and the *Superannuation (Excess Transfer Balance Tax) Imposition Act 2016*.

Colonial First State

Contributions

From 1 July 2017 a number of changes will come into effect which impact both a person's ability to make certain types of contributions and the tax treatment of those contributions.

Non-concessional contribution cap changes

A number of significant changes have been made to the non-concessional contributions rules. These are summarised as follows.

Reduced non-concessional contributions cap

From 1 July 2017 the annual non-concessional contribution cap will be reduced from $180,000 to $100,000 for clients with a total super balance of less than $1.6m.

Where a client's total super balance is $1.6m or more, their non-concessional contribution cap will be reduced to nil (see below for more information on the $1.6m rule).

Indexation

The annual non-concessional contribution cap will be set at four times the concessional contribution cap. The concessional contribution cap, which will be reduced to $25,000 on 1 July 2017, is indexed in increments of $2,500. Therefore the non-concessional contributions cap will increase in line with increases in the concessional cap, in increments of $10,000.

FirstTech comment

It is important to note that there is no change to the non-concessional contribution cap for the 2016–17 financial year. Therefore, the current cap of $180,000, or $540,000 under the bring forward rule, continues to apply until the end of 2016–17.

Bring forward rule retained

The bring forward rule, which allows clients to bring forward two future years of non-concessional contributions will be retained for those under age 65.

Therefore, taking into account the reduction in the non-concessional cap to $100,000 in 2017–18, clients will be able to make non-concessional contributions of up to $300,000 in one year using the bring forward rule depending on their total superannuation balance.

Transitional rules

Where a client has triggered the bring forward rule in either the 2015–16 or 2016–17 financial year, but has not fully utilised their full $540,000 cap by 30 June 2017, their remaining cap will be reassessed to take into account the reduction in the non-concessional cap from 1 July 2017.

The adjusted bring forward amount will depend on when the client triggered the bring forward period, and is summarised in the following table:

2015–16	2016–17	2017–18	2018–19
$180,000	$180,000	$100,000	
	$460,000		
	$180,000	$100,000	$100,000
		$380,000	

A client's remaining non-concessional contribution cap will be recalculated on 1 July 2017 based on the reduced non-concessional cap and the value of the client's non-concessional contributions made during the bring forward period.

Example 1

Joanne (age 50) triggered the bring forward rule in 2015–16 by making a $300,000 non-concessional contribution. She does not make any non-concessional contributions in 2016–17.

On 1 July 2017, her new bring forward cap is recalculated to be $460,000 (to take into account the reduced cap of $100,000 for the 2017–18 financial year).

As Joanne has already contributed $300,000 during the bring forward period, her remaining non-concessional cap for the 2017–18 year will be recalculated as $160,000.

Example 2

Albert (age 50) triggered the bring forward rule in 2016–17 by making a $300,000 non-concessional contribution.

On 1 July 2017, his new bring forward cap is recalculated to be $380,000 (to take into account the reduced cap of $100,000 for the 2017–18 and 2018–19 financial years).

As Albert has already contributed $300,000, his remaining non-concessional contribution cap for the remainder of the bring forward period is recalculated as $80,000.

FirstTech comment

Where a client makes non-concessional contributions prior to 1 July 2017 that exceed the reassessed bring forward cap, they will not be penalised or required to withdraw the excess. Therefore, clients should consider where possible using up their entire $540,000 bring forward cap during 2016–17, so that the transitional rules don't apply to reduce the level of contributions they can make.

Example 3

Penelope (age 50) triggered the bring forward rule in 2016–17 by making a $540,000 non-concessional contribution.

While her new bring forward cap would have been reassessed as $380,000 under the transitional rules from 1 July 2017, she will not breach her non-concessional contribution cap as the contribution was made prior to 1 July 2017 when a $540,000 bring forward cap was available to her.

Non-concessional contributions cap reduced to nil where total super balance exceeds $1.6m

Where a client's total super balance is greater than or equal to $1.6m at 30 June in a financial year, their non-concessional contribution cap in the following financial year will be nil. That is, these members will not be able to make any non-concessional contributions.

FirstTech comment

Clients with total superannuation balances of $1.6m or more on 30 June 2017 will not be able to make non-concessional contributions in the 2017–18 financial year under the new rules. Therefore 2016–17 may be their last opportunity to make non-concessional contributions depending on the value of their total super balance in the future.

Calculation of total super balance

A client's total superannuation balance will generally be calculated as the sum of:

- the market value of all of their accumulation accounts
- the market value of all of their account based income streams (including transition to retirement income streams)
- the total value of all non-account based income streams included in their transfer balance account (see section on $1.6m transfer balance cap), and
- the value of any benefits that are not included in either their accumulation accounts or their transfer balance account as they have been rolled over and are in transit between funds on the day of measurement.

Where a client has contributed any structured settlements amounts, such as personal injury payments, to super, these amounts are excluded from the calculation of their total super balance.

The value of a client's accruing interest in a defined benefit fund will also be included in their total super balance. Valuation rules will depend on the type of fund and the nature of the client's interest.[2] Where a client is an accruing member of as defined benefit fund, advisers should contact the fund regarding how it should be valued.

Bring forward rule modified

Where a client is eligible to use the bring-forward rule but has a total super balance of $1.4m or more, they will only be able to bring forward the number of years of contributions that takes their balance to $1.6m.

This is summarised in the following table:

Total super balance at 30 June prior to financial year	Contribution and bring forward available
Less than $1.4 million	3 years ($300,000)
At least $1.4 million but less than $1.5 million	2 years ($200,000)
At least $1.5 million but less than $1.6 million	1 year ($100,000)
At least $1.6 million	Nil

Example 4

Jim's total super balance at 30 June 2017 is $1.49 million. As his total super balance is over $1.4m but less than $1.5m, he is only able to make $200,000 of non-concessional contributions in the 2017–18 financial year.

It is important to note that a client's ability to make any non-concessional contributions during a bring forward period is retested each year based on the client's total super balance as at the end of the previous financial year. This means that a client that triggers the bring forward rule but does not utilise their full non-concessional cap may have their remaining cap reduced to nil where their balance grows to over $1.6m.

Example 5

Harry (age 50) has a total super balance at 30 June 2017 of $1.49 million. He is therefore eligible to use a two-year bring forward and make non-concessional contributions of up to $200,000. Harry then makes non-concessional contributions of $110,000 during the 2017–18 financial year.

At 30 June 2018, Harry's total super balance has increased to $1.61 million due to contributions and investment returns. As a result his non-concessional contribution cap for the second year (which would otherwise have been $90,000) is reduced to nil.

Conversely, if a client's total super balance falls to below $1.6 million as at 30 June in a financial year that is within a three year bring forward period, the client can utilise their remaining bring forward cap in the following year.

2 The value of such an interest will be valued according to the Income Tax Assessment Regulations where a valuation method exists (this will be relevant to accruing interests in public sector super schemes) or otherwise will be equal to the total super benefits that would become payable if the client voluntarily ceased the interest at that time.

Example 6

Donald (age 60) has a total super balance at 30 June 2017 of $1.39 million. He is therefore eligible to use a three-year bring forward and contribute $300,000. Donald makes non-concessional contributions of $150,000 during the 2017–18 financial year.

At 30 June 2018, Donald's total super balance has grown to $1.64 million due to contributions and investment returns. His remaining non-concessional contribution cap for the second year (which would otherwise have been $150,000) is therefore reduced to Nil.

At 30 June 2019, Donald's total super balance has reduced to $1.58 million due negative investment returns and benefit payments he took after satisfying a condition of release. His remaining non-concessional cap for the third year is his original bring forward cap ($300,000), less non-concessional contributions already made during the bring forward period ($150,000), which is $150,000.

Had Donald's total super balance at 30 June 2019 been $1.6 million or more, his non-concessional cap contribution cap for the third year would have again been reduced to nil.

FirstTech comment

Because of the ongoing testing of a client's total super balance in years two and three of a bring forward period, clients should look to use all of their bring forward cap in the first year of their bring forward period, to avoid their remaining cap being reduced.

Changed eligibility requirements for Government co-contribution

In addition to the existing eligibility requirements, clients will not be eligible for the Government co-contribution in a year if:

- their non-concessional contributions exceed their non-concessional contribution cap for that year, or
- their total superannuation balance was equal to or greater than $1.6m as at 30 June at the end of the previous financial year.

Concessional contribution cap changes

A number of changes have been legislated in relation to concessional contributions that will come into effect on 1 July 2017.

Reduced concessional contribution cap

The concessional contribution cap will be reduced to $25,000 from 1 July 2017 and will apply to everyone regardless of age.

The cap will be indexed to average weekly ordinary time earnings (AWOTE) in increments of $2,500.

Concessional contributions to constitutionally protected funds/unfunded DB schemes

Currently, concessional contributions to a constitutionally protected super fund do not count towards the concessional cap. In addition, concessional contributions to other unfunded defined benefit interests are generally Nil.

However from 1 July 2017, concessional contributions to constitutionally protected super funds and unfunded defined benefit schemes will count as concessional contributions.

In this case, modifications to the rules will ensure that it will not be possible for concessional contributions to these schemes to breach a client's concessional cap.

However, concessional contributions to one of these schemes could result in a client's concessional contributions to other types of super funds exceeding the concessional cap.

Example 7

During the 2017–18 year, Louise makes concessional contributions of $50,000 to a constitutionally protected accumulation fund. She also makes concessional contributions of $20,000 to ABC Retail Super Fund.

The $50,000 of concessional contributions made to the constitutionally protected fund count towards Louise's concessional cap. However, even though they exceed the $25,000 concessional cap, they cannot be considered excess concessional contributions.

However, because her cap is fully utilised, the $20,000 of concessional contributions made to ABC Retail Super Fund are all excess concessional contributions.

FirstTech comment

Clients who are members of constitutionally protected super funds often undertake strategies involving salary sacrificing large amounts to those schemes. While these strategies can continue under the new rules, clients should be aware that any concessional contributions they are making to other schemes may become excess as a result of this change.

Division 293 income threshold reduced to $250,000

Currently, clients whose income (defined as income for surcharge purposes) plus low tax contributions exceeds $300,000 are subject to Division 293 tax.

Division 293 tax (15%) applies to 'taxable contributions' (the amount of low tax contributions that sit over the $300,000 threshold).

From 1 July 2017, the income threshold will reduce from $300,000 to $250,000, meaning more clients may be impacted by Division 293 tax going forward.

FirstTech comment

The overall impact of this measure will be to increase the tax burden by up to $3,750 (i.e. 15% of $25,000) on concessional contributions.

Inadvertently exceeding the $250,000 threshold will be a key concern. Examples that may cause a client to exceed the $250,000 threshold include taxable capital gains and employer termination payments.

Clients will not receive a Division 293 notice from the ATO until up to 18 months after making the concessional contribution which may come as a surprise to those unaware that they have exceeded the threshold.

SG maximum earnings base limited to the concessional cap

From 1 July 2017, the SG maximum earnings base is effectively limited to the concessional contributions cap.

While unlikely to be relevant on 1 July 2017, differences in indexation between the SG maximum earnings base and the concessional cap may see this rule apply in future years.

This rule will prevent a client with one employer from having compulsory contributions that are excess concessional contributions. However, where a client has more than one employer, they can still breach the concessional cap with compulsory contributions as the maximum earnings base applies individually to each employer.

Personal deductible contributions changes

From 1 July 2017, anyone who is eligible to make voluntary super contributions will also be eligible to make personal concessional (tax-deductible) contributions.

Under current rules, the ability to make personal concessional contributions is limited to clients who:

- have not 'done anything' to be considered an employee as defined by the Super Guarantee Administration Act 1992, or
- satisfy a 10% test which requires that less than 10% of their income is attributable to employment.

This change is welcome news for employees, who will have the flexibility to make concessional contributions either via salary sacrifice (if allowed by their employer) or personal tax-deductible contributions. This flexibility could assist with:

- end of year super top ups by making personal concessional contributions to use up any remaining concessional contribution cap
- deciding how to contribute bonuses, annual leave and long service leave
- contributing lump sum leave payments received upon termination of employment tax-effectively.

FirstTech comment

While anyone under 75 will be able to make a personal concessional contribution from 1 July 2017, those aged 65 to 74 will need to meet a work test (40 hours within 30 consecutive days in the financial year they make a contribution over the age of 65) to be eligible to contribute to superannuation. The original Budget proposal to abolish this work test for all members aged between 65 and 74 did not proceed.

Simplification of eligibility criteria will likely result in an increase in the use of personal concessional contributions. However, it is critical to be aware of the strict requirements and timeframes that apply to submitting a 'notice of intent to claim a tax deduction' form and having it acknowledged in writing by the fund. Clients will also need to have regard to their concessional contribution caps.

Refer to the FirstTech Super Guide for further details about these important requirements.

Contributions to some schemes not tax-deductible

Clients who make personal contributions to the following types of superannuation schemes will not be able to claim those contributions as a tax-deduction.

- A commonwealth public sector super scheme in which the client has a defined benefit interest
- An untaxed super scheme
- Other superannuation schemes specified in Regulations (none at present).

Carry-forward concessional contributions

From 1 July 2018, clients with a total superannuation balance below $500,000 can carry forward any unused concessional cap amounts for up to five financial years.

This reform allows eligible clients who do not use all of their concessional cap in a particular financial year, to carry forward their unused concessional cap amounts to future years.

Carry-forward concessional contributions may assist clients with breaks in employment to make 'catch-up' contributions when they return to work.

To be eligible to make catch-up concessional contributions in a year a client must have a 'total super balance' of less than $500,000 as at 30 June at the end of the financial year immediately preceding the financial year in which the contribution is to be made.

The definition of 'total superannuation balance' is the same as that used for the non-concessional contribution cap (see above).

If a client is eligible to make catch up contributions they can add any previously unused concessional cap amounts from the previous five financial years to their current year's concessional cap.

Example 8

On 30 June 2025, Colleen has a total superannuation balance of $450,000. She is therefore able to add any previously unused concessional cap amounts from the previous five financial years to her cap for the 2025–26 financial year.

For the previous five financial years Colleen made total concessional contributions of $20,000 per year. Assuming the general concessional cap is still $25,000 by 2025–26, Colleen could therefore make total concessional contributions in that year of $50,000, (5 × $5,000 plus $25,000) without exceeding her concessional cap.

It is important to note that under this reform only unused concessional cap amounts from 2018–19 and future years can be carried forward.

Example 9

On 30 June 2019, Tim has a total superannuation balance of $400,000. He is therefore able to add previously unused concessional cap amounts to his concessional cap for the 2019–20 financial year.

Tim has an unused concessional cap of $7,500 in 2017–18 and $15,000 in 2018–19. However as only unused concessional cap amounts from 2018–19 can be carried forward, Tim can increase his concessional cap for 2019–20 by $15,000, but not by the unused cap from 2017–18.

Where an eligible client applies unused concessional cap amounts, they are applied starting with the earliest unused cap amounts first. This ensures that remaining unused cap amounts are preserved as long as possible.

Example 10

In 2025–26, Heidi is eligible to apply unused concessional caps. She has $10,000 of unused cap in each of the previous five financial years. Heidi chooses to only use $10,000 of her unapplied cap. This $10,000 is taken from the 2020–21 financial year (the fifth previous year), rather than a later year.

FirstTech comment

This reform was originally proposed to commence from 1 July 2017, however the commencement date was delayed to 1 July 2018.

The ability to make catch-up concessional contributions may assist clients with higher taxable income in a particular year to use up any unused concessional cap amounts and to manage their tax.

For example, where an eligible client is selling assets during an income year, it may be worth contributing enough of the proceeds to super as a personal deductible contribution to use up any unused concessional cap from previous years and to qualify for a deduction to offset any CGT liabilities.

Spouse contribution tax offset extended

The spouse contribution tax offset provides a tax offset of up to $540 for a contributing spouse where they make eligible spouse contributions of up to $3,000.

Under current rules the receiving spouse must have total income (assessable income, reportable fringe benefits amounts and reportable employer superannuation contributions) not exceeding $10,800 in order for the contributing spouse to receive the maximum offset.

Under the new rules the receiving spouse can have total income not exceeding $37,000 in order for the maximum offset to apply – a partial offset may apply where the receiving spouse has a total income of less than $40,000.

Example 11

In 2018–19, Karen has total income of $39,000. George makes a spouse contribution for Karen of $3,000.

George is entitled to a tax offset of 18% of the lesser of:

- $3,000 - [(receiving spouse's assessable income + RFB + RESCs) - $37,000], and
- the amount of the spouse contribution actually made.

George is entitled to a tax offset of $180.

FirstTech comment

The increase in the spouse income thresholds from $10,800 to $37,000 will make this tax offset more widely available. For low income earners, strategies targeting both the co-contribution and spouse contribution tax offset may be effective.

Superannuation income stream rule changes

A number of significant changes have been made to the taxation of income streams at both super fund and member levels. These rules are summarised as follows.

$1.6 million transfer balance cap

From 1 July 2017 a new transfer balance cap will apply to limit the amount of benefits a client can transfer from the accumulation phase to support retirement phase income streams.

This reform is designed to limit the amount of benefits a client can transfer to the tax-free retirement phase.

Broadly, the balance of existing retirement phase income streams at 30 June 2017 as well as the initial value of new income streams commenced after 1 July 2017, will be measured against an individual's personal transfer balance cap. Any amounts in excess of the cap will need to be rolled back to accumulation phase or withdrawn from the superannuation system.

Meaning of retirement phase income streams[3]

Retirement phase income streams include all superannuation pensions and annuities other than:

- transition to retirement income streams
- non-commutable allocated pensions and annuities

General transfer balance cap

The general transfer balance cap for 2017–18 will be set at $1.6 million and will be indexed annually in line with increases in the Consumer Price Index (CPI) in increments of $100,000.

Personal transfer balance cap

The personal transfer balance cap determines the amount that a client can transfer into retirement phase income streams. The personal transfer balance cap initially equals the general transfer balance cap in the year they first commence a retirement phase income stream. However over time, the personal transfer balance cap may differ from the general transfer balance cap due to proportional indexation (see below).

Example 12

Patricia retires in 2017–18 and commences an account based pension with the whole of her balance in a public offer superannuation fund.

As Patricia first commenced to receive a retirement phase income stream in 2017–18 her personal transfer balance cap will be set at $1.6 million.

Indexation of personal transfer balance cap

Where a client has commenced a retirement phase income stream but has not fully utilised their transfer balance cap, their personal cap will be subject to proportional indexation based on the value of any increase in the general transfer balance cap and the unused proportion of their personal cap.

Example 13

Glenda retires on 1 July 2017 and immediately commences a $1.2 million account based pension.

As Glenda commenced her first retirement phase income stream in 2017–18 her personal transfer balance cap is equal to the general transfer balance cap of $1.6 million. In this case, Glenda will have used 75% of her personal transfer balance cap and will have an unused cap proportion of 25%.

On 1 July 2019, the general transfer balance cap is increased by $100,000 to $1.7 million due to indexation.

Assuming Glenda has not commenced any other retirement phase income streams in the interim, her personal transfer balance cap will then be increased by $25,000 ($100,000 × 25%) to $1.625 million. In this case, Glenda will then have $425,000 of her personal cap remaining.

However, it is important to note that once a client has fully utilised their personal cap they will not be eligible for any further increases, as their remaining unused proportion will be nil.

Example 14

From the previous example, if Glenda had instead commenced a pension for $1.6 million on 1 July 2017, her personal cap would not increase when the general transfer balance cap increased to $1.7 million in 2019–20, as she will have already fully utilised her personal cap.

FirstTech comment

Due to these rules each client who has commenced a retirement phase income stream at some time will have their own personal transfer balance cap.

Advisers will need to ensure they have correctly identified the value of a client's personal transfer balance cap before they provide any advice to commence another retirement phase income stream.

Modified transfer balance cap for child beneficiaries

Where a child receives a death benefit income stream from their deceased parent, a modified transfer balance cap rule applies. This ensures that the child's own personal transfer balance cap at retirement is not impacted by their receipt of the pension from their parent.

Generally, a child's transfer balance cap will be as follows:

- If they have been receiving a death benefit income stream from before 1 July 2017, $1.6 million
- If they start to receive a death benefit income stream on or after 1 July 2017 and the parent does not have a transfer balance account (eg, the parent dies prior to reaching

3 Retirement phase income streams also exclude transition to retirement income pensions and non-commutable allocated pensions paid in accordance with the Retirement Savings Accounts Regulations 1997

retirement), their proportionate share of the death benefit multiplied by the general transfer balance account
    - eg, if the child receives 50% of a parent's death benefits on 1 January 2018, their transfer balance cap is $800,000
- If they start to receive a death benefit income stream on or after 1 July 2017 and the parent does have a transfer balance account, their proportionate share of the parent's benefits that were already in an income stream in retirement phase
    - eg, if the child receives 100% of a parent's death benefits and the parent had $300,000 in an account based pension, their transfer balance cap is $300,000

A child's transfer balance account will cease when their death benefit pension ceases. Generally, this will be by age 25 due to the requirement for a child to commute a death benefit income stream by that time. For disabled children who can continue their pension beyond age 25, the transfer balance account will cease once the pension assets are exhausted.

Death benefit rule changes

It is important to note that changes to the treatment of superannuation death benefits may result in a client's eligible beneficiaries being forced to take a death benefit as a lump sum where it would otherwise result in them exceeding their transfer balance cap.

For more information, please see super death benefit payment rule changes section below.

Transfer balance accounts

To determine when a client has exceeded their personal transfer balance cap, a transfer balance account system will be implemented from 1 July 2017.

Transfer balance accounts will work like a general ledger, with amounts being credited and debited depending on a client's circumstances.

Creation of transfer balance accounts

A client will have a transfer balance account created for them when they first commence a retirement phase income stream. Alternatively, where a client is receiving a retirement phase income stream on 1 July 2017, a transfer balance account will be created for them on that date.

The value of a client's transfer balance account will then change depending on whether amounts are credited or debited from the account on any particular day. The net value of the account at the end of each day will then be used to determine whether a client has exceeded their transfer balance cap at that time.

Amounts credited to transfer balance accounts

The following amounts are required to be credited to a client's transfer balance account:

- The value of all of a member's existing retirement phase income streams as at 30 June 2017
- The commencement value of new superannuation retirement phase income streams (including new superannuation death benefit income streams and deferred superannuation income streams) commenced on or after 1 July 2017
- The value of reversionary superannuation income streams as at the time the individual becomes entitled to them.[4] Note – a modification applies to defer the time at which a credit arises for a reversionary pension. Please see below for more information.
- Where a member has exceeded their transfer balance cap at a time, an amount of deemed earnings on the excess amount will also be added to the member's transfer balance account.

Value of retirement phase income streams

The value of a retirement phase income streams that will be credited to a member's transfer balance account will depend on the type of income stream paid.

For account based income streams (other than market linked income streams):

- where the income stream commenced prior to 1 July 2017 – the value of the income stream account balance on 30 June 2017, or
- where the income stream commenced on or after 1 July 2017 – the commencement value on the start day

Where a member has a non-commutable defined benefit income stream or a market linked income stream, the value of the income stream is determined by multiplying the member's annual income entitlement by a pension valuation factor. For more information on these rules, please see the capped defined benefit income streams section below.

Timing of credit for reversionary pensions

Where an income stream automatically reverts to a nominated beneficiary on the death of the original recipient, the value of the pension as at the time of death will count as a credit to the beneficiary's transfer balance account.

However, to give the beneficiary time to arrange their affairs, the credit will be deferred and will not arise in the beneficiary's transfer balance account until 12 months from the date of death.

This rule applies where a pension reverted to a member's beneficiary on or after 1 July 2016. For example, where a pension reverted to a member's beneficiary on 1 January 2017, a credit will not arise in the beneficiary's transfer balance account until 1 January 2018.

Where a beneficiary receives a reversionary pension that reverted prior to 1 July 2016, the balance of the reversionary pension at 30 June 2017 will count as a credit to the beneficiary's transfer balance account.

4 Note: given a reversionary beneficiary generally becomes immediately entitled to a reversionary pension upon the death of the original recipient, the value of the credit will be based on the value of the pension as at the date of death.

FirstTech comment

It is important to note that once a retirement phase income stream has commenced, any increase in the value of the pension due to investment returns will not be treated as a credit to the member's transfer balance account.

This means clients may wish to consider commencing retirement phase income streams as soon as possible where they will be impacted by the transfer balance cap, as any growth that occurs after that time will not result in the client exceeding their transfer balance cap.

Example 15

On 1 July 2017 Tiffany has $2 million in the accumulation phase of her super fund. On the same day Tiffany satisfies a condition of release and uses $1.6 million of her benefits to commence an account based pension.

After 12 months Tiffany's account based pension account had grown to $1.65 million due to investment returns exceeding the value of her pension payments. In this case, the $50,000 increase in her pension account balance will not be treated as a credit and will not result in her exceeding her personal transfer balance cap.

Amounts debited from transfer balance accounts

The following amounts will act as debits to a client's transfer balance account:

- The value of any lump sums commuted from a retirement phase income stream (including where the commutation results in a negative transfer balance account value[5])
- The value of any structured settlement contributions made in respect of a client. In this case, the debit occurs at the later of when the contribution is made or when a transfer balance account is created for a client[6]
- The value of any replenishment debits approved by the ATO. Replenishment debits apply in limited circumstances where the value of a client's retirement phase income stream has been impacted by:
  - fraud or dishonesty[7]
  - bankruptcy
  - family law payment splits
  - situations where a trustee is unable to comply with a commutation authority due to a lack of funds in the relevant client's pension account[8]
  - where a pension or annuity ceased in a year due to the provider failing to meet the pension standards in a year.

The Government has also advised it will review the impact of the transfer balance cap amendments if there is a macroeconomic shock that substantially affects retirement incomes.

FirstTech comment

It is important to note that pension payments and negative investment returns do not count as debits. Therefore, the value of a client's retirement phase pension, such as an account based pension, could be quite different from the value of their transfer balance account where a client's account balance has been eroded by negative investment and/or pension payments.

Advisers may therefore need to check the value of a client's transfer balance cap before they recommend the commencement of any retirement phase income stream.

Impact of a rollover on a client's transfer balance account

Under the new rules where a client fully or partially commutes a retirement phase income stream, the value of the commutation will be debited from their transfer balance account and can result in a negative transfer balance account value.

This ensures that a client is able rollover the full value of any retirement phase income stream to another provider even where their pension balance has grown due to investment returns and now exceeds their personal transfer balance cap.

Example 16

Diego commenced an account based pension with $1.6 million on 1 July 2017, fully using up his personal transfer balance cap. In 2020, his account based pension balance has grown to $1,750,000 due to strong investment returns. He then commutes his pension and rolls over the lump sum to another provider and commences a new account based pension.

In this situation, Diego's transfer balance account would have the following entries:

Year	Credit/Debit	TBA Balance
2017–18	Credit $1.60m	$1.60m
2020–21	Debit $1.75m	- $150,000
2020–21	Credit $1.75m	$1.60m

As a result, Diego has been able to commute, rollover and recommence a new account based pension for $1.75 million without exceeding his transfer balance cap of $1.6 million.

5 Note: Permitting a transfer balance account to have a negative value allows a member to fully commute and rollover a retirement phase income stream that has increased in value from one provider to another without exceeding their personal transfer balance cap. See Impact of a rollover on a member's transfer balance account section for more information.

6 This ensures that the value of any structured settlement contributions made prior to the member commencing a retirement phase income stream will count as a debit and will potentially allow a member to commence a much larger retirement phase income stream than would otherwise be possible.

7 Where the offender has been convicted.

8 For more information on commutation authorities, please see Excess transfer balance determinations below.

FirstTech comment

The introduction of the transfer balance cap will result in super fund trustees being required to report certain transactions, such as the commencement and commutation of retirement phase income streams, to the ATO.

Depending on the reporting timeframes involved, this may lead to delays between when a transaction occurs and when it is reflected in a client's transfer balance account.

Consequences of exceeding the transfer balance cap

Where a client exceeds their personal transfer balance cap, the amount of the excess plus a notional earnings amount will be required to be commuted and removed from the retirement phase. In addition, the client will also be required to pay excess transfer balance tax on the amount of notional earnings.

Calculation of notional earnings

The notional earnings on an excess transfer balance amount will be calculated at the General Interest Charge rate (currently 8.76%[9]) for the period starting when the client commenced to have an excess amount and ending when the amount is removed from retirement phase.

Excess transfer balance tax will apply to notional earnings at the following rates:

- For assessments during the 2017–18 financial year – 15%
- For assessments from 1 July 2018 – 15% for the first assessment and then 30% for subsequent assessments.

Excess transfer balance account transitional rule

Where a client breaches their transfer balance cap on 30 June 2017 by less than $100,000, the excess amount will be disregarded for a period of six months.

However, this transitional rule will only apply where the excess amount is removed from the retirement phase by the end of the six month period.

FirstTech comment

Clients who are members of large funds with retirement income stream balances over $1.7 million will therefore need to take action in the lead up to the end of the financial year to reduce the combined the value of their income streams to no more than $1.6 million by 30 June 2017.

However, where a client is a member of a SMSF, they may not know the value of their retirement phase income streams until several months after the end of the financial year when the fund's annual return is completed.

In this case, these clients may wish to proactively request the trustee commute enough of their income streams to reduce their transfer balance account to $1.6 million by 30 June 2017.

Excess transfer balance determinations

Where a client has an excess transfer balance amount, the ATO will issue an excess transfer balance determination to the client. The determination will specify the amount (known as the crystallised reduction amount) that must be commuted and removed from retirement phase.

The determination will also include a default commutation notice which will identify the fund which the ATO will issue a commutation authority.

Where a client is receiving multiple retirement phase income streams from different providers they can elect for the commutation authority to be issued to a different provider. To be valid the election must be made to the ATO in the approved form within 60 days of the date of the excess transfer balance determination.

Funds must comply with a commutation authority

Once the member has made an election to choose a different fund or where the 60 day period has lapsed, the ATO will issue a commutation authority to a fund specifying the crystallised reduction amount. The trustee must generally comply and commute the amount specified in the notice within 60 days.[10] The trustee is also required to notify the ATO of compliance with the notice within 60 days. During the 60 day period, there is an expectation that the fund will make reasonable efforts to contact the member to seek instructions (eg, which option/product does the member want rolled back to accumulation phase). The commuted amount can be rolled back to accumulation phase or paid as a superannuation lump sum benefit payment.

Where a fund fails to comply with a commutation authority, the entire income stream will cease to be in retirement phase (and no longer qualify for the earnings tax exemption), from the start of the financial year in which the fund failed to comply with the commutation authority and all later financial years.

FirstTech comment

Where a commutation authority is issued to a self-managed superannuation fund, advisers may need to assist trustees to ensure the specified crystallised excess amount is commuted and removed from the retirement phase within the required time frame otherwise significant tax penalties will apply.

The transfer balance cap and defined benefit income streams

Where a client is receiving certain non-commutable defined benefit income streams (known as capped defined benefit income streams) on 30 June 2017, or commences to receive a capped defined benefit income stream on or after 1 July 2017, special rules apply to:

- determine the value of the income stream for the purposes of the transfer balance account

9 General interest charge rate December quarter 2016

10 Note: certain funds will be exempt from having to comply with a commutation authority, this includes where the fund is only paying non-commutable pensions or where there is insufficient balance to pay the commutation amount.

- ensure that a client cannot have an excess transfer balance amount to the extent the excess is attributable to a capped defined benefit income stream, and
- modify how the pension payments from capped defined benefit income streams are taxed.

Meaning of capped defined benefit income stream

Capped defined benefit income streams are defined in section 294-130 the Income Tax Assessment Act 1997. The types of retirement phase income streams that qualify as capped defined benefit income streams are summarised as follows:

- complying lifetime pensions commenced either before or, on or after 1 July 2017, and
- the following types of income streams commenced prior to 1 July 2017:
  - complying lifetime annuities
  - complying term pensions and annuities
  - complying market-linked pensions and annuities (eg, a term allocated pensions)

The Government has also confirmed that regulations may designate further capped defined benefit income streams.

Note: At the time of writing it is still unclear how commutable lifetime superannuation pensions and annuities will be valued for these rules.

Value of capped defined benefit income streams

The value of a capped defined benefit income stream for the purpose of the transfer balance cap is:

- For lifetime pensions or annuities – the client's annual income entitlement × 16
- For term and market linked income streams – the client's annual income entitlement × number of years (rounded up to the nearest whole number) in the remaining term.

A client's annual income entitlement is calculated by annualising the first payment an individual is entitled to receive after the valuation is required.

Example 17

On 30 June 2017 Joan is receiving a capped defined benefit lifetime pension which pays her $3,000 per fortnight.

The value of Joan's pension for the purposes of the transfer balance cap is calculated as follows:

Annual entitlement = ($3000/14) × 365 = $78,214

Pension value = $78,214 × 16 = $1,251,430

Capped defined benefit income streams and excess transfer balance amounts

Due to the fact that capped defined benefit income streams are generally non-commutable, special rules apply to ensure that a client cannot exceed their personal transfer balance cap to the extent the excess is attributed to a capped defined benefit income stream.

This means that where a client only has a capped defined benefit income stream, and its value exceeds their personal transfer balance cap (eg, $1.6 million for 2017–18), they will not have an excess transfer balance. Therefore, the client will not have any excess transfer balance tax liability and will not be required at commute an amount.

However, where a client has a capped defined benefit income stream, and another type of retirement income stream, such as an account based pension, they will have an excess transfer balance amount to the extent that it can be attributed to that other income stream.

Example 18

On 1 July 2017 Jessie turned 65 and commenced an account based pension from her retail public offer super fund with a starting balance of $1,000,000. Two weeks later on 14 July 2017 Jessie retired and her employer's corporate super fund commenced paying her a lifetime pension (which met the definition of a capped defined benefit income stream) with an annual payment entitlement of $80,000.

In this case Jessie's transfer balance account will have a total balance of $2.28 million in relation to the following credits:

- $1 million for the account based pension, and
- $1,280,000 ($80,000 × 16) for the lifetime pension

As a result, Jessie will be assessed as having an excess transfer balance amount of $680,000 on 14 July 2017. In this case, as the excess can be attributed to Jessie's account based pension, excess transfer balance tax will apply and Jessie will need to commute $680,000 from her account based pension.

Tax treatment of pension payments from capped defined benefit income streams

To ensure equivalent tax treatment of capped defined income streams with other types of retirement phase income streams, a separate defined benefit income cap of $100,000pa will apply. Pension payments over $100,000pa will subject to additional taxation, depending on whether they are from a taxed or untaxed pension.

Payments that count towards the defined benefit income cap

Payments that count towards the defined benefit income cap include payments made from a capped defined benefit income stream that are paid to a client:

- age 60 or over, or
- under age 60 from a death benefit income stream where the deceased member was age 60 or over at the time of death.

The defined benefit income cap

A client's defined benefit income cap for a financial year is generally equal to the general transfer balance cap for the corresponding financial year divided by 16. For example, the defined benefit income cap for 2017–18 will be $100,000, ie $1.6m/16[11].

11 However, a client's defined benefit income cap will be reduced where:

- they first become entitled to concessionally taxed payments from a defined benefit income stream part way through a year, ie they turn 60 part way through a year. In this case, their cap will be reduced on a pro-rata basis, or
- a component of their total payments is not subject to concessional tax treatment. This may occur where a member under age 60 is receiving non-concessionally taxed payments from both a defined benefit pension commenced in their own name as well as concessionally taxed payments from a death benefit pension in the same year.

Tax treatment of concessionally taxed income received in excess of the defined benefit income cap

The income tax treatment of concessionally taxed income from a capped defined benefit income stream depends on whether it is from a taxed or untaxed source.

Payments from taxed sources

Where a client receives concessionally taxed payments from a taxed source (ie, payments made up of either tax-free component and/or taxable component (taxed element), the payments will continue to be tax-free up to the defined benefit income cap.

However, where payments exceed the defined benefit income cap, 50% of any excess (including any part of the payments made up of tax-free component) will be included in their assessable income and will be taxed at their marginal rate. The assessable portion will also not be eligible for the 15% pension tax offset.

Payments from an untaxed sources

Where a client receives concessionally taxed payments from an untaxed source (ie, the payments consist wholly of taxable component (untaxed element)), the payments will continue to be included in the client's assessable income and will get the benefit of the 10% pension offset up to the defined benefit income cap.

However, where payments exceed the defined benefit income cap, the amount will be included in the client's assessable income but they will not be eligible for the 10% pension offset.

Payments received from both taxed and untaxed sources at the same time

Where a client receives concessionally taxed capped defined benefit income from both sources, such as where they receive payments made up of:

- tax-free component and taxable component (taxed element), and
- taxable component (untaxed element)

the payments from the taxed source are assessed against the defined benefit income cap first.

Example 19

Josh is 63 and receives a capped defined benefit income stream of $170,000 in 2017–18 that is made up of the following tax components:

- $20,000 tax-free component
- $100,000 taxable component (taxed element)
- $50,000 taxable component (untaxed element).

In this case the following tax treatment would apply to his payments:

- The tax-free and taxable component (taxed element) combined will be assessed against the defined benefit income cap first
  - first $100,000 – tax-free
  - remaining $20,000 balance exceeds the defined benefit income cap – 50% tax free and 50% included in assessable income and not eligible for 15% pension offset
- Remaining $50,000 payments made up of taxable component (untaxed element) in excess of defined benefit income cap included in assessable income but not eligible for 10% pension tax offset.

Death benefit income stream rule changes

The Government has made a number of changes to the tax and regulatory treatment of superannuation death benefits paid as income streams to increase flexibility and to cater for the introduction of the transfer balance cap.

Rollover of death benefits permitted

To facilitate the ability of clients receiving a death benefit income stream to change product providers, the definition of a rollover superannuation benefit has been amended to allow eligible beneficiaries[12] to rollover superannuation death benefit lump sums from 1 July 2017.

In consequence of this change, the Government has made a number of changes to ensure that a death benefit will always be treated as a death benefit for tax and regulatory purposes (see removal of prescribed period section below).

Therefore, where a death benefit income stream is commuted and the lump sum rolled over to a new provider, the amount must immediately be used to commence a new death benefit income stream in the new fund.

12 Note: only certain eligible beneficiaries are able to take a death benefit in the form of an income stream. These include a member's spouse, financial dependants and interdependent relations. Children can only receive a death benefit income stream where they are a minor, financially dependent and under 25, or disabled (they must also commute the income stream to a lump sum by age 25 unless they remain disabled).

FirstTech comment

While these rule changes were implemented due to the introduction of the transfer balance cap, it is important to note that the ability to rollover a death benefit income stream will apply to anyone that receives a death on or after 1 July 2017.

Note – at this stage it is unclear how these rules will apply to a client who commenced to receive a death benefit income stream prior to 1 July 2017.

Removal of prescribed period

To ensure that a death benefit will always be treated as a death benefit for tax purposes, the rule which allowed a death benefit to convert to a member benefit where it was commuted outside the prescribed death benefit period[13] will be repealed from 1 July 2017.

This confirms that a client will not be able to commute a death benefit income stream and transfer the lump sum back to the accumulation phase at any time. Instead, a death benefit income stream will only ever be able to be commuted to facilitate the commencement of a new death benefit income stream with the same or a different provider, or to pay a lump sum death benefit.

FirstTech comment

Where the commencement or reversion of a death benefit income stream will cause a client to breach their transfer balance cap, the removal of the prescribed period confirms the client will not be able to commute and transfer the excess amount back to the accumulation phase after the prescribed period has ended. Instead, the client may now be forced to commute the excess and pay it as a death benefit lump sum.

However, this will depend on the amount of the death benefit and whether the beneficiary has the ability to commute an amount from a retirement phase income stream they commenced with their own member benefits.

For example, where a client had previously commenced a retirement phase income stream with their own member benefits, they could avoid paying a lump sum death benefit by commuting and transferring enough of their own income stream back to the accumulation phase to create the necessary room under their transfer balance cap.

Example 20

Joyce commenced an account based pension for $600,000 on 1 July 2017. Later that year Joyce's spouse, Murray, passed away and his $1.2m account based pension automatically reverted to her on 1 September 2017.

As a result, the value of Murray's reversionary pension will be credited to Joyce's transfer balance cap on 1 September 2018[12], resulting in an amount in excess of her transfer balance cap of $200,000.[13]

In this case Joyce would have two options to address the excess amount as follows:

Option 1 – Commute $200,000 from Murray's reversionary pension prior to 1 September 2018 and pay it as a lump sum death benefit to herself. In this case, Joyce's transfer balance account would be valued at $1.6m on 1 September 2018 after taking into account both the credit for the reversionary pension and the debit for the commutation. However, in this case she will have effectively transferred $200,000 out of the superannuation system.

Option 2 – Commute $200,000 from her own account based pension and transfer the amount back to the accumulation phase. In this case, Joyce's transfer balance account would also be valued at $1.6m on 1 September 2018 taking into account both the credit for Murray's reversionary pension as well as the debit for the $200,000 commutation from her own account based pension. However, in this case Joyce has not had to transfer any benefits out of the superannuation system.

FirstTech comment

The removal of the prescribed period may also impact a client's life insurance arrangements where insurance is held inside super with the intention of being used to fund tax effective death benefit income streams.

Example 21

Jeremy (age 45) took out a $2.5 million life insurance policy in an insurance only super fund with the intention that in the event of his death the proceeds could be used to pay death benefit income stream to his spouse (Peta, age 43).

However, due to the removal of the prescribed period and introduction of the transfer balance cap, if Jeremy were to die in 2017–18, Peta could only commence a death benefit income stream for $1.6 million and would be forced to take the balance as a lump sum death benefit.

Note: If Jeremy had dependent children the proceeds could also be used to pay death benefit pensions to them under the modified rules for child beneficiaries. Please see the Modified transfer balance cap for child beneficiaries section above for more information.

13 The prescribed period is specified in subsection 307-5(3) of the Income Tax Assessment Act 1997 and is generally the later of six months from the date of death or three months from the grant of probate.

14 Note: modified rules apply to delay the credit arising from a reversionary pension for 12 months from the date of death.

15 Assuming transfer balance cap in 2018-19 is $1.6 million.

Transition to retirement income stream rule changes

From 1 July 2017, earnings on assets supporting a transition to retirement (TTR) income stream (ie, one where the client has not satisfied a full condition of release) will no longer receive a tax exemption and will be taxed in the same way as accumulation phase assets.

This applies to both existing TTR income streams, and new TTR income streams commenced on or after 1 July 2017.

Impact on TTR strategies

Common TTR strategies involve a client continuing to work full time, commencing a TTR income stream, and using income stream payments to meet expenses while increasing salary sacrifice contributions. This strategy provides two separate benefits:

- Earnings on the TTR pension assets are exempt from tax
- The TTR income stream payments may be more concessionally taxed than the salary they replaced.

With the first of these benefits no longer available under the new rules, the tax savings achieved by TTR strategies are reduced.

TTR strategies for clients under 60

The benefit of a TTR strategy under the new rules for a client under age 60 is now very marginal at best, unless the client has a very high tax free proportion in their TTR income stream.

Example 22

Jessica is age 56 and earns $80,000pa. She has $270,000 in superannuation (100% taxable component).

Under the current rules, if Jessica commences a TTR strategy where she draws the minimum annual payment and salary sacrifices, she would receive a tax benefit in the first year of $2,161.

However under the new rules from 1 July 2017, due to tax applying to the earnings of a TTR pension, the tax benefit is reduced to $574.[14]

In addition to the tax on earnings of a TTR pension commencing from 1 July 2017, the reduction in the concessional cap to $25,000pa will also impact the effectiveness of a TTR strategy.

In the following case study the client makes concessional contributions of $35,000 under the current rules. However under the new rules from 2017–18, they must reduce their salary sacrifice due to the reduction in the concessional cap and make non-concessional contributions.

Example 23

Marie is age 56 and earns $80,000pa. She has $550,000 in superannuation (100% taxable component).

Under the current rules, if Marie commences a TTR strategy where she draws the minimum annual payment and salary sacrifices, her total concessional contributions (including superannuation guarantee) would be $35,000. Marie would receive a tax benefit in the first year of $4,418.

However under the new rules from 1 July 2017, tax applies to the earnings on TTR pension assets and a reduced concessional cap to $25,000pa applies. Marie must reduce her salary sacrifice contributions and make non-concessional contributions with any surplus income.

In this case, the tax benefit of the TTR strategy is eliminated and Marie is actually worse off by $834.

Marie is worse off under the TTR strategy as she pays tax on the TTR pension payments (as under age 60), that exceeds the tax savings on the salary sacrifice amounts under the $25,000 concessional cap.[15]

For clients under age 60, it is important to review their TTR strategies prior to 1 July 2017 to determine whether they should be altered or discontinued.

TTR strategies for clients 60 or over

The benefit of a TTR strategy under the new rules for a client aged 60 or over who has some concessional contributions cap free still exists, but is reduced compared to current rules.

Example 24

Andrew is age 60 and earns $80,000pa. He has $270,000 in superannuation (100% taxable component).

Under the current rules, if Andrew commences a TTR strategy where he draws the minimum annual payment and salary sacrifices, he would receive a tax benefit in the first year of $5,079.

However under the new rules from 1 July 2017, due to tax applying to the earnings of a TTR pension, the tax benefit is reduced to $3,491.[16]

Such clients may be best continuing with their TTR strategy, although it may need to be altered prior to 1 July 2017 to take into account the $25,000 concessional cap.

16 Assumptions – earnings: income and realised capital gains 4%pa, unrealised capital gains 4%pa, net income requirement $60,853pa, under the TTR strategy she salary sacrifices $13,273 and draws the minimum pension. Total concessional contributions including superannuation guarantee and salary sacrifice $20,873.

17 Assumptions – earnings: income and realised capital gains 4%pa, unrealised capital gains 4%pa, net income requirement $60,853pa, under the TTR strategy in 2016–17 she salary sacrifices $27,400, total concessional contributions $35,000. In 2017–18, salary sacrifice $17,400 and non-concessional $6,313. Total concessional contributions $25,000pa.

18 Assumptions – earnings: income and realised capital gains 4%pa, unrealised capital gains 4%pa, net income requirement $60,853pa, under the TTR strategy she salary sacrifices $16,562 and draws the minimum pension. Total concessional contributions including superannuation guarantee and salary sacrifice $24,162.

Example 25

Jack is age 60 and earns $80,000pa. He has $440,000 in superannuation (100% taxable component).

Under the current rules, if Jack commences a TTR strategy where he draws the minimum annual payment and salary sacrifices, he would receive a tax benefit in the first year of $8,498.

However under the new rules from 1 July 2017, due to the reduction in the concessional cap to $25,000pa, Jack must reduce his salary sacrifice. He then makes non-concessional contributions with the surplus income.

In this case, the tax benefit of the TTR strategy is reduced to $3,678.[17]

Where a client aged 60 or over has a TTR strategy in place but does not have any concessional cap free, the TTR strategy will generally only remain worthwhile if there is a more effective way to use the payments from the TTR income stream (instead of moving it back to accumulation phase and not receiving them). This could include:

- Debt reduction such as mortgage repayments
- Contributions to their spouse's account to help equalise superannuation balances. Spouse contributions may also be eligible for the spouse contribution tax offset.
- Implementing a recontribution strategy.

FirstTech comment

While earnings on TTR pension assets will be taxable from 1 July 2017, once the TTR pension converts to a normal account based pension, earnings will no longer be taxable.

Reviewing your clients' employment arrangements to determine whether they have met the retirement condition of release may result in considerable tax savings. For example, clients who cease a gainful employment arrangement after reaching age 60 or over have generally satisfied a full condition of release.

Transitional Capital Gains Tax (CGT) relief

Where a trustee of a complying super fund is required to move an asset from retirement phase to accumulation phase as a result of either the transfer balance cap or the removal of the earnings tax exemption for TTR income streams, the trustee can elect to reset the asset's cost base to its current market value.

This ensures that only capital gains that accrue after the asset was transferred back to the accumulation phase will be assessable.

Which assets can the CGT relief apply to?

In general the transitional relief will only apply to assets that a trustee has been required to transfer back to the accumulation phase due to the transfer balance cap and transition to retirement rule changes.

Different rules will then apply to determine whether a trustee is able to apply the relief in relation to a particular asset depending on which segregation method the fund uses. However, in all cases CGT relief can only apply to assets held by the fund throughout the pre-commencement period, ie from 9 November 2016[20] to 30 June 2017.

Consequences of making an election

Where a trustee makes the election in relation to an asset the fund will be taken to have disposed and immediately reacquired the asset for its current market value – triggering a notional capital gain under the CGT rules.

The consequences of making the election varies depending on whether the fund uses the segregated or unsegregated assets method for calculating its assessable and exempt income. However, it should be noted that electing to apply the relief will reset the asset's acquisition date for the purposes of 12 month CGT discount rule.[21]

Segregated method

Where the fund uses the segregated method any gain or loss from the deemed disposal will be disregarded and the asset's cost base will be reset to its current market value.

Unsegregated (proportional method)

Where the fund uses the unsegregated method any capital gain from the deemed disposal will result in a notional capital gain based on the proportion of the fund's assets that are backing the accumulation assets.

In this case, the trustee can elect to bring the notional gain to account in the 2016–17 year or defer the gain until the time the asset is disposed – at which time the deferred gain must then be brought to account.

FirstTech comment

The CGT transitional relief rules are complex and whether or not a fund should elect to apply the relief will depend on the fund's circumstances.

For a more detailed analysis of the CGT relief provisions please see the FirstTech fact sheet on the superannuation reforms and capital gains tax relief.[20]

Payments from income streams clarified

Since the release of Tax Ruling TR 2013/5, there has been some inconsistency between how a payment from a pension is treated for superannuation and tax purposes.

19 Assumptions – earnings: income and realised capital gains 4%pa, unrealised capital gains 4%pa, net income requirement $60,853pa, under the TTR strategy in 2016–17, total concessional contributions $35,000. In 2017–18, he salary sacrifices $17,400 and makes non-concessional $6,264. Total concessional contributions $25,000pa.

20 9 November 2016 (referred to as the start date) is the date the bill implementing these reforms was introduced into the Federal Parliament.

21 Where the fund uses the unsegregated method, the acquisition date for the CGT discounting rules will be reset to 1 July 2017 for the relevant assets. Alternatively, where the fund uses the segregated assets method, the acquisition date for the CGT discounting rules will be reset to the date the relevant assets ceased to be segregated current pension assets.

22 At the time of writing (early December 2016) this is not yet available.

From 1 July 2017, the treatment of pension payments and partial commutations has been clarified for a range of purposes as follows[23]:

	Pension payments	Partial commutation (cashed out)
Counts towards ABP minimum payment?	Yes	No
Tax treatment	Income stream benefit	Lump sum
Exempt pension income for assets supporting payment (assuming retirement phase)	Yes	Yes
Debit from transfer balance account?	No	Yes

FirstTech comment

The removal of the ability to make an election under Tax Regulation 995-1.03 to tax pension payments as lump sums, clarifies the current uncertainty as to whether clients under age 60 can use this election to reduce tax on TTR income stream payments. Once the new rules are in place, only pension payments will meet the minimum annual payment requirement and they will be taxed as income stream payments, not lump sums.

The treatment of pension payments under the transfer balance account provides a strategy opportunity. Pension payments do not debit the client's transfer balance account while partial commutations are a debit, therefore clients who have used up their personal transfer balance cap may wish to ensure that any payments above the minimum from an account based pension are taken as partial commutations. This would, over time, reduce their transfer balance account and allow further superannuation savings to be moved to retirement phase.

23 Note: depending on the timing of the registration of the relevant amending regulations, these changes may apply as early as 1 January 2017.

Other superannuation reforms

Small funds prohibited from using segregated assets method in some situations

From 1 July 2017 SMSFs and small APRA funds will be prohibited from using the segregated assets method where:

- During the year, there is at least one retirement phase interest in the fund (eg, an account based pension), and
- Just prior to the start of the year, a particular member of the SMSF:
  - has a total superannuation balance of more than $1.6 million, and
  - is receiving a retirement phase income stream (from any fund).

The Government has also announced it will make regulations to remove the requirement for SMSFs paying account based income streams to obtain actuarial certificates. At this stage no further detail has been provided.

Low income super tax offset

The low income super contribution has been abolished from 1 July 2017. From that date, it has been replaced by a low income superannuation tax offset, which essentially continues the same concession.

The low income superannuation tax offset seeks to return the tax paid on concessional contributions, if the individual is a low income earner with adjusted taxable income of $37,000 or less.

The low income superannuation tax offset provides for a Government contribution of 15% of the first $3,333 of concessional contributions (up to $500) made by an eligible client.

FirstTech comment

The original Federal Budget proposal was for the low income super tax offset to be paid as a non-refundable tax offset. However in the final legislation, the payment is not paid as a tax offset, but rather uses a similar payment method as the original low income superannuation contribution.

Anti-detriment payment abolished

Under the current rules, where a lump sum death benefit is paid to a spouse, former spouse, or child, the fund may increase the death benefit by paying an anti-detriment payment.

This payment can be calculated in a number of ways, but is often equal to 17.65% of the deceased client's taxable component.

Under the changes, superannuation funds will no longer be able to pay anti-detriment payments where the deceased died on or after 1 July 2017.

Where a member died prior to 1 July 2017, a fund can still pay an anti-detriment payment on or after 1 July 2017, so long as its paid prior to 1 July 2019.

FirstTech comment

This change means that re-contribution strategies will no longer adversely impact beneficiaries that would have qualified as eligible beneficiaries for an anti-detriment payment.

Earnings tax exemption extended to deferred income stream products

Under the current rules, a superannuation income stream qualifies for tax free earnings if it is currently paying income stream payments.

However from 1 July 2017, the earnings tax exemption will be extended to deferred superannuation income streams (including guaranteed annuities and group self-annuities) that commence paying income stream payments at a later time.

Deferred superannuation income streams will be defined separately in Regulations yet to be made.

For a deferred superannuation income stream to qualify for an earnings tax exemption, it must be held by someone who has already satisfied one of the following conditions of release:

- Retirement
- Reaching age 65
- Terminal medical condition
- Permanent incapacity

Example 26

Peter purchases a deferred pension from the age of 55 that pays an income stream from the age of 80.

The earnings tax exemption will apply from the date Peter satisfies a condition of release such as retirement or attaining the age of 65.

FirstTech comment

At this stage, it is unknown how deferred income streams will be assessed for social security purposes. The Government has said it will consult on how these new products are treated under the Age Pension means test.

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