TECHNICAL NEWS
Latest changes and insights
FOR ADVISER USE ONLY. NOT FOR PUBLIC DISTRIBUTION

Federal Budget super changes

3 May 2016

The 2016 Federal Budget contained a range of measures that, if legislated, will impact your clients' retirement savings plans and your advice.

Note: Unless stated otherwise, these changes have a proposed start date of 1 July 2017, but may not be made law.

CC cap

The measure

The concessional contribution (CC) cap will be reduced to $25,000 pa regardless of age. The higher cap that currently applies to individuals aged 49 or over on 30 June of the previous financial year, will no longer apply.

The drop in the cap to $25,000 will limit the contributions that attract concessional tax treatment and may limit the amount of additional voluntary employer contributions, personal deductible contributions and salary sacrifice.

The CC caps for 2015/16 are:

Age	Annual cap amount
48 or under on 30 June 2015	$30,000
49 or over on 30 June 2015	$35,000

This measure will be broadened to capture certain members of unfunded defined benefit schemes and constitutionally protected funds.

Table of contents

Opportunities, impacts and actions

Clients who have the capacity to fully utilise the current CC cap for 2015/16 and 2016/17 may wish to consider doing so before the CC cap reduces.

There may be a need to reconsider a client's existing transition to retirement strategy to avoid breaching the CC cap – see page 3.

Clients currently maximising the higher cap will need to reconsider their contribution strategy.

The 'maximum contribution base' determines the minimum superannuation contributions support that employers must provide their employees as 'SG' on a quarterly basis.

When the reduced CC cap takes effect, there will be limited scope to make additional CCs for clients that earn close to or above the maximum contribution base.

The introduction of the 'catch up' regime (see below) may, however, provide an increased capacity for some to make additional CCs.

Catch-up CCs

The measure

Individuals will be able to make CCs above the annual cap, where they have not fully utilised their CC cap in previous financial years.

Amounts are carried forward on a five year rolling basis. The new regime will only apply to unused amounts from 1 July 2017.

This measure is limited to individuals with a super balance of less than $500,000.

Opportunities, impacts and actions

These changes will allow individuals to make additional or 'catch-up' contributions, assuming they have financial capacity.

These opportunities may arise due to broken work patterns as a result of maternity or paternity leave, or a focus on other financial priorities in earlier years, which result in unused cap amounts.

When considered in light of the proposals that allow individuals aged under 75 to claim deductions for personal contributions regardless of employment status (see below), this new measure may also provide a timing and forward planning strategic advantage.

The timing of contributions can be planned, allowing for larger deductible contributions to be made in years of higher income (eg realisation of capital gains or higher income from distributions from trusts or other passively earned income).

Extra 15% contributions tax

The measure

The income threshold above which an additional 15% tax is payable on CCs will be reduced from $300,000 to $250,000.

The lower threshold will also apply to members of defined benefit schemes and constitutionally protected funds covered by the tax. Existing exemptions that currently apply (in respect of Judges and certain State office holders) will be maintained.

CCs made within the caps, such as employer contributions, salary sacrifice contributions or personal contributions for which a personal tax deduction is claimed, are ordinarily taxed at 15% in superannuation.

However, since 1 July 2012, certain high income earners have also incurred an additional 15% tax on CCs. This is commonly referred to as 'Division 293 tax'.

The additional tax is levied on the individual personally. It can be paid out of the client's cash reserves or by completing a release authority to have an amount released from their super fund.

Opportunities, impacts and actions

There is generally little scope to reduce a client's liability for Division 293 tax. As 'income' for this purpose includes CCs made within the cap, making personal CCs (such as salary sacrifice contributions or by claiming deductions for personal contributions) may not be helpful.

If your client will have income[1] in excess of $250,000 in the 2017/18 financial year, there may be an opportunity to discuss these changes with them. This is so that when they receive communication from the ATO in relation to their liability for this tax, they have some understanding of what it is and why they have received the notice.

Work test abolished

The measure

Currently an individual who is aged 65 or over at the time a contribution is made, must have satisfied a work test in that financial year, for a fund to be able to accept a contribution. This work test will be abolished.

The ability to make spouse contributions will also be extended to age 74. Again, no work test will be required to be satisfied by the receiving spouse.

Currently, spouse contributions cannot be made for individuals aged 70 or over and the work test must be satisfied from age 65 to 69.

It's unclear whether this measure will impact 'contributions splitting' arrangements between spouses, specifically where the receiving spouse has reached preservation age and has retired.

Currently, these individuals cannot receive contribution splits. Legislation requires that such individuals have not 'retired' rather than requiring them to have met a 'work test', so it may be the case that current rules relating to these arrangements will be unchanged.

Opportunities, impacts and actions

This change obviously provides greater opportunities to make super contributions for older clients.

For example (subject to the lifetime NCC cap – see page 4), it may now provide older clients who are downsizing the ability to contribute sale proceeds in to super.

It will also provide individuals aged over 65 the ability to make contributions to super under the CGT Cap. Currently they would be unable to do so if a work test had not been met.

This may be of particular benefit when sale proceeds are lagged.

Personal deductible contributions

The measure

All individuals under age 75 will be able to claim a tax deduction for personal superannuation contributions, regardless of employment status.

Currently only self-employed individuals (eg sole traders) or those who derive less than 10% of total income from employment sources, are eligible to claim a tax deduction.

The steps to claiming a deduction will not change, such as the rules that relate to the lodging the Notice of Intent form.

Opportunities, impacts and actions

Care should be taken to avoid breaching the CC cap which will be lowered to $25,000.

On the other hand, there may be an opportunity for certain individuals who do not utilise their annual CC cap in full from 1 July 2017 to make additional 'catch-up'.

This may provide a planning advantage whereby larger deductible contributions may be made in years of higher income.

Pension 'transfer balance cap'

The measure

A $1.6 million lifetime 'transfer cap balance' will be introduced for superannuation pensions. The cap will limit the total amount that a person can use to start pensions in their lifetime.

Earnings on the amount in pension phase within the cap will not be restricted and will continue to be taxed at 0%.

Amounts accumulated in super in excess of $1.6 million will remain in accumulation phase and continue to have earnings taxed at the concessional rate 15%.

Individuals already in pension phase with balances above $1.6 million will be required to reduce their aggregate pension account balances to no more than $1.6 million by 1 July 2017. There is no grandfathering of existing pensions.

Tax penalties will apply if amounts are transferred in excess of the $1.6 million cap (including penalty tax to earnings on the excess transferred).

While the exact nature of this penalty tax is unclear, it is proposed to be similar to the tax that applies when there is a breach of the NCC cap under the current rules.

Currently the excess NCC and associated earnings are taxed at the person's marginal tax rate if an election is not made to withdraw the excess (and associated earnings) from superannuation.

It's unclear what impact, if any, death benefit pensions will have on an individual's $1.6m transfer cap.

Currently 100% of the amount accumulated in superannuation during a person's lifetime can be used to commence a pension once a condition of release has been met.

Opportunities, impacts and actions

Super continues to be a tax effective structure as earnings are taxed at 15% compared to a client's marginal tax rate. Clients are still able to make lump sum withdrawals.

Transition to retirement

The measure

Once an individual reaches their preservation age, they are able to access their preserved superannuation as a 'non-commutable income stream', known as a transition to retirement (TTR) pension. Currently earnings on any amounts in pension phase are taxed at 0%.

From 1 July 2017, the tax on earnings will increase to 15% while the income stream is deemed to be a TTR pension.

It's unclear whether the 0% tax on earnings will apply once a full condition of release has been satisfied or the pension must stop and a new pension commenced (subject to the transfer cap balance).

The ability for individuals to treat certain pension payments as a lump sum will be abolished. This follows recent industry discussion and ATO commentary that indicates an ability to elect for pension payments to be taxed as lump sums and access the $195,000 'low rate cap'.

Opportunities, impacts and actions

Advisers will need to revisit TTR strategies in light of the:

- taxation of earnings
- introduction of the transfer balance cap, and
- reduction in the CC cap.

Some existing TTR clients may want to unwind the arrangement. Also, the measures may reduce the future opportunity set for this strategy. We will explore these issues further and provide additional insights shortly.

NCC changes

The measure

A lifetime non-concessional contribution (NCC) cap of $500,000 will apply to Australians up to age 74 from 7.30pm, 3 May 2016.

All NCCs made on or after 1 July 2007 will count towards a person's lifetime NCC cap. This effectively means that for many clients they may not be able to make further NCCs after the Budget announcement.

These measures will replace the annual NCC cap, which is currently $180,000, as well as the 'bring-forward' rule, which allows individuals aged under 65 on 1 July of a financial year to potentially contribute up to $540,000.

These measures will decouple the NCC cap from being a multiple of the CC cap. This lifetime NCC cap will be indexed to AWOTE.

Any contributions above the $500,000 cap made after commencement, as well as assumed earnings on these amounts, will be subject to penalty tax if they are not withdrawn.

NCCs made prior to commencement cannot result in an excess. However, a person who has already contributed greater than their lifetime cap will not be able to make subsequent NCCs without attracting penalty tax.

The lifetime cap will include NCCs made into defined benefit accounts and constitutionally protected funds.

If a member of a defined benefit fund exceeds their lifetime cap, ongoing contributions may continue, however, on an annual basis the person must remove an equivalent amount, including earnings on such amounts, from any accumulation account they hold. The contributions made to the defined benefit fund do not need to be removed.

It's unclear whether there will be any changes to the interplay that exists between the excess CCs regime and the 'flow-over' effect this can have on a person.

Opportunities, impacts and actions

As the lifetime NCC cap includes NCCs made since 1 July 2007, it may prevent some clients from making additional contributions. This would include clients who have undertaken the recontribution strategy.

This also means that any future recontribution strategy must be carefully considered before implementation. Any unimplemented advice to undertake a recontribution strategy will need to be reviewed and revisited.

Anti-detriment payments

The measure

Anti-detriment provisions will be abolished. An anti-detriment payment is an additional amount that may be included in a lump sum death benefit paid to eligible beneficiaries (typically a spouse or child).

It represents a refund of contributions tax paid by the deceased member over their lifetime. Currently, it is voluntary for a fund to make these payments and it is generally quite difficult for self-managed super funds to make anti-detriment payments, due to funding limitations and other issues.

The taxation of death benefits will remain unchanged and will therefore continue to be paid tax free to tax dependants and taxable to non-tax dependants.

However, the removal of the anti-detriment provisions will remove the often significant incentive for superannuation death benefits to be received as a lump sum rather than an income stream.

Opportunities, impacts and actions

There is arguably nothing that can be done to affect a more favourable outcome in relation to this measure, outside of ensuring that if a death benefit is/becomes payable in respect of a client this financial year, and a lump sum is the more appropriate option, that action is taken to ensure that the lump sum death benefit is paid prior to 1 July 2017, to maximise the lump sum death benefit payable.

The changes will however remove the existing consideration of 're-contribution strategy vs. anti-detriment', and will create a more even playing field between self-managed super funds, retail funds, and industry funds in respect of death benefit options.

Contact details

For further information, please contact MLC Technical Services on **1800 645 597.**