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MARCH 2017 SMSF NEWSLETTER

The changes to superannuation that will take effect from 1 July, 2017 are the most significant changes in a decade. It is for this reason our annual newsletter is being released early. There are changes in both Concessional & Non-concessional contributions, Pensions, Transition to Retirement Income Streams and Capital Gains Tax concessions. They may relate to either Income Tax or Superannuation legislation. Some will only affect members with significant holdings, others will have an impact on many funds. Many are quite complex. Some changes will require action before 30 June 2017, others will only impact after that date. This newsletter is only a general guide. Each super fund's situation will be unique.

NEW TERMINOLOGY

Total Super Balance (TSB)

This is a new concept that will be encountered in managing super. Referred to as TSB, it will have an impact on several areas within super. It combines the balances of all an individual's superannuation funds, but is more complex than a simple adding of the numbers. Refer to ATO guide LCG 2016/D12. It combines:

- The combined accumulation phase superannuation interest of the individual. This includes deferred superannuation income streams and transition to retirement income streams;
- The Transfer Balance Account (to be explained later), modified to reflect the current value of an account based income stream, but disregards amounts attributed to personal injury contributions;
- All rollovers that are in transit between super funds.

While all assets must be reported at market value as at 30 June each year, that value has generally had minimal impact except for the calculation of minimum pension payment amounts. The value of assets will now also affect the TSB, which will be used in several areas. I suspect these values will come under greater scrutiny by the ATO. While this is applicable to all asset classes, it is particularly relevant where the fund holds real property, unlisted investments and/or collectibles, as these classes can be more difficult to value.

Transfer Balance Cap (TBC)

Within this area, there will be the General TBC (GTBC) and Personal TBC (PTBC). Refer to the ATO guides LCGs 2016/8, 2016/9 & 2017/D3.

The GTBC is the generic limit of reasonable benefits. It will be $1.6 million from 1 July 2017 and will be indexed in $100K increments.

The PTBC is the adjusted amount applicable to an individual. An individual's PTBC may be different from the GTBC. As an example, where an individual has commenced a pension, the PTBC will be the unused portion of the TBC.

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When the GTBC is increased, because of the indexation, the PTBC will increase proportionally. For example, if the commencement value of a pension (or 1 July 2017 value of an existing pension) was say $1.2 million, the PTBC is $400,000. That is 25% of the GTBC. When indexation increase occurs, the PTBC will only increase by 25% of the GTBC increase. In addition, the percentage is calculated when an individual's TBA (see next) is at its highest in any previous period.

Transfer Balance A/c (TBA)

The Transfer Balance Account (TBA) is a specific measure of an individual's PTBC, to be administered by the ATO. The balance will move because of a range of credits and debits to the TBA.

Credits will include:

- Pension account balance at 1 July 2017;
- New pensions commenced after that date;
- Notional earnings on 'excess' pension balances;
- Reversionary pension values at Date of Death;
- Death Benefit Pensions values at date of death. It should also be noted that Death Benefit Pensions will now be able to be rolled over to another super fund.

Debits will include:

- Full or part commutations of a pension account;
- Family Law payment split – when the ATO is advised;
- Transactions void under Bankruptcy – when ATO is advised;
- A structured settlement contribution & pension from personal injury matters;
- A reduction in member balance due to a fraud, where the offender is convicted and the ATO is advised.

Other matters that relate to an individual's TBA are:

- Investment gains and losses will not effect an individual's TBA, but the Government says it may reassess this in the event of a macro-economic event like the GFC;
- TRIS pensions do not count towards the TBA. This means the change from a TRIS to a 'full' pension when a condition of release has been met is important.
- Special rules apply for death benefit child pensions. This may depend on whether the TBA had been accessed or not. There may be access to 2 TBAs.

Excess TBC Tax

An excess TBC is the amount by which an individual commences a pension that exceeds their PTBC, or where an individual's pensions exceed $1.6 million on 1 July 2017. This will be further detailed later in this newsletter.

CONCESSIONAL CONTRIBUTIONS

Currently the cap for Concessional Contributions is $30,000 for people aged below 49-years and $35,000 for those above that age. From 1 July, 2017, the cap will be $25,000 for everyone. This cap will continue to be indexed, like at present, in accordance with AWOTE, but will now be adjusted in $2,500 increments.

Another change in this area will affect those contributing to "Constitutionally Protected Funds", mainly Federal and State government employee funds.

These contributions have historically not counted towards the Concessional Contributions Cap, but will do so from 1 July 2017. While these funds will still be exempt from incurring Excess Contributions Tax, they will impact on anyone who also makes Concessional Contributions to other funds as the cap may be partially or fully utilised. Refer to ATO LCG 2016/11

If a fund makes use of contribution reserves, that the cap is applied when the contribution is allocated to the member. If a contribution is made in June 2017 but not allocated to the member until July, the new, lower cap will apply.

<u>The 10% employment income test in relation to claiming a tax deduction will cease from 1 July 2017.</u> Anyone can claim a tax deduction for contributions. All the 'intent to claim a deduction rules' still apply. The notice must be lodged by the member with the trustee before any roll-over is effected, before any pension is commenced and before their personal income tax return is lodged.

In the 2016 Federal Budget, it was proposed to remove the 'work-test' for individuals aged between 65 and 74. This has been removed from the legislative changes, so the 'work-test continues.

While the changes include the allowance of 'catch-up' contributions, where a prior year's limit was not fully used, it does not commence until 1 July 2018 and does not allow for using any unused cap before that date, so will have no effect until the 2019/20 financial year.

DIV. 293 TAX

This is the tax payable by high income earners on concessional contributions where their adjusted income exceeds the nominated threshold. The only change is the reduction in the threshold from $300K to $250K.

NON-CONCESSIONAL CONTRIBUTIONS

The Non-Concessional Contributions (NCC) cap will reduce on 1 July 2017 from the current $180,000 per year to $100,000 per year. The current 3-year bring-forward rules will still be available, so it is still possible for an individual to contribute up to $540,000 until 30 June 2017 (subject to any existing use of the bring-forward rule). If the bring-forward rule is activated after 30 June 2017, the maximum will be $300,000. Individuals will need to be vigilant where the bring-forward rule was activated in the 2016 or 2017 years, but not fully utilised. As an example, where a NCC of $220,000 was made in the 2017 year, thus activating the bring-forward rule, the available balance for 2018 and 2019 combined would be $160,000 ($180,000 + $100,000 + $100,000 - $220,000).

The ability to make any NCCs will also be controlled by an individual's TSB. No NCCs can be made after 30 June 2017 where the TSB exceeds $1.6 million as at the end of the preceding year. This will include fund expenses paid by a member and treated as a NCC. In addition, the TSB balance may impact the use of the bring-forward rule. Where the TSB is below $1.4 million, the individual can use 3-years. For a TSB between $1.4 and $1.5 million, 2-years. The bring-forward rule cannot be used where the TSB exceeds $1.5 million.

Currently, where a fund receives a single NCC in excess of the member's cap, the fund is able to reject and refund the excess under SISR 7.04(3). It is proposed to repeal that regulation, effective 1 July 2017. The same rules then will apply as do currently when the NCC is exceeded by a series of contributions each under the NCC.

There are a number of areas that are exempt from the NCC limit changes. These include Government co-contributions, proceeds from the settlement from an injury resulting in a permanent disability as well as proceeds from the disposal of a small business, where it qualifies for CGT exemption. In relation to the small business CGT area, ongoing discussion about changes to CGT concessions means 'watch this space'.

SPOUSE CONTRIBUTIONS

While the contribution limit and rebate values have not changed, the spouse income threshold has been increased to $37,000.

LISC = LISTO

The name has changed from 'Low Income Super Contribution' to 'Low Income Super Tax Offset'. The income threshold is still $37,000, it is still 15% of contributions and still has a maximum of $500.

PENSION BALANCE CAP

1 July 2017 will see the introduction of a balance cap for pensions equal to an individual's PTBC. For the 2017/18 year, the PTBC will be $1.6 million. Where an individual has an existing pension above $1.6 million, the excess must be commuted into an accumulation account prior to the start of the year.

As the value of an individual's pension account may not be known as at 30 June 2017, a suggested solution, where an individual's pension account will exceed $1.6 million or there is a risk that it may occur, could be for the individual to request the trustee, prior to 30 June 2017 and in writing, to commute, on 30 June 2017, the amount by which the pension account (or sum of all pension accounts) exceeds $1.6 million. The trustee should acknowledge the request in a trustee minute and in writing to the member. Bear in mind that the $1.6 million is the sum of all pension accounts, either within the same SMSF or in another super fund, so be aware of the total situation.

Where an individual's TBC does exceed $1.6 million on 1 July, 2017, transitional rules apply where the excess is below $100,000. In such a situation, there will be no liability for any tax where the situation is resolved before 31 December 2017. The ATO must be advised of the rectification.

Other than the transitional provision above, where an Excess TBC occurs on or after 1 July, 2017, the fund will receive a direction for commutation from the ATO. The commutation direction will equal the excess amount plus notional earnings up to the date of the ATO notice.

Notional earnings will be calculated from the date of the excess up to the date of the rectification at the GIC rate. The notional earnings will be subject to Excess TBC Tax The assessment will be issued by the ATO once the notice of rectification has been received. The tax will be assessed to the member personally, not to the fund.

As an example, if an individual with no existing pension as at 1 July 2017 commences a pension of $1 million on 1 August 2017. There is no excess. If the individual commences a second pension, say on 1 October 2017 (whether in the same fund or another), for $800,000, the combined pension commencement amounts would total $1.8 million. The excess TBC would be $200,000.

Where a fund fails to comply with an ATO Commutation Direction, the fund may not be eligible for Exempt Current Pension Income (ECPI).

It must also be noted that SMSFs & SAFs will not be able to use the segregated assets method to calculate the ECPI where the total super balance exceeds $1.6 million.

Where an individual has either a Defined Benefits Pension (DBP) or a Market Linked Pension (MLP), special rules apply. For a DBF, the TBA will be the annual income entitlement multiplied by 16 (TBA = Income x 16). For a MLP, it will be annual entitlement to income multiplied by the remaining term of the pension. If the MLP has say 5 years remaining, TBA = Income x 5). In both cases, where the TBA exceeds $1.6 million, the excess is written off and there will be no Excess TBS Tax for that pension, but it will leave no balance for any other pension. Refer to ATO LCGs 2016/D10 and 2017/D1.

Furthermore, in relation to both DBPs and MLPs, where the pension exceeds $100,000, there will be additional tax payable on the excess above that amount, or if from an untaxed source, the tax off-set will be modified. These funds may now need to register for PAYG Withholding, even if no tax is payable.

POOLED V SEGREGATED ASSETS

It is generally known that where all assets are linked to a specific account, they are segregated assets. It does not stop there. Pooled assets can only occur when the asset is apportioned between both pension accounts and accumulation accounts. Where a fund has only pension or only accumulation accounts, the assets are not pooled. They are segregated. It is simply that the other class of account, pension or accumulation, has a nil balance. Pooled assets can occur whether the Accumulation and Pension accounts are held by the same member or different members. If a SMSF was a segregated fund as at 30 June 2017, but has a member who has exceeded the $1.6 million cap, assets will become pooled assets when the excess is reverted to Accumulation mode.
Actuarial certificates will be required in future years.

OTHER PENSION CHANGES

Effective from 1 July, 2017, a Transition to Retirement Income Stream (TRIS) will no longer be eligible for ECPI concessions. This will mean that all income earned by the TRIS will be taxed at 15%. There is no change to the personal tax treatment of pension income by the member, so the pension income will still be tax-free to individuals over 60-years in their personal tax returns.

Historically, it was possible in some circumstances to treat a lump-sum payment from a super fund as a pension payment within the fund.

This was beneficial to individuals under 60. It helped meet minimum pension requirements while being a tax-free payment under the lifetime lump-sum threshold. No longer will pension payments be able to be treated as lump-sum payments.

Similarly, where an individual commuted part of a pension and the commutation was paid out by the fund (excluding a roll-over), that payment was a lump-sum, but counted towards meeting a minimum pension requirement. From 1 July 2017, such a commutation will not count towards meeting the minimum pension requirements. It must be noted that any in-specie transfer of an asset to a member is a commutation and lump-sum withdrawal. The effect is that all pensions must now be paid in cash.

CGT CONCESSIONS

Because of the changes that are detailed above, superannuation funds may now have assets that will be subject to capital gains where those assets were previously exempt. A concession will apply to funds with pension accounts greater than $1.6 million and to all TRIS as at 30 June 2017. Refer to ATO Guidance statement LCG 2016/8.

The concession is designed to avoid 'wash sales' to increase the cost bases of assets. Trustees can elect to re-set cost bases to market value, where the fund must move part from pension to accumulation because of the changes, or if the pension is a TRIS. The asset will also be deemed to have been acquired at that date and will need to held for a further 12 months to be eligible for a CGT discount.

To be eligible for this concession, the asset must have been held at the time the legislation was introduced into Parliament, 9 November, 2016. The concession can be applied on an asset to asset basis and even a parcel to parcel basis. It need not be applied to all assets.

Where the eligible fund has segregated assets (100% in pension phase), they will become pooled assets.

Where the fund already has pooled assets because the fund has both pension and accumulation accounts before the re-set, the asset is deemed to be sold as at 30 June 2017. The fund must then calculate the Notional Capital Gain on the asset. It can elect to include the taxable portion of the gain in the 2017 income or elect to defer that gain until the asset is actually sold. The tax on the gain will then be payable. The notional gain is not included in the ECPI calculation.

Example – A pooled fund has a value of $3 million as at 30 June 2017, consisting of a pension account (PA) of $2 million and an accumulation account (AA) of $1 million. $400,000 of the PA is commuted back to the AA. They are for different members.

Included in the fund is an asset (held for > 12 months) with a cost base of $70,000 and a market value of $100,000. The trustees elect to use the CGT concession. The gain is $30,000 of which $10,000 is attributed to the AA so is taxable. The tax on the gain would be $1,000 ($10,000 less 33.3% discount @ 15%). The trustees can either pay that tax now, or pay it when the asset is sold. It will still be payable even if that account converts to a pension.

Trustees who are eligible for the CGT concessions will have a number of decisions to make before 30 June 2017. For each asset, do they elect to revalue and do they elect to defer any tax liability. The decisions will vary depending on the current and estimated future situations of the fund. Every scenario needs to be considered on its own merit.

Trustees need to be aware that if any cost bases are re-set, plus if any tax liability for a notional gain is deferred, an ATO election form must be prepared and submitted. Elections are non-revokable and are expected to be a part of the Annual return.