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IOOF: Second tranche of draft super reforms released – remaining matters

Treasury has released the second tranche of exposure draft legislative and regulative amendments to implemenet their proposed budget measures.

Our Tech Alert dated 28 September addressed the changes proposed in point 1 below – the transfer balance cap. This Tech Alert addresses the Budget measures in points 2 to 6 below:

1. Implementing the $1.6m Transfer Balance Cap for commencing income streams from 1 July 2017
2. Concessional contribution changes
• Lowering of the concessional contributions cap to $25,000 effective 1 July 2017
• Implementing the "roll forward" for up to five years of a person's unused concessional contributions cap commencing from 1 July 2018
• Removal of the tax-exempt earnings on transition to retirement pensions from 1 July 2017
3. Removal of the anti-detriment payment from 1 July 2017
4. Lowering the Division 293 tax threshold (the additional 15% tax payable on concessional contributions for higher earners) from $300,000 to $250,000
5. Removal of the super lump sum tax election
6. Consequential amendment for SMSFs and SAFs

Concessional contributions changes

Lowering of the concessional contributions cap to $25,000 effective 1 July 2017

The draft legislation reduces the concessional contribution cap to $25,000 per annum effective 1 July 2017, in line with the Federal budget announcement from May. A positive change in this space is that the concessional contributions cap will now be indexed (to AWOTE) in $2,500 instalments, rather than $5,000.

With respect to contributions to constitutionally protected funds and unfunded defined benefit schemes, the draft Bill includes measures to ensure these contributions are considered concessional contributions – but importantly these contributions would be 'carved-out' for the purposes of excess concessional contributions. This is because these are contributions to untaxed schemes and the intention is for higher rates of tax to apply when benefits are paid from these schemes. This will mean existing members of constitutionally protected funds and unfunded defined benefit schemes will still be able to arrange to make salary sacrifice contributions in excess of the concessional contributions cap without these contributions being treated as excess concessional contributions. However, these contributions will count towards the concessional cap and they will not be able to make any additional concessional contributions to taxed schemes.

Implementing the 'roll forward' for up to five years

Additionally, the draft legislation introduces the ability to carry forward up to five years of unused concessional contributions cap for people whose accumulated superannuation balances, including monies in pensions, is less than $500,000 on 30 June of the previous financial year.

To calculate a person's total superannuation balances:

1. Add the value of all their accumulation interests based on their market value
2. plus the market value of any income stream with a market value (for example, account based pensions, term allocated pensions)
3. plus the value of other income streams based on their transfer balance account value
4. plus any rollovers in progress which are not captured by the above calculations.

The carry-forward is only triggered when a person has concessional contributions in excess of their annual limit, so contributions reduce the current year cap first, rather than always using the earliest accrued unused cap. Once the annual cap is triggered, the unused portions are used from the earliest year to the most recent year, and are only used to the extent they are required. The draft Bill also makes it clear that unused concessional contributions cap amounts until do not begin to accrue until the 2018/19 financial year.

As a consequence to these changes an amendment to the Super Guarantee maximum contributions base has been introduced. This amendment ensures that different indexation methods applying to concessional contributions cap and the maximum contributions base would not result in mandatory Superannuation Guarantee contributions being equal to the concessional contributions cap. While the current maximum contributions base will remain in place, this measure will automatically adjust the maximum contributions base in relation to an individual to prevent mandatory Superannuation Guarantee contributions creating excess contributions.

Removal of the tax-exempt earnings on transition to retirement pensions

As previously announced, the Exempt Current Pension Income (ECPI) treatment of earnings on transition to retirement pensions has been removed. This has been done by re-defining the criteria for the pension tax concession. Generally, under present arrangements any earnings in relation to capital that has been set aside to meet pension liabilities is exempt from tax. Going forward, this definition is changing such that the earnings concession is only available to 'retirement phase' super income streams. Generally a super income stream will be considered as being in retirement phase if an income stream benefit is payable – however there is an explicit statement that an income stream is not in retirement phase if it is a transition to retirement income stream.

These changes do not impact the tax treatment of transition to retirement pension income in the hands of the recipient. These continue to be taxed under the usual superannuation income stream rules, that is, over age 60 payments from a transition to retirement pension remain non-assessable non-exempt income.

It is also important to note that this definition of 'retirement phase' not only excludes transition to retirement pensions from the exemption on tax, but also excludes them from inclusion in the transfer balance cap for an individual – as a transfer balance credit is only for income streams started in retirement phase.

Removal of Anti-detriment payments

As announced in the 2016 Federal budget, the anti-detriment payment is to be removed for people who pass away after 1 July 2017. For people who pass away before this date, they may still qualify for anti-detriment payment on a super lump sum death benefit if paid before 1 July 2019 – giving super trustees and members a small window to finalise death benefit claims for those who pass away before the end of the current financial year.

The tax treatment of death benefits has not otherwise changed.

Lowering the Division 293 tax changes

In line with the Federal budget proposal, the threshold under which Division 293 tax will be payable will be lowered to $250,000 effective 1 July 2017. The existing operation of this tax will continue as per currently legislated, there will simply be a higher number of people impacted.

Removal of super lump sum tax election

Under existing law there is a technical ambiguity which allows people to elect for payments from a non-commutable account-based pension (otherwise known as a transition to retirement pension) to be taxed as lump sums. This is despite the pension benefit being completely preserved. This election enabled certain people access to the low rate cap, reducing tax payable on these income stream benefits.

The amendments remove the ability to elect for a superannuation pension to be treated as a lump sum. Going forward, pension payments will be taxed as an income stream benefit and superannuation lump sums can only be paid as per the existing definition – which has also been clarified to ensure that a payment from a superannuation income stream that is a partial commutation should be treated as a superannuation lump sum.

Consequential amendment for SMSFs and SAFs

The Government has proposed removing the ability for SMSFs and SAFs to use the 'segregated method' of fund earning accounting, where a single member has total superannuation benefits over the transfer balance cap, and that member is in retirement phase. This is regardless whether the trustee would have the ability to maintain segregated assets without issue (ie the fund is invested in assets that can be discretely divided between the pension and accumulation interest). These funds will be required to use the unsegregated method for calculating their exempt current pension income (ECPI) – the portion of fund earnings which is not subject to tax.

Conclusion

Largely these changes are an implementation of announcements from the 2016 Federal budget, however there are many interesting points to be found by looking at the detail. We will continue provide updates as we follow the progress of these amendments through parliament.