Nov 29 2016 at 11:00 PM | Updated Nov 29 2016 at 11:00 PM

Get a head start on the complex new super world

The new super rules are set to make life complicated for superannuants with larger accounts. **Illustration: Karl Hilzinger**

by **Sally Patten**

At first brush, the superannuation reform package, which passed through the Parliament last week, seems straightforward enough. What could be difficult about a $1.6 million ceiling on the amount of money that can be held in a tax-free private pension? Or lowering the income threshold at which the higher 30 per cent contributions tax is levied to $250,000 from $300,000? Or reducing the level of money that can be injected into super each year on an after-tax basis to $100,000 from $180,000?

It is true that some of the new rules will simply require superannuants to adjust their savings habits, or accept the fact that they will be paying more in tax after July 1 next year.

But other savers will find that the brave new super world is highly complex. Individuals have seven months to absorb the new rules and their implications. This week Smart Investor provides a guide to some of the more complicated aspects to the super reforms in an effort to give readers a head start as they begin to rethink their financial affairs.

Transfer balance cap

Related articles

Retirees must now raise their investing game

Divorce costs you five years financially

The most significant change – and the measure likely to create the most headaches – is the imposition of a $1.6 million transfer balance cap on super pensions.

"This is a big change from how pensions worked in the past. It is a significant shift away from the current system. It will limit the amount you can accumulate, as well as put a limit on the amount you can get into a tax-free pension," says Josh Rundmann, technical services manager at financial services firm IOOF.

"You need to understand how it operates," he says.

Super death benefits

Among the items that will count towards the $1.6 million transfer balance cap is the value of death benefit pensions received from a spouse who has passed away. The effect of this is that far more people will be caught by the rules than might be expected.

As William Fettes, of DBA Lawyers, said in a recent note to clients: "This aspect will have a significant impact on the succession plans of all fund members who collectively with their spouse have more than $1.6 million in superannuation."

Under the rules, the surviving spouse who has more than $1.6 million in a private pension because of the death of a partner will be given 12 months to meet the transfer balance cap rules. This means that the surviving partner will need to think about the best way of splitting the assets between the pension and accumulation phases, where the latter will attract earnings tax of 15 per cent and capital gains tax of between 10 per cent and 15 per cent.

Segregation of assets

Self-managed super funds will no longer be allowed to segregate their assets for tax purposes. While they will be able to assign which assets they want to be held in a tax-free pension and which investments they would like to hold in an accumulation account, tax will be levied on a proportional basis across the fund. As a result, there is no gain to be had from, say, placing the fully franked shares into an accumulation account on the grounds that franking credits can be used to offset tax.

Likewise, in the case of do-it-yourself schemes, the fund as a whole must be able to meet the pension drawdown rules, rather than the pension account on its own. "It doesn't matter where the money is drawn down from," says Rundmann.

However, segregation of assets for tax purposes will be allowed for individuals whose super savings are on a platform, such as part of a retail super fund, rather than in a self-managed scheme. This could trigger questions about where is the best place to hold assets that are in the pension phase, particularly in cases where the tax savings from being able to split the assets are significant.

That said, shifting to a different model might not be straightforward. Retail platforms limit the types of assets that can be held in a fund, and are not an option for savers who hold direct property in the retirement schemes. Platforms that are overseen by an external trustee could limit the mix of assets that can be held and the fees may be higher. Furthermore, the shift may require starting a new pension, so the superannuant would potentially no longer be grandfathered from a series of pension changes that came into effect in January last year.

SMSF tax relief on a commercial property

What to do if your pension balance tops $1.6m

Super fix: your questions answered

Latest Stories

China's cheap airfares threaten Qantas
8 mins ago

Why Xi will struggle with his reforms
8 mins ago

'George Brandis is not going to London'
9 mins ago

More

Some advisers have suggested that a way of tackling the segregation rules could be to set up two separate self-managed funds, and placing a pension account in one and an accumulation account in the other. However, this would require the assets to be physically separated, the pension account would need to be able to meet the drawdown rules on its own and so the trustee would need to consider its liquidity position. There would be two sets of fees to pay. Still, for some it may be worth considering.

Capital gains tax

Super funds will be able to reset the cost base of assets that are reallocated from the retirement phase to the accumulation phase between November 9 and June 30, 2017.

The upside of this allowance is that any tax-free capital gains that have been locked in to date will be retained. Capital gains tax will be payable only on gains made after the reset base.

The downside is that it will be important to ensure that all assets are properly valued. Formal valuations are not required for assets, such as property, every year, but, says Naree Brooks, a partner at professional services firm PwC: "You may wish to get an external valuation." For self-managed funds, the way in which segregated and unsegregated assets will be treated for resetting purposes will be different, so Brooks recommends getting advice early. "You need to do a bit of preparation to understand your position," she says.

Proportional indexation

The $1.6 million balance transfer cap is to be indexed to consumer prices in lots of $100,000, but on a proportional rather than nominal basis. Under the fractional indexation system, for people who do not transfer the full $1.6 million into a super pension in the first instance, the percentage of the limit that they have not used will be indexed to CPI.

Let's look at an example. If a retiree transfers $1.2 million to a pension account in July next year, they will retain the right to contribute another $400,000, or 25 per cent of $1.6 million, at some future date. If by the time they contribute a second tranche the limit has risen to $1.7 million, they will be able to contribute $400,000, plus 25 per cent of the $100,000 incremental rise. In other words, they will be able to inject another $425,000 into a tax-free pension.

If in the meantime, the retiree has withdrawn $200,000 from their pension account, they will be able to contribute $625,000. In other words they will be able to contribute the $200,000 that was withdrawn, plus $400,000 of their unused cap and 25 per cent of the incremental rise.

Concessional contributions

From July next year the amount of pre-tax money that can be pumped each year into super will fall to $25,000. Self-managed super fund members can use a "contribution reserving strategy" to bring forward next year's pre-tax contribution into the current year and so utilise this year's higher contributions ceiling, says Nerida Cole of Dixon Advisory.

The strategy is most likely to suit people who are self-employed or who are supported by their own investment income. "This is a complex strategy and the SMSF is likely to need additional paperwork completed by the trustees to implement the strategy within the very strict provisions," says Cole, adding that the individual will be prohibited from making further concessional contributions into super in 2017-18.