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PERTH 23-25 NOV 2016

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# STRATEGIES FOR ACCESSING SUPER

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24th November 2016

# Session Outline

- New 1.6m pension cap
- Defined Benefit Income Streams
- Reversionary Pensions
- Transitional CGT Relief
- Segregation
- Transition to Retirement Income Streams

# Budget Measures

- 27 September 2016 exposure draft legislation and explanatory material released
- Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 introduced 9 November 2016
- Bill currently before the House of Representatives

# Budget Measures

- Legislation intends to limit earnings tax exemption by limiting the amount of capital that can be transferred to a pension by an individual
- If an individual exceeds their pension cap, the Commissioner will direct the super fund to commute (reduce) their pension interests down

# The Cap

- General transfer balance cap for the 2017/2018 financial year is $1,600,000
- Cap will be indexed with CPI in increments of $100,000
- Indexation amounts will be proportionate
- Proportionate indexation amount = Unused cap percentage x Indexation increase

# Example 1

- Ron on the 1st of July 2017 has an income stream valued at $1,000,000
- On the 30th of June 2018 Ron commutes $200,000 to pay out personal debt
- In 2020/21 the general transfer cap is indexed to $1,700,000. How much can Ron put into retirement phase in 2020/21?

# Example 1

- Proportional Index = $37,500
- ((1,600,000 - 1,000,000)/1,600,000) x 100,000
- Ron’s personal cap for 2020/2021 is $1,637,500.
- Ron’s transfer account balance for 2020/21 is $800,000.
- The additional amount that Ron can put into retirement phase is $837,500.

# Balance Transfer Cap

- Each individual will have a personal transfer balance cap reflecting the total amount they can transfer to the “retirement phase”
- An individual breaches their transfer balance cap if their transfer balance account exceeds their personal transfer balance cap.
- Notional earnings accrue on the excess balance and are credited to the balance

# Balance Transfer Cap Credits

- Value of all assets supporting pension liabilities at 30 June 2017
- Value of new pensions commenced from 1 July 2017
- Value of reversionary pensions (modified for children)
- Notional earnings that accrue on excess transfer balance amounts

# Balance Transfer Cap Debits

- Commutation in full or in part of an income stream
- Contribution in respect of a structured settlement or order for personal injury
- Loss which is a result of fraud or dishonesty
- Clawback of certain contributions under bankruptcy
- Payment split as a result of separation orders

# Balance Transfer Cap Strategy

- Losses or gains after pension start disregarded, would be good to allocate high growth assets, strategies for segregation discussed later
- Pension payments disregarded, all withdrawals beyond the pension minimums should be treated as lump sum/partial commutations assuming no other accumulation balances exist

# Example 2

- George is aged 60 and has a pension in retirement phase of 1.6m at 30 June 2017
- During the 2017 FY he draws 100k
- If whole 100k is treated as pension no impact on BTC
- If instead $64,000 treated as pension, excess treated as partial commutation, reduces the BTC by $36,000

# What Happens if You Breach the Cap?

- ATO directs SMSF to commute pension by amount of the excess including notional earnings on the excess
- Individual liable for excess transfer balance tax on their notional earnings
- The tax rate on notional earnings for ‘first time offenders’ is 15% goes up to 30% for subsequent breaches

# What Happens if You Breach the Cap?

- Notional earnings calculated at GIC rate (9.01% Sept 2016 quarter)
- Large differences between actual fund income and notional earnings might provide strategy benefit
- CGT relief discussed later would deal with most potential variances

# Process

- ITR or some other form of reporting alerts the ATO that the BTC has been breached
- Excess transfer balance determination (ETBD) and default commutation authority issues
- Objection if incorrect 60 days from ETBD
- Notification of subsequent transfer debits 60 days from ETBD
- Election to change fund/pension selected 60 days from ETBD
  - Allows individual to pick and choose which income streams are to be commuted

# Process

- Commutation authority issues after ETBD
  - Default commutation authority followed if no adjustment
  - The superannuation fund is required to reduce the selected pension(s) within 30 days of issue
  - Failure to comply will mean the income from assets supporting the offending pension will be taxed

# Transitional Rule

- Transfer balance cap breaches of less than $100,000 that occur on 30 June 2017 do not give rise to notional earnings or an excess transfer balance tax liability if they are rectified within 60 days
- Not much of a concession seeing as most SMSF's will not have their financials prepared by that date
  - some investment reports not available until October or November

# Defined Benefit Income Streams

- DBIS cannot create a excess transfer balance amount
- DBIS used to determine if other member pensions exceed the cap and for NCC rules
- Different valuation rules depending on the type of income stream
- Reduction of tax free earnings achieved by taxing pension payments beyond an income cap (defined benefit income cap)

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# Example 3

- Wally has at 30 June 2017 a market linked pension worth 1.2m and a special value of 1.2m
- On the 4th of June 2018 Wally acquires a $500,000 account based pension
- Wally now has an excess transfer balance of $100,000 which he will be forced to commute from his account based pension and will be subject to excess transfer balance tax on the notional earnings on this amount.

# Defined Benefit Income Streams

- For the 2017-18 financial year, the defined benefit income cap is $100,000
- Taxed defined benefit arrangements - half of any excess is included in the recipient's assessable income and taxed at the individual's marginal rates
- Untaxed defined benefit arrangements – 10% offset limited to the first $100,000 of benefit received

# Reversionary Pensions - Spouse

- Was six months, now 12 months period of grace
- Does not apply to pensions used to pay death benefits which weren't reversionary
- No ability to commute back to accumulation
- Reversionary life interests should be reviewed
- Cherry pick high taxable component pensions first

# Example 4

- Bill and Dawn have a 2m fund with 4 x 500k pensions
- Each have a 500k taxable and 500k exempt pension
- Bill dies Oct 17 his two pensions revert to Dawn
- Dawn now has 2m in pension
- 12 months to deal with this

# Example 4

- Goal 1 maximise exempt componentry in pension
- Goal 2 maximise amount that can be left in super
- How?
- Keep the reversionary pensions to avoid cashing out
- Commute 400k of Dawn’s taxable pension back to accumulation

# Example 4

| Balance | Jul-17 | Oct-17 | Oct-18 | Component |
|---|---|---|---|---|
| Bill ABP 1 | 500,000 | 0 | 0 | Taxable |
| Bill ABP 2 | 500,000 | 0 | 0 | Tax Free |
| Dawn ABP 1 | 500,000 | 500,000 | 100,000 | Taxable |
| Dawn ABP 2 | 500,000 | 500,000 | 500,000 | Tax Free |
| RABP 1 | 0 | 500,000 | 500,000 | Taxable |
| RABP 2 | 0 | 500,000 | 500,000 | Tax Free |
| Accum | 0 | 0 | 400,000 | Taxable |
| **Total** | **2,000,000** | **2,000,000** | **2,000,000** | |

# Reversionary Pensions - Children

- Child personal transfer balance cap is generally determined by reference to the value of the deceased's retirement phase assets that they receive
- The modified transfer balance account ceases when the income streams are exhausted or when the child is forced to commute at age 25 (unless they have a permanent disability)

# Example 5

- Emma dies on 6 June 2018 aged 55 with accumulation interests worth $2 million.
- Emma's two daughters Sana and Chloe are the sole beneficiaries of her superannuation interests.
- Emma has left instructions that her superannuation interests are to be shared equally between Sana and Chloe.

# Example 5

- As Emma has not yet retired, her beneficiaries are entitled to their proportion of the general transfer balance cap, expected to be $1.6 million in 2018.
- Sana and Chloe will each receive a transfer balance cap of $800,000 (50 per cent of the general transfer balance cap).
- The remaining $200,000 that each child receives would need to be taken as a lump sum and cashed out of the superannuation system.

# Transitional CGT Relief Rules

- Allows funds to reset the cost base on CGT assets that are moved or reapportioned from the retirement phase to the accumulation phase prior to 1 July 2017
- Segregated asset provisions simple, asset is reset by assuming it has been disposed of and reacquired.
  - No tax consequence, no carried forward notional gains, should be utilised as much as possible

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# Transitional CGT Relief Rules

- Proportional asset provisions are problematic
  - choosing the reset creates a notional gain that is attributable to the accumulation phase
  - gain will form part of the net gains for the year unless deferred
  - deferred gain added to net CGT on eventual disposal

# Transitional CGT Relief Rules

- Proportional asset provisions are problematic
  - if the asset is not disposed of with 10 years the cost base will revert to what it was
  - be careful about the election it's irrevocable
  - significant changes in circumstances may mean the election has harmful consequences

# Example 6

- Malcolm and Lucy have a 4m fund of which 50% is in pension for Malcolm and Lucy's balance is in accumulation
- The fund has cash of 1m and a 3m commercial property
- Property has been owned for 15 years cost base of 1m
- Malcolm chooses to use the proportional method
- 400k is dropped back into accum at 30 June 2017

# Example 6

- Unrealised gain on the fund assets is 2m
- 1/3 CGT discount means net gain is 1.33m
- Actuary exemption is 45%
- Notional gain 1.33m x 55% = 733k
- 5 years later disposal of the property for 4m
- 1m capital gain triggered (4m less new cost base of 3m)
- 733k deemed cap gain is crystallised

# Example 6

- Discount CGT 666k, Deemed CGT 733k
- Discount CGT picks up proportionate exemption
- Deemed CGT does not
- So if Lucy goes into pension fund is 70% exempt
- Assessable gain is 733k + (666k x 30%) = $933k
- No election gain (4m-1m) x 2/3 x 30% = 600k
- Election has cost the client $49,950

# Segregation

- SMSFs will not be able to use the segregated method to determine their earnings tax exemption for an income year if:
  - The fund has at a time during the income year, *at least one pension* (ie any member)
  - The fund has a person that has a *total superannuation balance* that exceeds $1.6 million; and
  - That person is the recipient of a superannuation income stream *from any fund*

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# Segregation Strategy

- Where there is high disparity between the yield of various SMSF assets consider using two SMSFs:
  - One in retirement phase, high yield assets, high tax free component
  - One in accumulation mode, low yield assets, high taxable component

# Example 7

| | SMSF | |
|---|---|---|
| | 30-Jun-18 | |
| | Yield | MV |
| Com Property | 10.00% | $3,000,000 |
| Term Deposit | 2.50% | $1,000,000 |
| Cash at Bank | 1.00% | $200,000 |
| Total Assets | | $4,200,000 |
| | | |
| Bill | ABP | $1,600,000 |
| Chloe | ABP | $1,600,000 |
| Bill | Accum | $500,000 |
| Chloe | Accum | $500,000 |
| **Total Equity** | | **$4,200,000** |

| | SMSF | |
|---|---|---|
| | 30-Jun-18 | |
| Income Tax | | |
| Earnings | | $327,000 |
| ECPI | 76% | $249,143 |
| TI | | $77,857 |
| **Gross Tax** | **15%** | **$11,679** |

# Example 7

| **30-Jun-18** | **SMSF 1** | | **SMSF 2** | |
|---|---|---|---|---|
| | Yield | MV | Yield | MV |
| Com Property | 10.00% | $3,000,000 | | |
| Term Deposit | 2.50% | $100,000 | 2.50% | $900,000 |
| Cash at Bank | 1.00% | $100,000 | 1.00% | $100,000 |
| Total Assets | | $3,200,000 | | $1,000,000 |
| Bill | ABP | $1,600,000 | Accum | $500,000 |
| Chloe | ABP | $1,600,000 | Accum | $500,000 |
| Total Equity | | $3,200,000 | | $1,000,000 |
| Income Tax | | | | |
| Earnings | | $303,500 | | $23,500 |
| ECPI | 100% | $303,500 | 0% | $0 |
| TI | | $0 | | $23,500 |
| **Gross Tax** | **15%** | **$0** | **15%** | **$3,525** |

# Transition to Retirement Income Streams

- Earnings tax exemption provisions now only apply to complying superannuation funds if a superannuation income stream is in the “retirement phase”.
- A superannuation income stream will not be in the “retirement phase” if it is a TRIS.

# Transition to Retirement Income Streams

- Regulation 995-1.03 ITAR to be repealed to remove the ability to treat income stream benefits as tax free lump sums (up to the low rate cap of $195,000)
- Post 1 July 2017 TRIS strategy still benefits those over 60, sacrifice amount is taxed at 15% whilst the pension paid is tax free

# Example 8

- Bruce is looking to salary sacrifice and start a TRIS
- Is this strategy viable for 2017 and beyond?
  - Salary Package Inc Super $90,000
  - Members Balance $350,000
  - Taxable Component 100%
  - Asset Yield Inc Realised Gains 5%
  - Pension Payment 4%

# Example 8

| | No TRIS | TRIS (2016/17) Under 60 | TRIS (2016/17) 60 & Over | TRIS (2017/18) Under 60 | TRIS (2017/18) 60 & Over |
|---|---|---|---|---|---|
| **Salary package** | 90,000 | 90,000 | 90,000 | 90,000 | 90,000 |
| **Employer superannuation** | -7,808 | -25,000 | -25,000 | -25,000 | -25,000 |
| **Salary** | 82,192 | 65,000 | 65,000 | 65,000 | 65,000 |
| **PAYG withheld** | -19,968 | -14,040 | -14,040 | -14,040 | -14,040 |
| **Pension received** | 0 | 14,000 | 14,000 | 14,000 | 14,000 |
| **PAYG withheld** | 0 | -2,704 | 0 | -2,704 | 0 |
| **Net Cashflow** | **62,224** | **62,256** | **64,960** | **62,256** | **64,960** |

| Individual tax rates | No TRIS | TRIS (2016/17) Under 60 | TRIS (2016/17) 60 & Over | TRIS (2017/18) Under 60 | TRIS (2017/18) 60 & Over |
|---|---|---|---|---|---|
| **Taxable income** | 82,192 | 79,500 | 65,000 | 79,500 | 65,000 |
| **Tax expense** | 20,001.88 | 18,974.50 | 13,947.00 | 18,974.50 | 13,947.00 |
| **Less: Tax offsets** | 0.00 | -2,100.00 | 0.00 | -2,100.00 | 0.00 |
| **Tax payable** | **20,001.88** | **16,874.50** | **13,947.00** | **16,874.50** | **13,947.00** |

# Example 8

| Superannuation fund | No TRIS | TRIS (2016/17) Under 60 | TRIS (2016/17) 60 & Over | TRIS (2017/18) Under 60 | TRIS (2017/18) 60 & Over |
|---|---|---|---|---|---|
| **Contributions** | 7,808 | 25,000 | 25,000 | 25,000 | 25,000 |
| **Earnings** | 17,500 | 17,500 | 17,500 | 17,500 | 17,500 |
| **Less: ECPI** | 0 | -17,500 | -17,500 | 0 | 0 |
| **Taxable income** | 25,308 | 25,000 | 25,000 | 42,500 | 42,500 |
| **Tax expense (15%)** | **3,796.20** | **3,750.00** | **3,750.00** | **6,375.00** | **6,375.00** |
| **Overall tax expense** | **23,798.08** | **20,624.50** | **17,697.00** | **23,249.50** | **20,322.00** |

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# TRIS Planning

- Last year to maximise TRIS strategy
- Last year to use (Reg 995-1.03 ITAR) election to access the low rate cap
- Commutation for most arrangements after 1 July 2017
- Continue arrangements for those over 60 who can't access an ABP

# Can the client convert their TRIS to an ABP?

- Reg 6.01(7) SISR retirement under 60
  - the trustee must be reasonably satisfied that the person <u>intends</u> never to again become gainfully employed, either on a full-time or a part-time basis
- Reg 6.01(7) SISR retirement over 60 under 65
  - as per above, <u>or</u>
  - an arrangement under which the member was gainfully employed has come to an end

# Can the client convert their TRIS to an ABP?

- Gainfully employed means (Reg 1.03(1) SISR):
  - employed or self-employed for gain or reward in any business, trade, profession, vocation, calling, occupation or employment
- Part-time means (Reg 1.03(1) SISR):
  - gainfully employed for at least 10 hours, and less than 30 hours, each week

# Can the client convert their TRIS to an ABP?

- Simply ceasing to receive a wage from a related entity or ceasing to be a director or trustee of a related entity won't be enough. You must demonstrate you have ceased working.

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