Navigating the impact of superannuation changes – a road map

KM Private Clients Tax Update
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It is likely that draft legislation regarding the proposed changes to the taxation arrangements for superannuation benefits will be released in October 2016. Confidential consultation with Industry will take place in September 2016. With a new Parliament containing an uncooperative Opposition and an unpredictable Crossbench, the final outcome of those tax changes is currently uncertain.

What is certain however, is that there will be changes to taxation arrangements for pensions. This has ramifications not only for current financial arrangements but your asset succession plans going forward.

These changes are earmarked to commence 1 July 2017. As such you need to start preparing for these changes now.

The purpose of this Paper is to give you a road map of the issues that you need to start considering now in preparation for the release of the proposed tax legislation.

The analysis is based on limited information released by the Federal Government and the ALP's Press Release on its Superannuation policy. Actions need to be taken in conjunction with advice specific to your personal financial characteristics.

Tax changes with immediate impact: Lifetime Non-Concessional Contribution Cap

Effective 3 May 2016, the Government has proposed a lifetime non-concessional contribution cap of $500,000. This means (if legislated in its current format), where you have contributed $500,000 or more as a non-concessional contribution after 1 July 2007, you can no longer make further non-concessional contributions to Superannuation without penalty. The ALP opposes the retrospectivity of this change, arguing the $500,000 cap on non-concessional contributions should apply prospectively from 3 May 2016. There is also discussion as to whether or not the $500,000 is a reasonable cap.

Action Required

It is suggested that until this position is clarified through legislation, no further non-concessional contributions to Superannuation are made.

Proposed changes effective 1 July 2017

The Government has made a number of announcements with respect to changes earmarked to be effective 1 July 2017. Some of these do not require any preparatory planning and are currently being opposed by the ALP. As such I propose not focusing on those proposed changes in this Paper. If and when legislation is introduced in relation to some of these changes I will provide further commentary.

The changes earmarked that I will focus on are those that we need to plan for now.

Reduction in Concessional Contribution Cap

It is proposed that from 1 July 2017, the annual concessional contribution cap will be reduced to $25,000 for all individuals.

For the year ending 30 June 2017, the caps are $30,000 for those under 49 years of age on 30 June 2016 and $35,000 for those over 49 years of age on 30 June 2016.

Action Required

You need to consider whether or not you should be maximising your concessional contributions in the current financial year in anticipation of the concessional contribution cap being lowered.

Concessionally Taxed Exempt Pension Cap Set at an Indexed $1.6 million

From 1 July 2017, the Federal Government proposes introducing a Retirement Account Cap of $1.6 million. This will be the total amount of superannuation assets that an individual can have in pension mode and upon which income derived by the Superannuation Fund will be exempt from income tax.

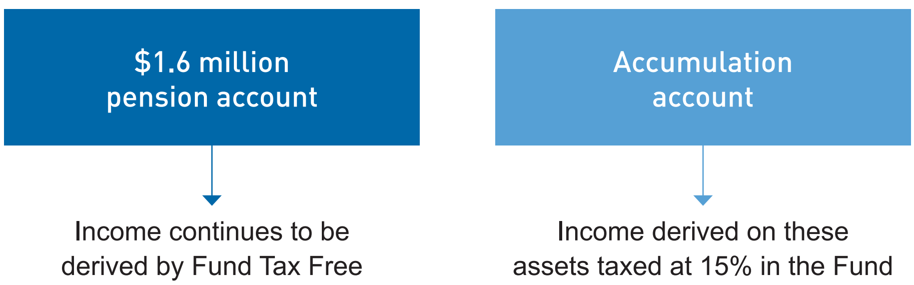
Accordingly, from 1 July 2017, those superannuates already in pension phase will have to separate their superannuation entitlements into two pools, being the $1.6 million pension account and the balance into accumulation mode. The income from assets in the $1.6 million pension account will continue to be derived by the Superannuation Fund tax free, whilst the balance of the assets deriving income in the accumulation account will have their income taxed at 15%.

What the changes are not:

1. The proposed changes are not a cap on your superannuation balance. Provided that your pension starts with $1.6 million or less, the pension balance can rise over time in excess of $1.6 million due to fluctuations in the investment earnings.
2. It is not a change in the income tax regime for pension income paid to the individual. That is, if you are over age 60, pension income can continue to be paid to you tax free.

What will your Accumulated Superannuation Interests look like on 1 July 2017?

For those with more than $1.6 million in accumulated superannuation and aged over 60, your accrued superannuation benefits on 1 July 2017 are likely to look like this:



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How do you prepare your financial position to be ready for this?

To prepare for the tax changes you need to:

- Understand the characteristics of the assets within your Superannuation Fund.
- Articulate your personal financial objectives which may impact other personal financial matters that you need to address. Cash flow planning and asset succession objectives need to be revisited and possible changes may need to be incorporated in an updated financial management strategy.

You can prepare for the release of the superannuation tax changes by gathering information on these matters now.

Understanding the characteristics of your superannuation assets

There is not a "one size fits all" approach to prepare for these tax changes. Accordingly, you need to understand the characteristics of your superannuation assets to enable the most tax effective strategy on a member by member basis to be updated.

The characteristics you need to consider are:

1. **Do you currently have more than $1.6 million in Superannuation Benefits?**

   The $1.6 million test is a per member test. Accordingly, you need to understand what amount you have personally in superannuation over all of the Funds that you have an interest in.

2. **Have you contributed over $500,000 in Non-Concessional Contributions since July 2007?**

   If you, or where applicable your spouse or children, have not exceeded this threshold there may be tax planning opportunities you can avail of prior to July 2017.

3. **What is the unrealised capital gains profile of your asset base in superannuation?**

   There are rumours that there will not be transitional provisions eliminating the Capital Gains Tax for unrealised gains at 30 June 2017 on pension assets rolled back to accumulation mode to accommodate the new $1.6 million pension limit.

   Irrespective of whether there will be transitional provisions, capital gains accruing from 1 July 2017 for assets in superannuation within accumulation mode will be subject to Capital Gains Tax. Accordingly, capital losses will become useful to absorb any future capital gains on assets within your Superannuation Fund exceeding the $1.6 million pension cap.

   As such, you need to ascertain the following:

4. **What is the unrealised capital gain or loss position on your asset base?**

   This will help determine:

   - whether you should realise some of those gains and losses prior to 30 June 2017
   - which assets (if any) are segregated within the $1.6 million pension account.

   Segregation of assets will be an issue that requires a deeper analysis on a case by case basis. Segregation involves specifically identifying those assets supporting the $1.6 million pension as opposed to having a pooled approach in relation to assets within your Superannuation Fund and pro-rating your accrued tax liability.

   Segregation may involve the creation of new investment accounts, bank accounts and for some clients, potentially operating out of two completely independent Self-Managed Superannuation Funds.

5. **What are the Tax Characteristics of your Member's Balance?**

   Superannuation Member's Balances are apportioned between "taxable" and "tax free" components.

   Where you are aged over 60, this apportionment does not impact your tax liability when you withdraw money from superannuation. What it will impact however, is the tax liability for the beneficiaries of your accrued superannuation when you pass away. If you currently have pensions with different tax free/taxable components, the decision to make is which component or pension is utilised to create the new $1.6 million pension and which components remain in accumulation mode ?

6. **Is your Pension reversionary?**

   A reversionary pension specifically identifies the beneficiary of your pension account when you pass away. Identifying whether or not your pension is currently reversionary is important for asset succession purposes.

Understanding your personal objectives

As well as understanding the tax characteristics of your superannuation interests, it is an important time to refocus your personal financial objectives going forward. These objectives need to be considered in identifying any changes in your strategy to accommodate these proposed tax changes.

Questions you need to consider are as follows:

1. **How much cash will I need to fund my lifestyle going forward?**

   The proposed tax changes focus attention on what your prospective cash needs are and how you are going to meet those needs.

   If we assume that you withdraw approximately 5% per annum from your $1.6 million pension account post 30 June 2017 (i.e. $80,000 per annum) where else will you access cash to meet your living needs? Have you investment assets outside superannuation you can access? Do you wish to make a significant capital purchase or gift money to others in the foreseeable future?

   These are questions that need to be answered to incorporate into an ongoing strategy.

2. **What is your Group's Tax Profile outside the Superannuation System?**

   The introduction of a 15% tax on Superannuation Fund earnings on assets over $1.6 million raises the question of whether or not you can get a lower rate of income tax by holding investment assets outside the Superannuation System.

   One must also remember that on death, the taxable component of superannuation assets bequeathed to someone other than a spouse or child under age 25, will suffer a 15% disguised Death Duty.

   This tax can be avoided if assets are withdrawn from the Superannuation System prior to death.

   Accordingly, consideration needs to be given as to what level of investment assets you hold outside the Superannuation System on 1 July 2017. This may impact whether or not you actually withdraw some of your superannuation benefits prior to 30 June 2017.

3. **What are your asset succession intentions with respect to your Superannuation Interests?**

   With the forthcoming changes in the tax rules, clients now need to reconsider their asset succession plans for their superannuation interests. The new rules will certainly have implications for how asset succession wishes for such assets are now implemented.

How to prepare for the changes – your road map

In summary, you will need to undertake the following prior to 30 June 2017:

a. Understand the characteristics of your assets within the Superannuation System.

b. Reconsider your personal financial objectives.

c. Consider the proposed legislation when it is released to plan for the changes in the tax on superannuation interests.

d. Develop a revised strategy taking into account (a), (b) and (c).

e. Prepare updated instructions for your Investment Advisor, Lawyers and Superannuation Administrators to ensure that all is in readiness for the superannuation changes.

f. Execute documentation to implement new strategies.

Work on this needs to commence now as your unique characteristics and objectives need to be considered carefully.

Please do not implement any changes without seeking professional advice.

About the author

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