Draft legislation released in relation to $1.6 million pension cap

KM Private Clients Tax Update
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The Federal Treasurer late yesterday released draft legislation for comment dealing with the new rules that will apply from 1 July 2017, concerning the amount of superannuation benefits that can be used to fund Tax Exempt Pension income.

Under current laws there is no limit on the amount of assets that can be used to fund Pensions that derive tax free income. From 1 July 2017, a transfer balance cap of $1.6 million will be introduced, limiting the tax exempt income within a Superannuation Fund to income derived from the equivalent amount of $1.6 million worth of assets.

Whilst the draft legislation is just that, it certainly signals the Government's intention in relation to some specific principles it wishes to apply in enacting this legislation. We will wait and see what happens to this legislation as it passes through both Houses of Federal Parliament.

Good news - reset of cost base of assets to market value as at 30 June 2017

Importantly, in this draft legislation the Government provides Capital Gains Tax Relief in relation to assets transferred out of pension phase into accumulation phase to comply with these new rules. As such, those people currently in pension phase with more than $1.6 million of assets supporting their pensions will be able to choose to 'mark to market' using the 30 June 2017 value of those assets as the new cost base of assets that are transferred back into accumulation phase.

This means effectively assets currently in pension phase will not have tax payable on accumulated gains that are unrealised as at 30 June 2017.

This is great news and should satisfy any claims of retrospectivity.

It is important however, for the uplifted cost base to apply, the Superannuation Fund must dispose of within 10 years of the legislation becoming effective (i.e. 1 July 2027) the asset now supporting the accumulation phase of a Member's Balance. If the asset is not sold within that time period, the cost base of the asset reverts back to its original cost base when it was acquired.

Accordingly, it is critical where you, under current legislation are permitted to be in pension phase, that you are in pension phase prior to 30 June 2017 to take advantage of these transitional provisions to mark to market the cost base of your superannuation assets.

Superannuation fund partially in pension phase and accumulation phase

There will be some Self-Managed Superannuation Funds that have Members in pension phase and other Members still in accumulation phase.

Where a SMSF Trustee chooses marks to market its assets as at 30 June 2017, a capital gain will be calculated by reference to the proportion of those assets that are in accumulation phase. This gain can be brought to account in the 30 June 2017 year, or deferred until the asset is sold, provided it is sold within a 10 year period.

Prevention of segregating assets if Superannuation Fund Balance over $1.6 million

Importantly, if a Superannuation Fund Member has over $1.6 million within the Superannuation System, a Self-Managed Superannuation Fund will not be able to specifically segregate assets into the exempt pension component of the Fund. This means that the Superannuation Fund is forced to use the proportional method of calculating the taxable income of the Fund. This will prevent people ‘recycling’ assets through their pension account at the point that they would like to realise a capital gain and have that gain exempt from tax.

This will simplify the administration of Self-Managed Superannuation Funds as Members will not have to choose which assets go into the exempt pension account and which assets stay in accumulation phase where their Member’s Balance is in excess of $1.6 million.

No relief for reversionary pensioners

If a Superannuation Pension recipient passes away and a Reversionary Beneficiary receives the balance of their pension, there is no transfer balance cap concession for the Reversionary Pensioner in relation to the receipt of this capital. For example, if a person passes away and their pension is reversionary to their spouse, if the surviving spouse has already used their $1.6 million transfer balance cap (i.e. they have their own tax exempt pension), the reversionary beneficiary has six months after the death of their spouse to have this reversionary pension revert to accumulation phase without penalty.

The exception to this rule is in relation to children under the age of 25, in receipt of reversionary pensions on the death of a parent. Such pensions do not count towards the child’s own $1.6 million Transfer Balance Cap. There is still however a $1.6 million cap applied to pensions transferred to children on the death of a parent.

Action required

It is pleasing that the Mark to Market Rules will mean that one does not have to dispose of assets to reset the cost base of pension assets prior to 1 July 2017. In addition, there is no ability to segregate assets where you have more than $1.6 million in pension account.

Both these measures significantly simplifies the implementation steps that we need to take prior to 30 June 2017 to prepare for the introduction of these measures.

We will continue to keep abreast of changes as they are announced, especially in relation to passage of legislation through Parliament.

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