Understanding the $1.6 million transfer balance cap

Version 1.0

This document provides some additional information about the **$1.6 million transfer balance cap** discussed in the SOA so that you can understand the benefits of the strategies recommended to you, and the associated costs and risks.

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HOW TO READ THIS DOCUMENT

Managing your finances to meet your day to day requirements as well as your long-term goals can be a complex task. There are all sorts of issues you will need to consider such as taxation, legislation, protecting your wealth and assets, associated costs and the inherent risks of investment. When undertaking a financial plan it is important that you understand how these issues will impact you and what you should expect over time.

Your financial adviser will provide you with a Statement of Advice (SOA) which sets out the details of the advice and how it will meet your goals and objectives.

This document provides some additional information to help you understand the financial planning concepts discussed in the SOA in relation to the **$1.6 million transfer balance cap**.

It is very important you read this document to help you understand the benefits of the strategies recommended to you and the associated costs and risks.

Please contact your adviser if you have questions relating to the content in this document, or need further information or clarification.

$1.6 transfer balance cap

From 1 July 2017 the Government will introduce a $1.6 million transfer balance cap. This cap limits the amount that can be transferred into the pension phase of superannuation and receive the benefit of 0% earnings tax. All individuals have their own transfer balance cap.

Income streams measured against the transfer balance cap are either a:

- superannuation income stream payable to an individual, or
- deferred income stream payable to an individual who has met one of the following conditions of release:
  - retirement,
  - terminal illness,
  - permanent incapacity, or
  - reaching age 65.

The assessment against the cap consists of debits and credits. A credit is an assessment against the cap such as when the income stream commences. A debit arises to reduce the amount assessed against your cap. Debits also include adjustments for certain amounts such as:

- contributions made under a structured settlement
- commutations (or lump sums) taken from your income stream
- adjustments to meet family law settlements.

What counts towards your cap

The transfer balance cap applies to all income streams – both those commenced before and after 1 July 2017. Income streams commenced prior to 1 July 2017 will be assessed on 1 July 2017. Those commencing after that date are assessed at the time the income stream commences. Superannuation income streams include:

- account based pensions
- lifetime and term annuities
- defined benefit pension
- death benefit superannuation income streams (with modifications for child death benefit pension)

  NOTE: Transition to retirement income streams are not assessed against the transfer balance cap.

Account based income streams are assessed based on the account value at commencement or, if an existing income stream at 1 July 2017, the account balances at that date.

Income streams that do not ordinarily have an account balance, such as defined benefit pensions and annuities, have a value determined based on a formula contained in the legislation. The calculation is:

Annual Income x 16

As the transfer balance cap applies to the individual, the cap is therefore cumulative of all income streams that are owned by that individual.

Exceeding the cap

An excess transfer balance occurs if the total value of income streams of an individual is above their transfer balance cap. In the case of an excess, it will be necessary to:

- reduce the amount held in pension phase (e.g. a partial commutation) and
- pay excess transfer balance tax.

This applies for income streams that can be commuted (i.e. converted to a lump sum) such as an account based pension. The excess amount can be rolled back to the accumulation phase of superannuation or taken as a lump sum tax withdrawal.

If non-commutable income streams (e.g. defined benefit pensions) are in excess of the transfer balance cap, the underlying capital cannot generally be removed to reduce the amount assessed against the cap. In such cases, excess transfer balance tax is not payable; however the taxation of the income stream payments is amended (see below).

The excess transfer balance tax is based on notional earnings determined by a legislative formula. Excess transfer balance tax is payable for all days where the amount held in pension phase of superannuation is in excess of the cap.

If a person exceeds their transfer balance cap, adjustments to the pension can be made as soon as possible to minimise the excess transfer balance tax. If the person is unaware or leave the funds in pension phase, the ATO will make a determination once the information from superannuation funds is received. Notional earnings will be calculated from the date of breach through to when a determination is made and that amount will then attract the General Interest Charge.

Notional earnings will be subject to tax at:

- 15% for the first breach, and
- 30% for the second and subsequent breaches.

Pre-1 July 2017 income in excess of the cap

Income streams started prior to 1 July 2017 will count towards the transfer balance cap from that date. The value of the income stream as at 30 June 2017 for account based income streams or the income formula for other types of income streams will be used to measure the portion of the transfer balance cap that is utilised. Generally, if the value of a commutable income stream will be in excess of the transfer balance cap, action can be taken prior to 1 July 2017 to reduce the value of income streams to below the cap prior to that date. The options available are to make the commutation by either:

- Roll the amount back to the accumulation phase of superannuation or
- Withdraw the amount and invest the amount in their individual names.

If action is taken prior to 1 July 2017 to comply with the transfer balance cap, CGT concessions may be utilised by the superannuation. The CGT concession allows the cost base of assets to be reset so that only gains accrued from that date will be taxable. This is a choice and not compulsory. A decision can be made regarding each asset. Excess transfer balance tax can be avoided if adjustments are made prior to 1 July 2017.

Non-commutable income streams exceeding the cap

Non-commutable income streams are assessed against the cap. The value of the income stream is determined by a legislative formula. In many cases, these income streams cannot be commuted if the assessment creates an excess against the transfer balance cap.

Where non-commutable income streams are in excess of the transfer balance cap, the taxation of the pension payments will change. The taxation of income above $100,000 will be subject to different taxation compared to those amounts within the cap. The taxation is summarised below:

Transfer balance cap indexation

The transfer balance cap may be indexed in future years to CPI in $100,000 increments. The extent that an individual benefits from indexation depends on whether that person has triggered a credit (or assessment) against their own transfer balance cap.

If a person has not triggered a credit against their transfer balance cap, they will benefit from the full increase of any indexation.

Those who have commenced an income stream but have not fully utilised the cap will have indexation applied only to the proportion of the unused transfer balance cap.

Indexation is not available for those who have completely utilised their transfer balance cap.

Type of scheme	Age	Amount below $100,000 income cap	Amount above $100,000 income cap
Taxed	< Preservation age	Taxed at marginal tax rate	Taxed at marginal tax rate
	> Preservation age – 59	Taxed at marginal tax rate less 15% offset	50% of amount above cap added to assessable income and taxed at MTR
	60 +	Tax-free	50% of amount above cap added to assessable income and taxed at MTR
Untaxed	< Preservation age	Taxed at marginal tax rate	Taxed at marginal tax rate
	> Preservation age – 59	Taxed at marginal tax rate	Taxed at marginal tax rate
	60 +	Taxed at marginal tax rate less 10% offset	Taxed at marginal tax rate

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