Bite magazine

Super change

AUGUST 1, 2017

A cap on the amount of money that can be held in the tax-free, income-generating, pension part of your super fund could have far-reaching consequences. By Frank Leggett

The start of the 2017-18 financial year sees a change to superannuation that is almost philosophical in nature. Prior to 1992, retirement living usually consisted of the age pension bolstered by personal savings and investment. The Keating government introduced the Superannuation Guarantee in 1992, requiring employers to make superannuation contributions for their employees. Since 2014, the employee contribution has been set at 9.5 per cent and is expected to rise to 12 per cent by 2025.

The primary objective of superannuation is to provide income in retirement to substitute or supplement the age pension. Whereas the government was pretty happy for people to look after themselves financially in retirement, there is now a perception that the age pension is the benchmark of what a person needs financially. In other words, the age pension is the amount of money that is considered a reasonable base income for survival in retirement.

The Association of Superannuation Funds creates a benchmark for the annual budget required by Australians in retirement. The benchmark assumes that the retirees own their own home and are relatively healthy. The figures are conservative to say the least. As of March 2017, the annual budget for a modest lifestyle was set at $24,250 for singles and $34,855 for couples. A comfortable lifestyle was set at $43,665 for singles and $59,971 for couples.

The change to superannuation overturns people's ability to keep substantial money in super to fund the retirement of themselves and their spouse. Now, obviously, if there's a huge amount of money in a superannuation account, it's lucrative for that money to be invested and earning in a favourable tax environment. The government has decided to create a transfer balance cap of $1.6 million. This means that whatever total amount you have in super, the maximum that can be in the zero tax environment is $1.6 million. Generally, dentists fall into the high-income bracket and this change will impact their finances in retirement.

Jonathan Harris, managing director of Harris Friedman Lawyers, is highly experienced in estate planning and frequently deals with dentists as clients. "These superannuation changes were introduced to stop people benefiting from vast amounts of money in a tax-free environment," he says. "Someone with more than $2 million in super is in a reasonably strong financial position and now the government doesn't want to give them such a large, tax-free concession. The government has drawn the line at $1.6 million. Whether this is an adequate amount, particularly with current interest rates, is a question still to be answered."

The transfer balance cap

As you pay money into your super fund, it is considered to be in the accumulation phase, which is not tax-free. The super fund will pay tax on any income earned by the fund. It is only when you reach retirement age (65 at present but there is talk of increasing this to 70) that your money will move into the pension (tax-free) phase.

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"The account from which you will draw a pension will be segregated and it will be a zero-tax environment," says Harris. "Previously, there was no effective limit to the amount you could have in the zero-tax environment. Now the transfer-balance-cap rules set the tax-free limit at $1.6 million. Income earned on any money in your super account above that $1.6 million limit will be taxed at between 15 and 17 per cent."

Property problems

Dentists are generally considered high-income earners and may need to reassess long-term planning for their super fund, particularly if they have moved their practice premises or other property into the fund.

"It's not uncommon for dentists, doctors and lawyers to transfer their business premises into a super fund," says Harris. "This has some tax advantages, including the fact that the rent being paid is earned in the super fund. Over time this can be a very good way to accumulate money in your super fund. However, the $400,000 property that was purchased in the fund in 2000 might be worth $2 million today."

Death and taxes

Previously, when a spouse died, all of their super entitlements could stay in the super fund and be enjoyed 'tax free' by the surviving spouse. Now, for couples with $3 million plus in super, it's possible that some of the entitlements of the deceased spouse will have to be moved out of the super fund. The balance transfer cap applies to each person.

Jonathan Harris explains: "Let's assume that a couple has $3 million each in super. They are both over 65 and they both draw pensions. They each have $1.6 million in their pension account and $1.4 million in their accumulation account. If the husband dies, the wife will move her $1.6 million pension balance into her accumulation account, which will then become taxable. She will then take a death benefit pension from her husband's $1.6 million pension account.

"A person can only have one $1.6-million amount enjoying the zero-tax benefit," he continues. "The $1.4 million that the husband has in his accumulation account will have to come out of their super fund. This may cause no difficulties if there is adequate cash or liquid assets in the fund, but it may cause a real headache if there is a lot of property in the fund. A transfer of an interest in real property out of your super fund to your spouse will crystalise a capital gains tax event, and, in NSW, will create a liability for stamp duty."

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Get advice

At first glance the $1.6 million cap doesn't seem like a big issue, particularly if the amount in your super fund is well below that limit. However, there can be potentially serious repercussions if you have large insurance policies or property holdings in the fund. Then it would be unwise to ignore the consequences.

Everyone's financial situation is different and the transfer balance cap can interact with your financial and estate planning in countless ways.

"You need to speak to your accountant, financial planner or superannuation specialist," explains Harris. "They'll need to look at the assets in your super fund and decide which ones will go into the capped pension fund and which ones will be excluded.

"Although it is complicated, you can cherry-pick your assets if you expect high income or big growth. While shares and cash are easy to value on 30 June 2017, other assets will have to be revalued to avoid your pension account exceeding the transfer balance cap amount.

“For those with lots of money in super, you will also need to speak to your lawyer to make sure your current will caters for the eventual release of funds from your super fund when a spouse dies. For people with blended families, the estate planning may have assumed all of the monies stayed in super,” says Harris.

The new superannuation changes need to be considered carefully. But, with a little planning and some good advice, your super fund can still provide considerable tax savings for yourself and your dependents after you die.