# May Newsletter

Only 6 weeks till the end of the financial year!

The months are flying by and our team have been working hard to ensure all our clients compliance requirements have been met over the past few weeks.

We are now into the tax planning season, if you need any assistance, please **contact us** to make your appointment.

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## XERO Pricing Plan Changes

Xero has recently advised that there will be a change to their pricing plans this coming June. Those with a current Xero software subscription will notice an increase in the monthly pricing from 2 June onwards. The pricing increase for the plans are $10 per month. This will automatically take effect from 2 June 2016.

If you have any questions on what plan you are currently on, please contact **Alison** at our office.

Please **click here** for more information on Xero's price increase.

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For any other enquiries, please find our contact details below.

**Contact Us....**

Kind Regards

The Team
**Mark Trovato Chartered Accountants**

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## HOT TOPIC THIS MONTH: THE BUDGET AND SUPERANNUATION

**A rundown of the implications to your superannuation**

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## XERO ADD-ON FEATURE

xero SILVER PARTNER

CIN7

For Inventory tracking, retail and wholesale management, Cin7 is an AddOn program that has been growing momentum in the Xero community.

For more information, please view their **website**.

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## Find us on:

# Superannuation and the 2016 Federal Budget

This month's Federal budget by the Government announced the most significant changes to Superannuation in the past 10 years. These changes are comparable to the changes made by the then Treasurer Peter Costello back in 2006.

This issue will not discuss the politics of the changes but will consider their implications.

For this purpose it is assumed that the changes as announced will be implemented.

This is a significant assumption given that the Government must win the 2 July election and have sufficient influence in the Senate to pass, without significant amendments, the necessary legislation to implement the changes.

Taken together the changes do implement the Government's (to be legislated) objective of superannuation that it is to provide income in retirement to substitute or supplement the Age Pension.

## The Big Picture

There are two changes which implement the Government's objective: namely the new contribution caps and the pension transfer cap.

The former limits the amount of money which can enter the superannuation system and the latter restricts the amount of super which can enjoy the earnings tax exemption (which applies to super in pension phase).

The new contributions caps are the concessional contribution cap of $25,000 per year (which applies from 1 July 2017) and a lifetime non-concessional contribution cap of $500,000 (which also applies from 1 July 2007).

The pension transfer cap is a lifetime cap of $1.6m. This cap means that from 1 July 2017 the amount of super which can move to pension phase (and thereby enjoy tax free earnings) will be restricted to $1.6m.

The significance of these two caps is easily appreciated by a comparison with the current arrangements.

Currently an individual has a maximum concessional contribution limit of $1,200,000 (calculated as 40 years' of concessional contributions at $30,000 each year).

Under the proposed arrangements the corresponding figure is $1,000,000 (40 years' of concessional contributions of $25,000 each year). This is a reduction of 17%.

In relation to the non-concessional contribution cap the current arrangements have a $7,200,000 cap (calculated as 40 years' of non-concessional contributions at $180,000 each year).

Under the proposed arrangements the cap will be $500,000. This is a 93% reduction.

Unfortunately in relation to the pension transfer cap, a similar comparison cannot be made as there is currently no limit to the amount of super benefits which can be held in pension phase.

From 1 July 2017 the limit will be $1.6m.

## Who are the most affected by the lifetime cap?

Any individual who has made non-concessional contributions since 1 July 2007 is immediately and adversely affected.

The $500,000 lifetime cap applies to all non-concessional contributions made since **1 July 2007.** This is not a typo….

This means there will be (and could be quite a number) of individuals who have already exhausted their lifetime cap.

Others may only have a small portion of their lifetime cap remaining.

At least the Government did have the sense to not require individuals who have already exhausted their lifetime cap (because of non-concessional contributions made before Budget Night) to remove their excess contributions from the super system.

The only consequence in this case is that the lifetime cap is exhausted and so any further non-concessional contributions will be treated as excess non-concessional contributions.

## Who is immediately affected by the pension transfer cap?

Any individual who on 1 July 2017 has a pension balance (or an aggregate balance) in excess of $1.6m will be affected.

Essentially, the excess pension balance must either be returned to accumulation phase or withdrawn from the super system.

Once the excess has been removed from pension phase a subsequent increase in the pension account by reason of investment returns can remain in pension phase.

If the excess pension balance is moved to accumulation phase, the balance will be subject to tax on its earnings at the normal super fund tax rate of 15%.

For individuals who move into pension phase after 1 July 2017, the $1.6m pension transfer cap will apply.

Consequently, any super balance in excess of $1.6m will either remain in accumulation phase (and be subject to 15% tax on earnings) or be removed from the super system (and if invested outside super – earnings would be liable to tax at the individual's marginal tax rate).

## What about transition to retirement pensions?

The proposed changes mean that from 1 July 2017, transition to retirement pensions will no longer be entitled to the earnings tax exemption.

There is no change in the taxation treatment of pension payments: they will be taxable but subject to a 15% tax offset if paid before age 60 and tax free if paid after age 60.

When the individual retires or turns 65, the pension balance will then be assessed against the pension transfer cap.

To the extent the pension balance is within the pension transfer cap, the earnings tax exemption will apply.

However to the extent the pension balance exceeds the pension transfer balance, the excess must be transferred to accumulation phase and earnings on the excess balance will be taxed at 15%. (or 10% for capital gains).

## Is this the end of super as we know it?

No, but Super will change.

The age of significant account balances is closed to new entrants (those with significant balances can retain them in the super system and, at worst, earnings on the significant balances will be concessionally taxed at 15% max).

Super balances which are still being formed will generally not be as large – and will only be formed as a result of many years' of concessional contributions at or near the concessional contributions cap with a possible fill up of $500,000 non-concessional contribution.

## Should we panic now or next week?

Assuming the changes as announced are implemented – they apply on and from 1 July 2017 (with the exception of the lifetime non-concessional contribution cap).

There is time to take considered advice and to act sensibly and not emotionally.

In relation to the lifetime non-concessional contribution cap – this is with us already.

Whether individuals proceed with the pre Budget non-concessional contribution strategies is a very difficult matter.

Other factors could be an assessment that the announced proposal will be modified by whichever government is the next government so the adverse tax consequences of making (prospectively) excess non-concessional contributions are remote.

This is a matter which needs to be considered with an SMSF adviser.

# Will the changes alter the focus of super planning?

Yes. Going forward super planning will be about 3 things;

- first the transfer of value into the super system which is not caught by the new lifetime non-concessional contribution cap;
- the second equalising the benefits of couples; and
- thirdly the transition to pension phase.

The first focus will be about limited recourse borrowing and the ability to make CGT non-concessional contributions.

The money borrowed under a limited recourse borrowing arrangement is not treated as a contribution (as it must be repaid).

The borrowed money can be invested to enhance the investment return (ie capital growth from the investment adds value to the super balances).

CGT non-concessional contributions are subject to their own lifetime cap of $1,415,000 (for 2017/18).

The ability to make CGT non-concessional contributions depends on qualifying for the small business CGT concessions of the 15 year asset concession and the retirement concession.

Consequently individuals who operate (or intend to operate) their own business should consider structuring their arrangements to remove any barriers from qualifying for the small business CGT concessions.

The second focus will be about equalising the super benefits of couples – each aiming to achieve $1.6m in super when they move to pension phase – and the doubling of the $1.6m pension transfer cap.

As a couple the combined pension account balance will be $3.2m.

This will be achieved by ensuring that each member of the couple makes the best use of the concessional contribution caps (and use of the ability to make catch up contributions) as well as contribution splitting and spouse contributions.

Also, transferring super between spouses by means of lump sum withdrawals (after age 60 when they are tax free) and recontributing the lump sum as a spouse contribution could be an effective strategy.

The third focus of super will be the transition from accumulation to pension phase and the need to make the most of the earnings tax exemption (by asset segregation) and the decision as to whether any balance in super should be retained in accumulation phase or taken out of the super system.

# What remains of Super?

What remains is that super continues to be one of the most tax preferred investments available in Australia.

Even if the earnings tax exemption has been limited (by the pension transfer cap) the ability to have investment earnings taxed at 15% max and not at an individual's marginal tax rate is still a very desirable feature of super.

# The details of the proposed changes

The super package consists of 12 significant changes with most of the **changes applying from 1 July 2017.**

However, one change – and it is a significant change – applies from Budget Night – 3 May 2016.

Unfortunately, most of the significant changes are detrimental with the insignificant changes being beneficial.

**Contribution changes**

## 1. Abolition of the "work test" for super contribution eligibility

This test currently applies to individuals in the 65-75 age bracket. For any super fund to accept contributions by or in respect of individuals aged 65 to 75, the individual must have been gainfully employed for at least 40 hours within a 30 consecutive day period. This test applies on a year by year basis and applies to all contributions (except certain contributions an employer is required to make by law). This change is **a beneficial** change

## 2. Reduction in the concessional contribution cap from $30,000 (or $35,000 if aged 49 or more) to $25,000

This change simply means that less tax deductible money can enter the superannuation system. This change is **detrimental**.

Most individuals can focus on topping up super in the last ten years of their working life after home mortgages and children's education costs are behind them. This drop in the cap means that less funds will flow into super when it's most needed.

## 3. Reduction in the threshold at which additional tax ("Division 293 tax") is imposed on concessional contributions

Currently, the threshold is $300,000 of income but this will reduce to $250,000. This simply means that the tax benefit of concessional contributions will be reduced by 15%. This change is **detrimental.**

## 4. Personal super contributions to be tax deductible

This change means that individuals who cannot currently claim a tax deduction for their personal superannuation contributions will now be able to claim a tax deduction. However, the $25,000 concessional contribution cap still applies. This change is **beneficial**.

## 5. Catch up of unused concessional contribution cap

This change means that individuals who have not been able to fully use their concessional contribution cap can carry forward and utilise their unused cap for up to 5 years by making additional tax deductible contributions. This change is **beneficial.**

## 6. Lifetime limit of $500,000 on non-concessional contributions

Currently, an annual limit of $180,000 applies to the amount of non-concessional contributions which can be made by an individual. Also, an individual can use up to 3 years' worth of cap as one or more contributions (ie the $540,000 bring forward rule).

This change significantly restricts the amount of non-concessional contributions which can be made to superannuation. Further, non-concessional contributions made before the Budget Night (ie from 1 July 2007) will be counted when determining whether the cap has been exhausted. This change is **very detrimental** and unlike the other changes applies immediately rather than from 1 July 2017.

## 7. Spouse Contribution Offset thresholds will be significantly raised from current $10,000 to $37,000

Currently, an individual who makes a non-concessional contribution for their spouse is entitled to a tax offset (rebate) in their tax return. The offset is calculated at the rate of 18% of the contribution. Only the first $3,000 of contributions give rise to the offset. Further, entitlement to the offset is means tested – so that a full entitlement only applies if the income of the spouse is $10,000 or less. The entitlement shades out as the spouse's income exceeds $10,000 and is completely shaded out once income reaches $13,800.

The change is to increase the means test threshold from $10,000 to $37,000. This means that a full entitlement will only begin to shade out once the spouse's income exceeds $37,000 and will be completely shaded out at $40,000. This change is **beneficial**.

## 8. Effective reversal of super tax on SG contributions for low income earners

This change is to introduce a "Low Income Superannuation Tax Offset" which is a refund of the tax paid on SG contributions. Essentially, it is the continuation of the current arrangement under a different name.

**Fund taxation changes**

## 9. Transition to retirement pension no longer eligible for earnings tax exemption

Transition to retirement pensions will no longer qualify for the earnings tax exemption. Consequently assets supporting these pensions will be taxed at 15% max. Only when the transition to retirement pension converts to an account-based pension (when the relevant member retires or attains age 65) will the pension be eligible for earnings tax exemption (and presumably be counted against the $1.6m pension transfer cap). This is a **detrimental** change.

## 10. Pension transfer cap of $1.6m

The amount of super which will enjoy the earnings tax exemption will be limited to $1.6m. This is a lifetime limit. For pensions already in progress as at 1 July 2017, and for pensions which commence after 1 July 2017, the pension balance will be tested against the limit. Any excess pension balance will be required to return to accumulation phase or withdrawn from the super system. How this transfer cap applies to death benefits paid as pensions and transfers from one fund to another is yet to be determined. This is a **detrimental** change.

**Benefit changes**

## 11. Removal of the ability to have pension payments taxed as lump sums

Currently individuals who are receiving a pension can elect to have their pension payment taxed as a lump sum (and thereby fall within the low rate cap of $195,000 and not be taxed). This election is relevant to individuals who have not attained age 60. This is a **detrimental** change.

## 12. Removal of the anti-detriment payment

Anti-detriment payments were a means to reverse the reduction in value of lump sum death benefits due to the imposition of tax on employer (and other deductible contributions) super contributions. Super funds – whether SMSFs or large funds will no longer be permitted to make such payments. While SMSFs had the legal ability to make such payments very few SMSFs actually could make such payments as SMSFs had no or limited means to finance such payments and so could not make them. While this is a **detrimental** change, it will not amount to a significant change.

Just to recap, the above budget changes are not law as at today until they receive Royal Assent which will not occur until after 2nd July 2016 federal election. As mentioned above, the proposed changes need to pass through the Senate without amendment.

The ALP in their Budget reply speech strongly disagreed with the retrospective changes to super proposed above for Non Concessional lifetime cap.

If you wish to talk to a financial advisor regarding any of the above, **please contact** us to arrange & assist in these discussions.



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