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The new $1.6 million pension cap

The legislation was passed on 23rd November 2016 – below is a summary of the details surrounding the $1.6 million pension cap.

Transfer Balance Cap

Commencing : 1st July 2017

Summary : Cap limits the amount individuals can transfer into pension, which in turn limits the amount of earnings that are exempt from taxation.

Cap Amount : $1.6 million for 2017-18 financial year and is subject to proportional indexation. The general transfer cap will be indexed in $100,000 increments in line with CPI

If an individual breaches the cap - excess amount plus notional earnings will be commuted and excess balance transfer tax applied.

Notional Earnings
The rate at which notional earnings accrue is based on the general interest change

The daily rate is worked out as follows:

$$\frac{\text{90 Day Bank Accepted Bill yield} + \text{7 percentage points}}{\text{The number of days in the year}}$$

Excess transfer balance tax
15% of notional earnings amount
30% for subsequent breaches
Due 21 Days after date of assessment

Transfer Balance Account

The transfer balance account operates in a similar way to a bank account statement balance.

Amounts and individual transfers to the retirement phase give rise to a credit in their transfer balance account. Similarly, certain transfers out of the retirement phase give rise to a debit in the individual's transfer balance account.

It is possible for an individual's transfer balance account to have a negative balance if their debits exceed their credits.

Credit Events

- Commencement of an income stream

NB : the growth of assets in the cap are excluded as are any reduction in the value of assets under the cap.

Debit Events

- Commutation of pension

At current market rate not at value when commenced – this can lead to a negative balance in the transfer balance account – ensuring any increases in asset values since pension commenced are not lost on commutation.

On 1 July 2017, Taylor purchases a pension worth $1.6 million. On 1 June 2018, the superannuation interest that supports the pension is valued at $1.7 million because of investment earnings. Taylor fully commutes the pension on this day and receives a $1.7 million superannuation lump sum.

Taylor debits his transfer balance account by $1.7 million to reach a transfer balance account of –$100,000. Taylor is entitled to start a new pension worth up to $1.7 million without breaching his transfer balance cap.

- Structured Settlements

ie Personal injury payments as defined in s292-95 ITAA 1997 – these are excluded from the cap.

- Fraud

If a loss is suffered as a result of fraud or dishonesty, and the offender is convicted, the individual is able to notify the Commissioner and receive a debit in their transfer balance account to the value of the reduction.

- Bankruptcy and void transactions

In very specific circumstances where a trustee in bankruptcy claws back superannuation, the individual is able to notify the Commissioner and receive a debit in their transfer balance account to the value of the reduction.

- Family Law Payment Splits

According to the Split of superannuation under Part VIIIB of the Family Law Act 1975, each spouse must notify the Commissioner in order for their respective debit to arise.

Child Pensions

A child recipient that receives superannuation death benefits from a parent is entitled to a modified transfer balance cap. This ensures that a child does not exhaust their normal transfer balance cap before they reach retirement age.

A child recipient is required to commute all of their superannuation income streams and remove the capital from the superannuation system when they turn 25, unless they have a permanent disability.

If multiple beneficiaries the cap is split between beneficiaries (so total doesn't exceed $1.6 million cap).

child recipient

A deceased person's dependant child that is under the age of 25.

If the child is between 18 and 25, the child must also be financially dependent on the other person to qualify to receive a superannuation death benefit income stream.

A deceased's child is also a dependant if they have a permanent disability, regardless of their age. (SISR 1994 subregulation 6.21(2A) and RSAR 1997 subregulation 4.24(3A)).

Emma dies on 6 June 2018 aged 55 with accumulation interests worth $2 million.

Emma's two daughters Sana and Chloe are the sole beneficiaries of her superannuation interests. Emma has left instructions that her superannuation interests are to be shared equally between Sana and Chloe.

Sana
Transfer Balance Cap
$800,000
Lump Sum
$200,000

Chloe
Transfer Balance Cap
$800,000
Lump Sum
$200,000

As Emma has not yet retired, her beneficiaries are entitled to their proportion of the general transfer balance cap, expected to be $1.6 million in 2018. Sana and Chloe will each receive a transfer balance cap of $800,000 (50 per cent of the general transfer balance cap). The remaining $200,000 that each child receives would need to be taken as a lump sum and cashed out of the superannuation system.

CGT Relief

There are transitional provisions provide Capital Gains Tax (CGT) relief. You are able to reset the cost base of assets reallocated from the retirement phase to the accumulation phase prior to 1 July 2017.

This relief is available for providers in respect of the assets held for individuals who choose to transfer amounts from the retirement phase to the accumulation phase to comply with the transfer balance cap or new transition to retirement income stream (TRIS) arrangements.

Where these assets are already partially supporting accounts in the accumulation phase (a non-segregated fund), tax will be paid on this proportion of the capital gain made prior to 1 July 2017.

This tax may be deferred until the asset is sold, for up to 10 years. Where the fund has not disposed of the asset within 10 years (before 1 July 2027), the notional gain ceases to exist and the cost base of the asset will revert to its original cost.

Example

Jon (receives superannuation income stream benefits) and Olivia (still in accumulation) have a SMSF supported by a single asset with a market value of $3 million, with two-thirds of the asset supporting Jon's $2 million superannuation income stream.

To comply with the transfer balance cap, Jon partially commutes $500,000 of his superannuation income stream back to the accumulation phase on 30 June 2017. This means the proportion of the fund's assets that support Jon's superannuation income stream is 50 per cent.

$500,000 of Jon's superannuation income stream

The cost base of this asset is $2.5 million, meaning that it already has accrued unrealised capital gains of $500,000. The fund chooses to apply the CGT relief arrangements to this asset, resetting its cost base to $3 million on 30 June 2017.

Notional Gain on the asset $166,667

The fund calculates the notional gain on the asset that is attributable to Olivia's accumulation interest as one-third of $500,000, equal to $166,667. The fund chooses to defer the inclusion of this amount in its annual return until the asset is sold.

In June 2020, the fund sells the asset for $4 million, realising a capital gain of $1 million (from the reset cost base of $3 million). After applying the one-third CGT discount and the exempt proportion of 50 per cent, the fund calculates its net capital gain for the 2019-20 year as $333,333.

Net Capital Gain for 2019-20 $333,333

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Deferred Notional Gain $167,667

Total Net Capital Gains for 2019-20 income year $500,000

The fund adds its deferred notional gain of $166,667 to this net capital gain, bringing its total net capital gains for the 2019-20 income year to $500,000.

If the fund had not sold the asset by 1 July 2027, the deferred notional gain would have ceased to exist as the cost base for the asset would revert to its original level of $2.5 million.