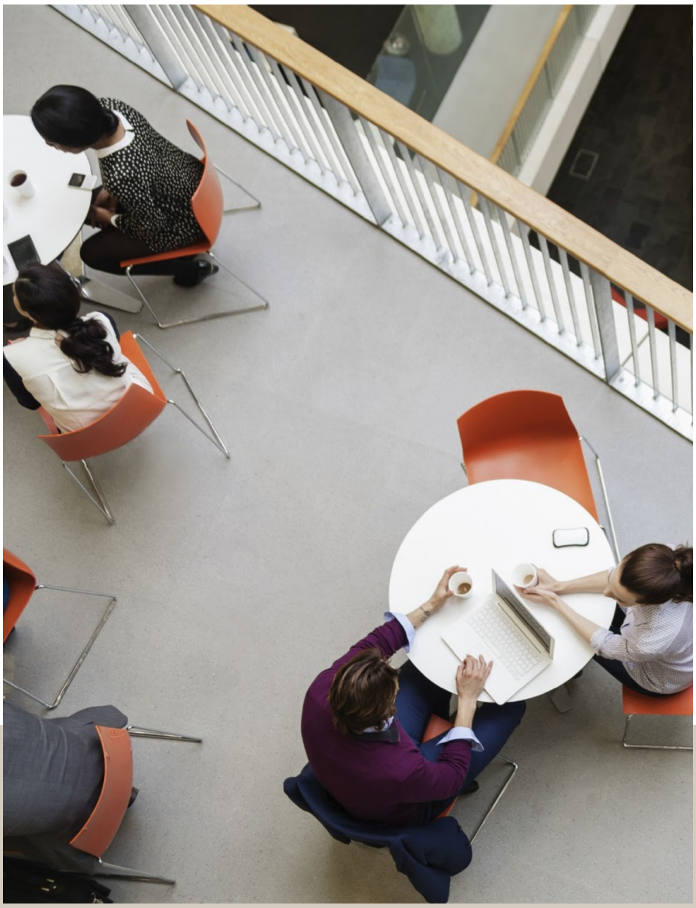

SUPERANNUATION INCOME STREAM RULE CHANGES

BY SIMEON LEVIN

A number of significant changes have been made to the taxation of income streams from 1 July 2017. This will have a practical implication on how to structure a property settlement in the most effective way.

$1.6 million Transfer Balance Cap

From 1 July 2017, a new transfer balance cap will apply to limit the amount of benefits a person can transfer from the accumulation phase to support retirement phase income streams.

This reform is designed to limit the amount of benefits a person can transfer to the tax-free retirement phase.

Broadly, the balance of existing retirement phase income streams at 30 June 2017 as well as the initial value of new income streams commenced on or after 1 July 2017 will be measured against an individual's personal transfer balance cap.

- General transfer balance cap

  The general transfer balance cap for 2017–18 will be set at $1.6 million and will be indexed annually in line with increases in the Consumer Price Index (CPI) in increments of $100,000.

- Personal transfer balance cap

  The personal transfer balance cap determines the amount that a person can transfer into retirement phase income streams. The personal transfer balance cap initially equals the general transfer balance cap in the year they first commence a retirement phase income stream. However over time, the personal transfer balance cap may differ from the general transfer balance cap due to proportional indexation, and an unusual debits and credits system.

It is important to understand that any amounts triggered in excess of the cap will need to be rolled back to accumulation phase or withdrawn from the superannuation system.

Transfer balance accounts

To determine when a person has exceeded their personal transfer balance cap, a transfer balance account system will be implemented from 01 July 2017. Transfer balance accounts will work like a general ledger, with amounts being credited and debited depending on a person's circumstances.

Creation of transfer balance accounts

A person will have a transfer balance account created for them when they first commence a retirement phase income stream. Alternatively, where a person is receiving a retirement phase income stream on or after 1 July 2017, a transfer balance account will be created for them on that date.

The value of a person's transfer balance account will then change depending on whether amounts are credited or debited from the account on any particular day. The net value of the account at the end of each day will then be used to determine whether a person has exceeded their transfer balance cap at that time.

Amounts credited to transfer balance accounts

The following amounts are required to be credited to a person's transfer balance account:

- The value of all existing retirement phase income streams as at 30 June 2017.
- The value of new superannuation retirement phase income streams commenced on or after 1 July 2017.
- The value of reversionary superannuation income streams as at the time the individual becomes entitled to them.
- Where a member has exceeded their transfer balance cap at a time, an amount of deemed earnings on the excess amount will also be added to the member's transfer balance account.

Note: Once a retirement phase income stream has commenced, any increase in the value of the pension due to investment returns will not be treated as a credit to the member's transfer balance account.

Amounts debited from transfer balance accounts

The following amounts will act as debits to a person's transfer balance account:

- The value of any lump sums commuted from a retirement phase income stream.
- The value of any structured settlement contributions made in respect of a person (e.g. personal injury payments).
- The value of any replenishment debits approved by the ATO. Replenishment debits apply in limited circumstances where the value of a person's retirement phase income stream has been impacted by:
  - Fraud or dishonesty
  - Bankruptcy
  - Family law payment splits
  - Situations where a trustee is unable to comply with a commutation authority and as a result, the income stream is no longer in retirement phase
- Where a pension or annuity ceased to be in retirement phase due to the provider failing to meet the pension standards in a year.

Note: Pension payments and negative investment returns do not count as debits. Therefore, the value of a person's retirement phase pension (such as an account based pension) could be quite different from the value of their transfer balance account where a person's account balance has been eroded by negative investment and/or pension payments.

Consequences of exceeding the transfer balance cap

Where a person exceeds their transfer balance cap, the ATO will direct the income stream provider to commute and remove the excess amount from the retirement phase. . This can be done by transferring the excess amount back to accumulation phase or withdrawing the excess amount from superannuation. The person may also be liable to pay tax on any excess notional earnings amounts.

Practical example

Joe and Gina have opted to use collaborative practice to get divorced. They are currently working with the team to understand their options for a property settlement and are specifically reviewing how to deal with their superannuation fund.

Joe has accumulated significant amounts of superannuation and at 1 February 2017, his SMSF account balance is $2.1 million. Gina, on the other hand, had taken considerable time off paid employment to have and look after their children.

When she was working, she was paid considerably less than Joe. Consequently, her SMSF account at 1 February 2017 is $320,000.

They are both 60 years of age and are considering retirement and commencing pensions in the near future. Under the new Transfer Balance Cap rules, Joe's account will be assessed separately to Gina's at 1 July 2017, to determine if he has an excess transfer balance amount.

Rather than taking his full account balance in the property settlement, Joe might negotiate a superannuation interest split of $500,000 to Gina (and equalise this payment by taking a larger stake in other assets in the pool). This will allow him to reduce his SMSF account balance to $1.6 million before 1 July 2017 in order to comply with the new transfer balance cap rules.

Gina's increased account balance of $820,000 is well within her transfer balance cap and so both she and Joe can commence pensions using their full account balances.

In summary

For the legal team representing a family unit in collaborative practice and especially when your clients have larger sums of money locked up in superannuation, please think about bringing a financial neutral into the process. From 1 July 2017, there will be a number of complex changes to the superannuation system that may affect a property settlement – to ensure it's both fair and effective!

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