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Federal Budget 2016-17
Tax insights
Superannuation changes

Snapshot

Up until 3 May 2016, it had been a long time since we had seen significant and far-reaching changes to Superannuation.

The majority of the Budget announcements are due to be effective from 1 July 2017, however the major announcement in relation to a lifetime cap for non-concessional superannuation contributions is due to apply from 3 May 2016.

Now that the Government is in caretaker mode as we head towards an election on 2 July 2016, the superannuation industry has some time to debate these announcements and assess their impacts.

We have analysed the Government's proposals as contained in the Budget announcements and considered the impact on employers, superannuation funds and individuals.

Our comments below are based on the assumption that all measures are legislated as announced. However, given the impending election, and some policy differences between the Government and ALP, it cannot be guaranteed that all measures will be legislated as announced. It will be necessary to continue to monitor the developments in this area, especially prior to undertaking any actions in response to the anouncements.

Contributions - caps, deductions and offsets

Lifetime cap of $500,000 for non-concessional superannuation contributions

The most significant and most immediate change is the introduction of a lifetime non-concessional contributions cap of $500,000 effective from 7.30 pm (AEST) on 3 May 2016. The cap will be indexed (in $50,000 increments) based on wages growth.

In addition, the lifetime cap will take into account all non-concessional contributions made on or after 1 July 2007.

If an individual has already made non-concessional contributions of $500,000 or more in total since 1 July 2007, no further non-concessional contributions will be allowed.

Contributions made before 7.30pm (AEST) 3 May 2016 will not result in an excess and can remain in super, however, excess contributions made after that time will need to be removed or be subject to penalty taxes.

Similar rules will apply to after-tax contributions made into defined benefits accounts and constitutionally protected funds.

The limitation on further non-concessional contributions will curtail the ability of individuals to add to their superannuation balances, even if the monies previously contributed had been detrimentally impacted by market factors such as the global financial crisis.

The limitation on non-concessional contributions does not affect the small business CGT contribution cap (which is $1.395m for the 2016 financial year and will be $1.415m for the 2017 financial year).

Action needs to be taken to understand and challenge the impacts of the proposed changes

Concessional contributions cap reduced to $25,000 from 1 July 2017

The annual concessional contribution cap will be reduced to $25,000 for all individuals regardless of age from 1 July 2017. The cap will be indexed based on wages growth.

The concessional contribution cap is currently set at $30,000 for those under age 49 on 30 June for the previous income year (or $35,000 for those aged 49 or over on 30 June for the previous income year) for the 2016 and 2017 financial years.

Division 293 tax threshold to be reduced

From 1 July 2017, the Division 293 tax threshold (beyond which high income earners pay an additional 15% contributions tax) will be lowered from $300,000 to $250,000.

The lower Division 293 income threshold will also apply to members of defined benefits schemes and constitutionally protected funds currently covered by the Division 293 tax. Existing exemptions from the Division 293 tax are to be maintained.

Scope to make personal deductible contributions to broaden

From 1 July 2017 all individuals up to age 75 will be allowed to claim an income tax deduction for personal superannuation contributions up to the concessional contribution cap, regardless of work status.

This is particularly beneficial for those who are partially self-employed and partially wage and salary earners, individuals whose employers do not offer salary sacrifice arrangements, and individuals aged over 65 (but under 75).

Individuals who are members of certain prescribed funds (such as untaxed funds, all Commonwealth defined benefits schemes, and certain state, territory or corporate defined benefits schemes) would not be entitled to deduct contributions to those funds.

Catch-up concessional contributions allowed in limited circumstances

From 1 July 2017, individuals with a superannuation balance less than $500,000 will be allowed to make additional concessional contributions where they have not used their concessional contribution cap in previous years. Contribution amounts can be carried forward on a rolling basis for a period of five consecutive years, but only unused contribution cap amounts accrued from 1 July 2017 can be carried forward.

The measure is designed to allow people with lower contributions, interrupted work patterns or irregular capacity to make contributions, e.g. women or carers, to make “catch-up” payments to boost their superannuation savings.

It will also apply to members of defined benefit schemes.

Low income superannuation tax offset introduced

From 1 July 2017, a low income superannuation tax offset (LISTO) will be introduced to effectively reduce the tax on superannuation contributions for low income earners who are possibly paying more tax on their superannuation contributions and earnings than they might otherwise be paying if they received the contribution as their own income.

The LISTO is a non-refundable tax offset paid to the individual’s superannuation fund, based on the tax paid on concessional contributions made on behalf of the individual. The LISTO is capped at $500 and will apply to individuals with adjusted taxable income up to $37,000.

The $500 cap reflects the tax on contributions of approximately $3,333.

Scope for low income spouse tax offset broadened

The low income spouse tax offset provides up to $540 per annum (based on 18% of the contribution made) for the contributing spouse.

From 1 July 2017, the income threshold for the receiving spouse (whether married or de facto) for eligibility for the offset will be increased from $10,800 to $37,000.

The offset remains capped at $540, but will apply to more people.

Deloitte perspective

The impact for individuals

- Individuals who are looking to maximise their contributions might like to take the opportunity to contribute up to the higher caps in the 2016 and 2017 financial years
- Individuals who have income in the $250,000 to $300,000 range might like to take the opportunity to make concessional contributions in the 2016 and 2017 financial years before the Division 293 tax impacts their contributions
- Individuals who have multiple and varied work arrangements who have previously been impeded by the need to be “substantially self-employed” will be able to take advantage of the new deduction arrangements from 1 July 2017. In addition, individuals who have retired but who are under age 75 (and who have other sources of assessable income) will be able to take advantage of the new deduction arrangements from 1 July 2017. Rather than making non-concessional contributions in the 2016 and 2017 years, individuals might consider whether it is appropriate to defer these contributions until after 1 July 2017 when some of the contributions could be deductible
- Individuals, with superannuation account balances less than $500,000 from 1 July 2017, will have additional options available to them to ‘catch-up’ on their superannuation contributions now that they are not as restricted by annual concessional contribution caps. Couples with unequal balances above and below the $500,000 level should consider their contribution policy to ensure, where appropriate, that one of the balances remains under $500,000 should the need for catch-up contributions in the future be likely

- Individuals might like to consider how they might qualify for the capital gains tax contribution cap regime when they are assessing their ability to contribute into superannuation
- Individuals who have already made non-concessional contributions of $500,000 or more since 1 July 2007 will be effectively prohibited from making any further non-concessional contributions to their super fund. These individuals need to closely assess the implications of this measure on their retirement planning, in particular in relation to any current or committed investments that required non-concessional contribution inflow to meet their commitments (e.g. repayments on borrowing arrangements) or to help fund future pension or death benefit payments
- Where there is no current eligibility to the LISTO or the Low Income Spouse Tax Offset, individuals might consider delaying contributions if they will qualify for an offset from 1 July 2017.

The impact for employers

- Employers may like to consider providing education and awareness of these superannuation changes to their employees
- Employers will need to consider the impact of the reduced concessional contribution caps on their salary sacrifice arrangements
- Employers will need to consider carefully the timing of contributions made (especially under salary sacrifice arrangements and especially near June 2017) to ensure that contributions being made are made in the correct year and don't result in excess contribution when the cap reduces
- Employers may need to consider the impact of these changes in light of any defined benefit arrangements in place.

The impact for superannuation funds

- Superannuation fund collateral and member communications will need to be reviewed and updated for the tax changes
- Superannuation fund systems will need to be updated or revised, for example, to administer LISTO, potential revised fund-capped contribution caps, and processing around distribution and collection of notices of intent to claim deductions from their members.

Anti-detriment payments

Anti-detriment death benefit provision to be removed

The anti-detriment provisions in respect of death benefits from superannuation will be removed from 1 July 2017. The anti-detriment provisions are often used, not only to pay additional benefits to beneficiaries, but also to create a tax deduction in the fund (often a substantial deduction) that could be used against income and contributions made to the fund in the current and future years.

Deloitte perspective

The impact for individuals

- Individuals should keep abreast of changes or enhancements to retirement income products. It may be that newer products could be more appropriate to their circumstances than currently available products

The impact for superannuation funds

- Superannuation funds will need to consider their administration systems and policies in relation to anti-detriment payments
- Superannuation funds may like to consider any scope to use the anti-detriment provisions in the period up to 30 June 2017 in cases where death benefits are to be paid to tax dependants (e.g. spouse, minor children, financial dependants) directly or through the deceased's estate

- Superannuation funds may also need to consider reviewing their member information in relation to death benefits paid to dependants

- Current reserving policies, where they exist, for anti-detriment reserves, will need to be reconsidered before 1 July 2017.

Pension balances – caps, TRISs and pension products

Pension transfer balance cap to be applied to everyone

In an effort to “better target tax concessions to ensure the superannuation system is sustainable, and improve confidence in the system by reducing the extent that superannuation is used for tax minimisation and estate planning” (Budget 2016 Superannuation Fact Sheet 02), a transfer cap of $1.6m on the total amount of superannuation savings that can be transferred from accumulation phase to pension phase will be introduced from 1 July 2017.

The $1.6m transfer cap will be indexed (in $100,000 increments) linked to CPI.

Subsequent earnings on these transferred balances will be allowed to remain in pension phase, but if the full $1.6m transfer cap has been used, any reduction of balances below that cap amount (e.g. because of pension payments or non-performing investments) can’t be added to from accumulation accounts or contributions.

Income earned on assets in pension phase will be exempt from tax (provided all other criteria have been met, such as meeting minimum pension requirements).

Where superannuation balances have accumulated in excess of $1.6m, the excess can remain in accumulation phase (and earnings will continue to be taxed at the concessional rate of 15%).

Perhaps the biggest surprise was for individuals who already have benefits in pension phase (where earnings are tax exempt). Come 1 July 2017, if their pension phase balance exceeds $1.6m they will be required to ‘transfer’ the excess over $1.6m back into accumulation phase (where earnings are taxable) or pay out the benefits (assuming they’re eligible to take benefits from super).

Any amounts left in pension phase at 1 July 2017 above $1.6m or amounts transferred to pension phase above $1.6m will be subject to the same treatment as currently applies to excess non-concessional contributions (i.e. if the individual doesn’t remove the excess from pension the excess will be taxed at the top marginal tax rate).

There will also be rules regarding multiple transfers over time from accumulation phase to pension phase (particularly taking into account the indexing). Essentially if an amount is transferred to pension phase that, say, equates to 70% of the $1.6m cap, a further amount of up to 30% of the indexed cap (to be known as the ‘cap space’) would be able to be transferred to pension phase.

Defined benefit scheme and constitutionally protected fund scheme members

Commensurate treatment for members of defined benefits schemes and constitutionally protected funds providing defined pensions will be achieved through changes to the tax arrangements for pension amounts over $100,000 from 1 July 2017.

Pension payments over $100,000pa to members of unfunded defined benefit schemes and constitutionally protected schemes providing defined pensions will continue to be subject to tax at marginal rates, however the 10% tax offset will be limited to $10,000 from 1 July 2017.

Members of funded defined benefit schemes will be subject to tax on 50% of the annual pension amount above $100,000 from 1 July 2017.

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The impact for individuals

- Individuals with pension phase balances over $1.6m at 1 July 2017 will need to act to transfer excess amounts to the accumulation phase or withdraw the excess from the superannuation funds
- The practicalities of this Budget measure will be the subject of a consultation process involving relevant stakeholders. Individuals will need to keep abreast of the mechanics and timing for transfer back to accumulation to ensure they are not caught by severe penalties and to ensure that the appropriate assets are maintained in pension phase or maintained in accumulation phase

The impact for superannuation funds

- Superannuation funds will need to ensure they have the ability for fund members to transfer their benefits from the pension phase and return to accumulation phase where their benefits exceed the $1.6million cap. Changes to Trust Deeds may be required.
- PAYG Withholding and reporting arrangements may need to be implemented (if not already in place) to reflect changes in the tax treatment of certain pensions.

Changes to tax treatment for transition to retirement income streams (TRIS)

Transition to Retirement Income Streams (TRISs) were introduced in 2005 with the intent of allowing people to supplement their earnings while they were reducing their working hours pending retirement. There were no rules put in place that required a reduction in working hours or earnings in order for a TRIS to be commenced.

Currently earnings on assets supporting TRISs are exempt from income tax. This tax exemption will be removed from 1 July 2017, although the ability to receive the TRIS is not being removed.

In addition, the ability for an individual to elect for their TRIS payments to be treated as a lump sum for tax purposes in certain circumstances (and which generally reduces the tax liability for an individual aged under 60) will be removed.

Other than these changes, the TRIS provisions remain the same.

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The impact for individuals

- Individuals considering commencing a TRIS may need to consider if it remains a relevant option for them.
- Individuals who are already in TRIS mode (and who are not likely to have satisfied the retirement requirements) may need to consider whether the changes from 1 July 2017 to the taxing of income in TRIS/pension phase and the changes to contribution caps (both concessional and non-concessional) make maintaining the TRIS worthwhile.
- As the new TRIS taxing rules only apply to TRISs and not to post retirement pensions, individuals should determine whether they qualify as meeting a retirement condition of release and advise their fund if that is the case.

The impact for superannuation funds

- Superannuation funds will need actuarial support (where they are not segregated) to ensure that they can identify income streams supporting TRISs.

  Superannuation funds will need to ensure processes are put in place to enable their members to keep them up to date on whether they have satisfied a condition of release such that TRIS restrictions do not apply or no longer apply.

Tax exemption for earnings supporting income streams

A key part of our superannuation system that has matured slowly is retirement income product development. One of the reasons for reduced innovation in this area relates to the fact that the tax exemption on earnings afforded to retirement income streams did not extend to certain products.

The changes propose that there will be tax exemption on earnings in the retirement phase to products such as deferred lifetime annuities and group self-annuitisation products. These products seek to provide individuals with income throughout their retirement regardless of how long they live.

Deloitte perspective

The impact for individuals

- Individuals should keep abreast of changes or enhancements to retirement income products. It may be that newer products could be more appropriate to their circumstances than currently available products

The impact for superannuation funds

- Superannuation funds may like to reassess their strategies around income stream products offered
- Superannuation funds might consider developing more flexible products for their members (or to attract new members).

Labor Party superannuation policies

The Labor Party announced the following superannuation policies back in April 2015:

- The Division 293 tax threshold (beyond which high income earners pay an additional 15% contributions tax) should be lowered from $300,000 to $250,000. This is consistent with the Budget announcement in relation to Division 293 changes
- Earnings in excess of $75,000 per annum in the pension phase should be taxed at 15%. This in effect is the measure to address large balances within superannuation and compares to the Budget announcement of the $1.6million pension transfer cap

In addition, following the Budget announcements the Labor Party confirmed its previously announced plan to establish a Council of Superannuation Custodians that would consider among other issues, superannuation tax changes.

In direct response to the Budget announcements on 3 May 2016, the Labor Party has suggested that it, in general, supports the Coalition Government's plan to curb superannuation tax concessions for wealthier Australians although at the same time indicating that retrospective changes to superannuation would not be supported.

It would appear from recent commentary from senior Labor Party politicians that the ‘look-back’ to 2007 to determine the ability to make non-concessional contributions is regarded as “retrospective”, but no specific mention has been made that any other superannuation changes announced in the Budget are seen as retrospective.

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