#138 Heffron SuperNews

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Heffron SMSF Solutions

Problem solved

In this newsletter, we switch our focus from strategy to implementation. What actually needs to be done by those who must change their pensions to respond to the new $1.6m pension transfer balance cap or changes to transition to retirement pensions? By when? And how?

Introduction

Since the first round of legislation was released in November 2016, Heffron's focus has been understanding the new rules, identifying the strategies, working with Treasury and the ATO where we have identified gaps or issues with the practical aspects of the new rules and responding to several subsequent updates from Treasury (who, as recently as 12 April released more key amendments).

As 1 July 2017 approaches, it's time to turn to implementation.

This edition of Heffron SuperNews looks at this in detail for those affected by the two major pension reforms – the $1.6m pension cap and transition to retirement pension changes:

- What needs to be done urgently?
- What must be documented before 30 June 2017?
- What can be left until the new financial year?
- What myths are emerging that we should simply stop worrying about?

We have considered this exclusively from the perspective of a self managed superannuation fund – other funds will require much more work before 30 June 2017.

Moving money to other funds

Some clients may decide to move part of their super to another superannuation fund – for example, to operate their pension and accumulation investments separately or maintain accumulation accounts with different tax free proportions separately. In the latter case, where the individual wishes to have multiple accumulation accounts, the transfer will need to occur before 30 June 2017.

It will be important to remember that the timing and process for doing that might affect apparently unrelated issues such as:

- The timing of re-setting any cost bases for the purposes of the CGT relief; and even
- Eligibility for the CGT relief itself (a fund with a mix of accumulation and pension balances that becomes 100% pension balances at any point before 30 June 2017 is ruled out of the relief entirely).

The $1.6m pension cap

Some decisions will need to be made in the lead up to 30 June 2017:

- Determine whether the pension is to be partly rolled back to accumulation phase or whether the excess over $1.6m is to be cashed out of the fund. A key point to note here is that even if a client ultimately intends to cash the balance out, rolling back to accumulation phase first (on 30 June 2017) might be simpler – the subsequent payment out of super can then happen at any time, including after 1 July 2017.
- Where a client has multiple pensions, decide the order in which those pensions should be rolled back); and
- Decide whether any changes should be made to the reversionary arrangements for those pensions remaining in place

The decisions on rolling back existing pensions need to be made **before 30 June 2017** but the minute can be worded to reflect the fact that actual balances are not known at that time.

What is important in documenting the instructions before 30 June 2017 is that the member's intentions (and the trustee's actions) are unambiguous, do not depend on any discretions or subsequent actions or choices by the member or any other party and the only unknown is the actual value of an account balance or a superannuation pension. The resolution also needs to be irrevocable

In our practice we will generally be recommending that this happens on 30 June 2017 after all income has been received for the year so that:

- The fund is in pension phase as long as possible;
- All pension payments have been made;
- There is no chance that the pension account can grow after the roll back (accidentally exceeding the $1.6m cap);
- If the fund is a segregated fund, this date will be the date on which cost bases are re-set under the CGT relief. 30 June 2017 is therefore a convenient date from a record keeping perspective; and
- Many funds will be able to avoid getting an actuarial certificate for 2016/17

Myth. If a fund has a mixture of pension and accumulation accounts even for just 1 day on 30 June 2017, it will be forced to obtain an actuarial certificate. This is not the case. Actuarial certificates are a tax requirement not a compliance requirement – so you only need to get one if you want to claim a tax exemption on income the fund earned during the period when it had that mix of accumulation and pension balances. If there was no income earned on that day, don't bother getting the actuarial certificate. If the fund did receive a lot of taxable income on that day, get the certificate!

Opting into CGT relief

The key action before 1 July 2017 is to *take whatever action is required to be eligible for the relief* and be clear on the date the cost base is re-set (called the "cessation time").

For a fund claiming the relief under the "segregated" method, this could include:

- Resolving to partly commute an account-based pension so that assets cease being "segregated" (in which case the cessation time will be whatever date that roll back occurs); or
- Accepting a contribution that is not kept apart from the remainder of the fund's investments (in which case the cessation time will be the date the contribution is accepted – even if this was back in January 2017); or
- For funds which have only transition to retirement pensions, no action is required as long as new amendments to the legislation (drafts were released for comment on 12 April 2017) are passed (in which case the cessation time is actually 1 July 2017 not 30 June 2017 in the draft changes).

Myth. Funds that are currently segregated (e.g. 100% in pension phase) only get CGT relief on the assets transferred back to accumulation phase rather than the whole fund. This is not the case. In fact the trustee generally won't know the exact balance being transferred back to accumulation phase at the time – making this requirement almost impossible to meet.

Generally, we expect funds to minute a proposed roll back to accumulation phase of an amount calculated in a certain way (e.g. the excess over $1.6m) and the entire fund will become pooled at that point. Under that scenario, **all assets of the fund that meet the conditions (eg held throughout 9 November 2016 – 30 June 2017) will be eligible.**

For a fund claiming the relief under the "proportionate" method, this could include:

- making sure the fund doesn't become 100% pension phase at any time during the period 9 November 2016 – 30 June 2017; and
- maximizing the Fund's actuarial % for 2016/17 (e.g. making contributions and pension payments late in the year).

Myth. You have to do something about the CGT relief for every pension client. This is not the case. Remember that broadly speaking the relief is only available for those affected by the $1.6m transfer balance cap or who have transition to retirement pensions (of any size). Clients who have less than $1.6m each, no other super and are fully retired cannot get the CGT relief in any case.

There are some steps that are vitally important but don't need to be carried out before 30 June 2017.

Choosing the assets

Choosing which individual asset the trustee will "opt in" to the CGT relief. The decision does not need to be made until the fund's 2016/17 income tax return is due for lodgment and it is reported to the ATO at that time.

Importantly, however, remember that if the fund is required to lodge its return early (e.g. often funds that have lodged late in the past are required to lodge before 31 October rather than 15 May) – it must be ready to also opt into the CGT relief at that time and lodging late will risk the fund's ability to claim the CGT relief.

Adjusting the cost base of fund assets where CGT relief has been adopted

While this takes effect from 30 June 2017 or another cessation date for certain funds using the segregated method, it does not need to be specifically reported to the ATO. Since the Fund ***is not actually required to make any decision about CGT relief*** until the 2016/17 return is due for lodgment, they can delay any cost base re-sets until that time.

One practical point, however, if the trustee, broker or adviser decide to sell assets in (say) August 2017 they will be unable to accurately determine the capital gains tax if they have not yet decided whether or not to opt into the CGT relief for that asset.

Those who need accurate reporting immediately after 1 July 2017 will therefore need to bring this decision forward, decide which assets should have their cost bases re-set and have that reflected in their investment systems as soon as possible.

For funds adopting the CGT relief on the proportionate method (which relies on the actuarial % for 2016/17) it will be impossible to determine precisely how much gain is being carried forward to future years until the 2016/17 accounts are prepared.

Transition to retirement pensions

The original legislation would have required some transition to retirement pensions to have been formally commuted and re-commenced in order to be treated as "retirement phase" pensions post 1 July 2017. This is important because only retirement phase pensions are eligible for the tax exemption on fund earnings.

Draft amendments released on 12 April will change this so that a transition to retirement pension will automatically become a full (retirement phase) account-based pension once a condition of release such as retirement or reaching age 65 is met.

If passed, this will apply for pensions already in place at 30 June 2017 and hence it will not be necessary to re-set these pensions during 2016/17.

(Note that if the member's transition to retirement balance is less than $1.6m, it might actually be beneficial for the pension to remain a transition to retirement pension until at least 2 July 2017 so that the CGT relief is available!)

Market linked pensions

There are a range of challenges presented by market linked pensions – There are some steps that should be taken before 30 June 2017:

- it will be beneficial for some clients to set a shorter or longer term for their market linked pension (see our paper "SMSF Strategies for 2016/17 and beyond", April 2017). Subject to the trust deed and pension contract this can be achieved by fully commuting and re-commencing the pension (with new terms applying to the new pension).

  This can be done on 30 June 2017 without knowing the actual balance of the market linked pension at that time – it would simply be expressed in a way that makes it clear the commutation represents the entire pension at the time;

- the legislation governing how the "special value" is determined (for the purposes of the $1.6m pension transfer cap) places enormous importance on the first payment for 2017/18. Essentially the law works by taking that first payment, identifying the number of days to which it relates and "reverse engineering" an annual amount. This makes sense where the regular pension payments are fixed (e.g. $5,000 per month) but not where there is no direct link between an individual payment and the period to which it relates.

  Someone who intends to take the bare minimum from their market linked pension might draw that in ad hoc amounts at different times during the year. Furthermore, the actual amount would be dependent on an account balance which is unlikely to be known at the time they take any payments early in the year.

In our practice we are recommending that:

- those who take regular payments should just continue to do so and the special value will be worked out using that amount (although note that the way the formula works, the amount used will not simply be (say) the July payment x 12).
- Those who always take the minimum should minute that in a way that ensures the minimum payment (once known) will be used to determine the special value of the pension.

Conclusion

There is undoubtedly a lot to do between now and 30 June 2017 for pension clients. Bear in mind, however, that those with SMSFs have some valuable breathing space and flexibility when it comes to implementing events such as pension roll backs.

We have attached a summary of the action we recommend now as a checklist.

2017 Super Reforms – pre 30 June 2017 implementation checklist

Recommended Action on existing full account-based pensions

- ☐ Minute the intended roll back(s) comprehensively now – to take effect at 30 June 2017 (or other appropriate date)
- ☐ Minute any changes to reversionary arrangements for remaining pensions

Recommended action on CGT relief

- ☐ Pre-30 June 2017: Minute noting the Fund's circumstances that will trigger eligibility for the CGT relief, which method will apply and the date on which cost bases will be re-set
- ☐ After 30 June 2017 (in conjunction with the lodgment of the annual return): Minute recording specifically which assets have been selected for CGT relief, their new cost base and (in the case of the proportionate method only) the deferred notional gain.

Action for transition to retirement pensions:

- ☐ Fully commute any that are no longer optimal – there is no urgency to do this before 1 July 2017
- ☐ Identify those where the member has already met a condition of release, re-classify them as full account-based pensions and take action in relation to roll backs etc. as outlined earlier.

Recommended Action for market linked pensions

- ☐ Minute and commutations / recommencements to re-set the term if applicable
- ☐ If the minimum payment for 2017/18 is to be used for the purposes of calculating the special value for pension transfer cap purposes, minute to ensure this is used regardless of the timing and amount of the first payment in 2017/18.