#142 Heffron SuperNews
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Heffron SMSF Solutions
Problem solved

As income tax returns for 2016/17 roll off the presses, it's time to make sure that some important CGT relief issues are not overlooked.

Introduction

One of the best things about the CGT relief was that for the most part, thinking about it could be deferred under after 30 June 2017. But as we begin to lodge 2016/17 returns, it's time to make sure:

- Relief is claimed where it can be and is beneficial for the client;
- It is not claimed in circumstances when it doesn't help the client reduce taxes over the longer term; and
- The right elections are made, paperwork completed etc.

Much has been written about the specific rules and regulations applicable to the relief and this newsletter does not aim to repeat this. We can provide comprehensive technical papers for anyone looking for a complete guide.

However, in this edition of Heffron SuperNews we highlight our top 8 tips for optimising the position for clients eligible for the relief.

Tip #1: Elect on time

Remember that:

- Elections about the CGT relief are made as part of the annual SMSF return (on the separate CGT schedule);
- For most funds likely to claim the relief, this means decisions can be made as late as May 2018 if the return is not lodged until that time (while new funds must lodge in February 2018 we expect most of these will be ineligible or choose not to claim the relief since it only applies to assets held at 9 November 2016); and
- Funds that have an earlier lodgment deadline (e.g. 31 October 2017 because they lodged their 2015/16 return late) only have until this time to think about CGT relief and make sure they lodge their return on time and opt in.

Tip #2: Check the "re-set date" carefully – don't assume it is 30 June 2017

For those taking up the relief on the "proportionate method", the date on which the cost base is deemed to be re-set is always 30 June 2017.

For those eligible under the "segregated method" however, the re-set date could be any time between 9 November 2016 and 30 June 2017. In fact, it could even be different dares for different assets (although this will be unusual).

The re-set date will be whatever date the relevant asset stopped being "segregated". This might be:

- the day a contribution was received after 9 November 2016;
- the day a member made an election after 9 November 2016 for a payment drawn from a pension to be taxed as a lump sum;
- the day pension accounts were partly commuted (often 30 June 2017); or
- simply the day the trustees decided to stop running the fund as a segregated fund.

Tip #3: Remember that funds providing transition to retirement pensions have a special deal

These funds are still potentially eligible for the relief even if ***nothing changed*** with their pensions in the lead up to 30 June 2017.

This is particularly relevant for those funds eligible for the relief on the "segregated method" where a fund normally had to ensure that the chosen assets had stopped being segregated before 30 June 2017.

If the fund had a transition to retirement income stream (TRIS), however, it will still be eligible for the relief even if there was no "end" to the segregation on or before 30 June 2017 and the TRIS remained in place beyond that time.

Equally, however, the TRIS does not ***have*** to be kept in place to secure the relief. A fund that fully commuted a TRIS and rolled it back to accumulation phase because it will no longer receive a tax exemption on its investment income can use this as a trigger to cease segregating assets (if, say, the fund was entirely in pension phase). It will then be eligible for the relief assuming all the other conditions are met.

Finally, remember that it doesn't matter how big the TRIS balance was or whether it was ever likely that the member's pension would exceed $1.6m. Funds with members receiving a TRIS have a special pathway to the CGT relief.

A fund with:

- One member receiving a TRIS (valued at $1m); and
- One member receiving an account-based pension (also valued at $1m)

would be eligible for the relief regardless of whether any changes are made to the members' pensions.

This would not be the case if the TRIS was a full account-based pension (see Tip #4 below).

Tip #4: Bear in mind the ATO view about needing to "take action" (other than for transition to retirement pensions)

Rightly or wrongly, the ATO takes the view that members need to actually be affected by the changes to entitle the fund to CGT relief.

In particular, funds that don't provide any transition to retirement pensions and instead just have full account-based pensions will miss out on the relief if none of the members needed to roll back any superannuation to meet the new $1.6m limit by 30 June 2017.

There are plenty who disagree with the ATO's view but for those wishing to avoid becoming the first test case, it is useful to know that the ATO has been consistent and vocal about the Commissioner's position.

Tip #5: Don't assume that it always makes sense to opt into the relief

Funds claiming the relief on the proportionate method effectively "lock in" to include the taxable portion of the capital gain built up before 30 June 2017 in a tax return – it's simply a matter of when it will be included

Consider a fund where 70% (according to the actuarial certificate) of the fund's investment income is exempt from tax in 2016/17.

By opting into the CGT relief, it would re-set the cost base of an asset it purchased several years ago from (say) $400,000 to $700,000. Doing so would trigger a taxable capital gain of:

$300,000 x 2/3[1] x (1 – 70%) = $60,000

Whether the fund elects to pay tax now on this $60,000 or defer the gain, it will have to recognise this taxable gain "one day" and pay tax on it eventually – it's just a matter of when.

That won't necessarily be ideal if the fund is highly likely to be 100% in pension phase by the time the asset is sold. Had the trustee done nothing about the CGT relief, the entire gain would have been entirely exempt from tax.

In this case, the trustees should consider:

Will the actuarial % be higher in the future when we sell the asset? If so, we may choose not to opt into the relief.

Tip #6: On the proportionate method – always defer the capital gain if the fund has capital losses (either carried forward from previous years or triggered in 2016/17)

Remember that if the capital gain triggered by opting into the relief is not deferred, it will be offset in full against any losses carried forward from previous years or realised in 2016/17.

It will therefore "use them up" even if the fund's actuarial % is very high.

In the example earlier, for instance, the full $300,000 gain would reduce any losses carried forward from 1 July 2016 or realised during 2016/17.

If, on the other hand, the $60,000 calculated earlier was deferred and only included in the tax return when the asset was sold, it would only "use up" $60,000 of the fund's carried forward capital losses at the time the asset was sold.

Note the special treatment of gains when the trustee chooses to defer them - this is the one and only time when the gain is discounted and then further reduced by the actuarial % ***before*** being applied to losses.

Tip #7: Don't ignore assets that are in a loss position

The focus of the CGT relief is obviously assets with large unrealised gains at 30 June 2017.

But remember that those claiming CGT relief and their exempt current pension income for 2016/17 under the proportionate method can also opt into the relief for assets currently in a loss position.

Funds that might choose to do this would be those with large capital gains already realised during 2016/17 (on which they are expecting to pay tax) and:

- have assets that are virtually worthless but have not yet been written off (so opting into the CGT relief will allow the fund to "use" the loss this year rather than waiting until the asset is formally written off); or
- are expecting their actuarial % to increase in the future relative to 2016/17. This might be common if a funds has only one member in pension phase during 2016/17 but

[11] The usual 1/3rd discount that applies to assets that have been held for more than 12 months.

the second member will commence a retirement phase pension in the next few years.

Why would this favour opting in to the CGT relief on an asset currently in a loss?

A capital loss is only as valuable as the amount of tax it can save. If a fund reaches a point where it is not paying much tax any more (thanks to a high actuarial %), the loss is less valuable.

In contrast, it might be very valuable in 2016/17 to reduce an immediate tax bill!

Tip #8: It's not a case of "one in, all in"

Funds that are eligible for the CGT relief are perfectly entitled to choose which assets they apply it to. They can even choose to defer recognising the taxable capital gain for some assets and not for others (although note that there is no deferral option in cases where opting into the relief crystallises a capital loss).

Conclusion

The CGT relief is potentially very valuable for those with large gains built up before 1 July 2017. But like most things in superannuation there are always many issues to think about before opting in.