Retirement Income – Transfer balance cap

The transfer balance cap limits the amount that can be transferred into what is known as the 'retirement phase' of superannuation and receive the benefit of 0% earnings tax. For the 2023/24 financial year, the general transfer balance cap is $1.9 million.

How it works

The transfer balance cap limits the amount that can be transferred into what is known as the 'retirement phase' of superannuation and receive the benefit of 0% tax on earnings.

All individuals have their own transfer balance cap. Your personal cap is determined based on a number of things, including:

- the general transfer balance cap at the time you first commence a retirement phase superannuation income stream,
- a proportional amount of indexation that may be applicable as a result of indexation to the general transfer balance cap, and
- the total of amounts that you have used to commence retirement phase income streams.

When a superannuation income stream is commenced or transfers to retirement phase, you will start to have a 'transfer balance account'. These accounts are managed by the Australian Taxation Office. This is a notional account, where certain types of transactions you make in relation to your superannuation income streams are recorded. Your transfer balance account relative to the available cap is what determines whether you're eligible to transfer additional amounts to retirement phase pensions in the future.

If your transfer balance account exceeds the cap at any time, additional tax and penalties may apply.

Income streams measured against the transfer balance cap include:

- account based pensions,
- defined benefit pensions, or
- deferred income stream payable or transition to retirement income streams payable to a person who has met one of the following conditions of release:
    - retirement,
    - terminal illness,
    - permanent incapacity, or
    - reaching age 65.

Death benefit superannuation income streams (with modifications for child death benefit pension) are also treated as retirement phase pensions and are assessed against the cap.

NOTE: Transition to retirement income streams are not assessed against the transfer balance cap until certain conditions of release have been satisfied (see above). Please refer to the 'Transition to Retirement Pension' Understanding Series for further information.

What counts towards your cap?

The transfer balance account operates via a credits and debits system, and doesn't reflect your pension account balances at a particular time. This means that your actual retirement phase pension balance may be more or less than the deemed balance of your transfer balance account.

A credit is an assessment against the cap which will most commonly apply when an income stream commences, or when a person has certain other types of superannuation income streams, such as 'transition to retirement' income stream, and they either reach age 65 or notify their fund that they have met another condition of release (such as retirement).

Where you commence a new account based retirement phase pension, the value at commencement is the amount that will be credited to your transfer balance account and assessed against the cap.

A debit arises to reduce the amount assessed against your cap. Debits include adjustments for certain amounts such as:

- contributions made under a structured settlement
- commutations (or lump sums) taken from your income stream, and
- adjustments to meet family law settlements.

Regular pension payments and market movement which may arise due to fluctuations in investment values, do not impact your transfer balance account. That is, they will not result in a credit or a debit.

Certain income streams, including defined benefit pensions and market-linked pensions, that do not ordinarily have an account balance, have a value determined for the purpose of the transfer balance cap, based on a formula contained in the legislation.

Exceeding the cap

An excess transfer balance occurs if the total value of all credits to your transfer balance account exceeds your transfer balance cap. This would arise for example, if your cap was $1.9 million and you commenced a pension with $2.1 million. In this case, you would receive a credit for $2.1 million and would have a $200,000 excess transfer balance amount.

You would not be deemed to have an excess however, if your cap was $1.9 million, you commenced a pension with this amount, and through investment returns, your account balance increased to $2.1 million over time. This is because you would only receive a credit to your transfer balance account of $1.9 million, as this is the amount you used to commence your pension, and market movement doesn't result in a debit or a credit.

In the case of an excess, it will be necessary to:

- reduce the amount held in pension phase (e.g. a partial commutation) and
- pay excess transfer balance tax.

This applies for income streams that can be commuted (i.e. converted to a lump sum) such as an account based pension. The amount commuted must also include notional earnings (see below). The excess amount can be rolled back to the accumulation phase of superannuation or taken as a lump sum withdrawal out of the superannuation system. Depending on your age, you may have to pay tax on any amount you take out of superannuation as a commutation. There is no limit to what you can maintain in a superannuation accumulation account, so this option may enable you to maximise your investments in a concessionally taxed environment.

If non-commutable income streams (eg defined benefit pensions) are in excess of the transfer balance cap, the underlying capital cannot generally be removed to reduce the amount assessed against the cap. In such cases, excess transfer balance tax is not payable; however the taxation of the income stream payments may change (see below).

The excess transfer balance tax is based on notional earnings determined by a legislative formula. Excess transfer balance tax is payable for all days where the amount held in pension phase of superannuation is in excess of the cap.

Notional earnings are subject to tax. The additional tax for the first breach of the cap is 15% and subsequent breaches 30%.

If you exceed your transfer balance cap, adjustments to the pension can be made as soon as possible to minimise the excess transfer balance tax. If you are unaware or leave the funds in pension phase, the ATO will make a determination once the information from superannuation provider is received. Notional earnings will be calculated from the date of breach through to when a determination is made and that amount will then attract the General Interest Charge.

Once you have received a determination, the ATO provides you the opportunity to reduce the amount held in your pension by the amount in that determination. If you do not take the necessary steps, the ATO can provide a notice to your superannuation pension provider to make the necessary commutation on your behalf.

Non-commutable income streams exceeding the cap

Non-commutable income streams are also assessed against the cap. The value of these income streams is determined by a legislative formula. In many cases, these income streams cannot be commuted if the assessment creates an excess against the transfer balance cap.

Where non-commutable income streams are in excess of the transfer balance cap, the taxation of the pension payments will change. Pension payment (income) above what is known as the 'capped defined benefit income cap' is subject to different taxation rates compared to those amounts within the cap. In 2023/24, the general capped defined benefit income cap is $118,750. However, your cap may be reduced, based on your personal circumstances, and the types of non-commutable pension income you're receiving.

The taxation is summarised below:

Type of scheme	Age	Amount below $118,750* income cap	Amount above $118,750* income cap
Taxed	< Preservation age	Taxed at marginal tax rate	Taxed at marginal tax rate
	> Preservation age - 59	Taxed at marginal tax rate less 15% offset	Taxed at marginal tax rate less 15% offset
	60 +	Tax-free	50% of amount above cap added to assessable income and taxed at marginal tax rate
Untaxed	< Preservation age	Taxed at marginal tax rate	Taxed at marginal tax rate
	> Preservation age - 59	Taxed at marginal tax rate	Taxed at marginal tax rate
	60 +	Taxed at marginal tax rate less 10% offset	Taxed at marginal tax rate

*A general cap applies in 2023/24. Please note that the $118,750 income cap may be reduced in certain circumstances.

Transfer balance cap indexation

The transfer balance cap may be indexed in future years to CPI in $100,000 increments. The extent that an individual will benefit from indexation depends on whether that person has triggered a credit (or assessment) against their own transfer balance cap.

If a person has not triggered a credit against their transfer balance cap, they will benefit from the full increase of any indexation.

Those who have commenced an income stream but have not fully utilised the cap will have indexation applied only to the proportion of the unused transfer balance cap.

Indexation is not available for those who have completely utilised their transfer balance cap.

NOTE: The transfer balance cap indexed on 1 July 2023 from $1.7 million to $1.9 million. Only individuals who start a retirement phase income stream for the first time from 1 July 2023 will be eligible for the new cap of $1.9 million. If you already had a retirement phase income stream at any time before 1 July 2023, your transfer balance cap will be between $1.6 million and $1.9 million, plus a proportion of the cap indexation.

Benefits

The benefits can include:

- Earnings on retirement phase account based income streams are taxed at 0% if within your transfer balance cap.
- Certain non-account based income streams payments, such as defined benefit pensions, receive favourable tax when assessed within the cap.
- Superannuation savings above the transfer balance cap can continue to be held in the accumulation phase where earnings are taxed at up to 15% which may be lower than your marginal tax rate.

Risks, consequences and other important things to consider

These may include:

- Commencing a superannuation income stream triggers an assessment against your transfer balance cap and the ATO establishes your transfer balance account.
- If the total amount used to commence superannuation income streams in retirement phase exceeds the cap, additional tax is generally payable.
- If you exceed the cap and have account based income streams, you are required to reduce the amount plus the notional earnings to ensure your transfer balance account reduces to your personal cap (including indexation where eligible).
- If you exceed the cap and have non-account based income streams (such as defined benefit pension), certain tax concessions no longer apply to the amount above your income cap (general cap is $118,750 p.a. in 2023/24).
- Death benefit pensions are also assessed against the transfer balance cap. Special rules apply to death benefits paid to children.
- When you first commence a retirement phase income stream and the ATO establishes your transfer balance account, indexation of your cap will be limited to the unused portion. If you have utilised the full transfer balance cap, no indexation will apply to your cap.

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Important information: