Understanding the $1.6 million transfer balance cap

Version 1.1

This document provides some additional information about the **$1.6 million transfer balance cap** discussed in the SOA so that you can understand the benefits of the strategies recommended to you, and the associated costs and risks.

HOW TO READ THIS DOCUMENT

Managing your finances to meet your day to day requirements as well as your long-term goals can be a complex task. There are all sorts of issues you will need to consider such as taxation, legislation, protecting your wealth and assets, associated costs and the inherent risks of investment. When undertaking a financial plan it is important that you understand how these issues will impact you and what you should expect over time.

Your financial adviser will provide you with a Statement of Advice (SOA) which sets out the details of the advice and how it will meet your goals and objectives.

This document provides some additional information to help you understand the financial planning concepts discussed in the SOA in relation to the **$1.6 million transfer balance cap**.

It is very important you read this document to help you understand the benefits of the strategies recommended to you and the associated costs and risks.

Please contact your adviser if you have questions relating to the content in this document, or need further information or clarification.

$1.6 transfer balance cap

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

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 pension, any indexation that may be applied to the general transfer balance cap, and the total amounts that you have used to commence retirement phase pensions.

When certain types of income streams are commenced, a person will start to have what is known as a 'transfer balance account'. 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, penalties may apply.

The transfer balance cap applies to all retirement income streams – both those commenced before and after 1 July 2017.

Income streams measured against the transfer balance cap are either a:

- superannuation income stream payable to an individual,
- some defined benefit pensions, or
- deferred income stream payable to an individual 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 the account holder reaches age 65, or notifies the fund that they have met another full condition of release (see above).

What counts towards your cap

The transfer balance account is operated 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.

Where you commence a new retirement phase pension, the account balance 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.

Defined benefit income streams that do not ordinarily have an account balance, have an account value determined for the purpose of the transfer balance cap, based on a formula contained in the legislation. The calculation is:

Annual Income x 16

As the transfer balance cap applies to the individual, the cap is therefore cumulative of all income streams that are owned by that individual.

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 exist for example, if the cap was $1.6 million and you commenced a pension with $1.8 million. In this case, you would receive a credit for $1.8 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 $1.6 million, you commenced a pension with this amount, and through investment returns, your account balance increased to $1.8 million over time. This is because you would only receive a credit to your transfer balance account of $1.6 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 excess amount can be rolled back to the accumulation phase of superannuation or taken as a lump sum tax withdrawal. There is no limit to what you can maintain in a super 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 is amended (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.

If a person exceeds their transfer balance cap, adjustments to the pension can be made as soon as possible to minimise the excess transfer balance tax. If the person is unaware or leave the funds in pension phase, the ATO will make a determination once the information from superannuation funds 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.

Notional earnings will be subject to tax at:

- 15% for the first breach or any breaches that occur in 2017/18, and
- 30% for subsequent breaches.

Non-commutable income streams exceeding the cap

Non-commutable income streams are assessed against the cap. The value of the income stream 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. The taxation of income above $100,000 will be subject to different taxation compared to those amounts within the cap. The taxation is summarised below:

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 benefits 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.

Type of scheme	Age	Amount below $100,000 income cap	Amount above $100,000 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	Taxed at marginal tax rate less 15% offset
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

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