thinkBIG 2018

White paper: Digesting the *real* impact of the overhaul to the superannuation system – what now?

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Prepared by:

Katie Timms
National Director
Superannuation & SMSF Services

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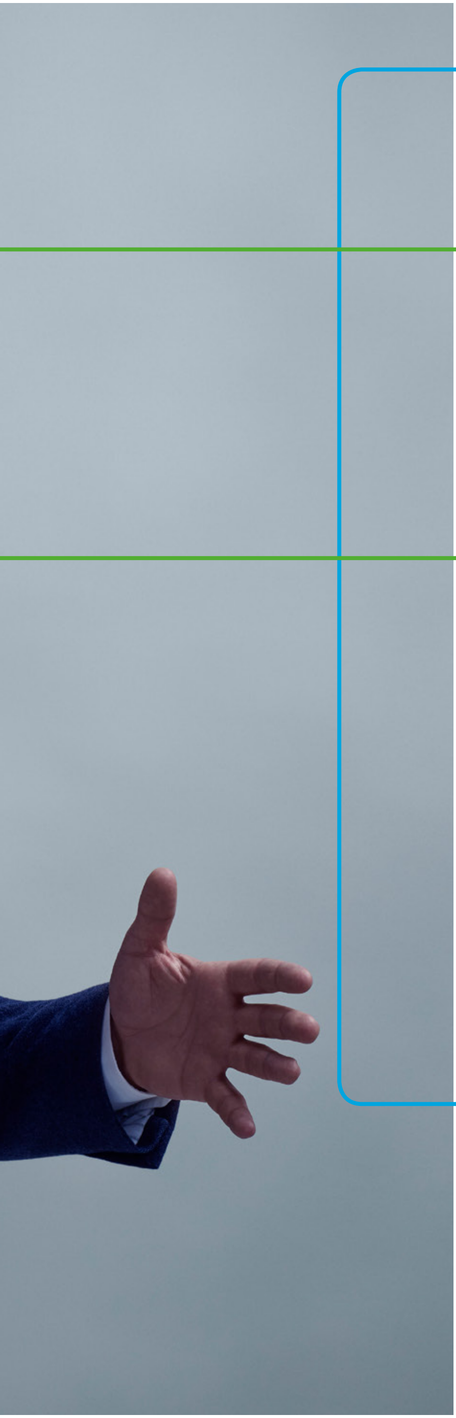


TWO YEARS ON, THE IMPACT IS CLEARER.

The May 2016 Federal Budget was one that sent shockwaves through Australia's superannuation system, as it overhauled almost all facets of super including contributions, pensions and reporting. A short time frame for introduction left some scrambling to address pensions over $1.6 million, and the availability of capital gains tax relief, and it is only now that the dust is settling that the longer term implications are really being felt.

In addition, announcements from Bill Shorten in March 2018 are threatening to undermine the system yet again by taking away the refunding of excess franking credits.

WHAT DOES IT ALL REALLY MEAN FOR PEOPLE PLANNING FOR THEIR RETIREMENT, AND FOR THOSE STILL TRYING TO RESTRUCTURE?


Concessional contributions have been reduced to a maximum of
$25,000 per person

CONTRIBUTIONS

The Change

From 1 July 2017, concessional (deductible) contributions have been reduced to a maximum of $25,000 per person.

Non-concessional (or after tax) contributions are limited to only $100,000 per person, with the availability of using the bring forward rule if under age 65, depending on how much is already in superannuation. This lets people use some of their cap from future years, but they need to be careful that their balance allows them to do so.

The table below demonstrates how much the bring forward rule allows you to contribute each year.

Super Balance @ 30 June	Total Contribution	Time Frame
$0 – $1,399,999	Up to $300,000	3 years
$1,400,000 – $1,499,999	Up to $200,000	2 years
$1,500,000 – $1,599,999	Up to $100,000	1 year
More than $1,600,000	Nil	Nil

Why is this a problem?

Treasury announced that these changes would impact less than 4% of super account holders, as so few people ever actually contribute more than $25,000 a year. This may very well be true but seems to overlook a few important facts.

Employees since 1992 have had the benefit of compulsory superannuation being provided for them, which provides a good basis for retirement savings. However, there are many who were working prior to this, and many self employed who have not had this provided. In addition, we know that cash flow to make extra super contributions isn't free until people are over 50, and the mortgage is paid off and the kids have moved out. Recent research from Class Super confirms this, and shows that almost 26% of SMSF members over 49 took advantage of the higher cap that was available, and a further 17% of members under 49 contributed more than the new limit of $25,000 last year[1]. For many business owners, it Is the business itself that is the retirement plan, so the cash for retirement isn't available until the business is sold.

[1] Source: Class Super December 2017 Benchmark Report

What do you need to do?

There were a few rays of light that the super reforms provided to help alleviate some of the contribution pain, but for many the changes only highlight the need to plan ahead, and to be prepared for how they intend to structure their retirement funding.

SOME KEY MATTERS THAT NEED TO BE CONSIDERED WHEN LOOKING AHEAD INCLUDE:

1. **Is there an ability to use the new catch up concessional contribution rules?**
   From 1 July 2018, you will be able to look back and contribute up to five years' worth of unused contributions – but only if your superannuation balance is less than $500,000, and your taxable income is high enough to allow the deduction.

2. **Have the new downsizer contributions been considered?**
   If you are over 65 and sell your house, you may be able to contribute some of the proceeds to super.

3. **Do you actually know what your total superannuation balance is?**
   It has become more important than ever to be more engaged with what and where your super is.

4. **If your business is your retirement plan, are you eligible for the small business capital gains tax concessions?**
   Is there a way for you to be able to structure to allow these all powerful exemptions to be used? Planning for a business sale should be taking place well before the actual sale is due, and understanding these opportunities with your adviser is vital.

An individual can only commence a pension with up to

$1.6 mil

The average SMSF balance is just under

$800,000

per member

A quarter of SMSFs own commercial property and a further **20%** own residential property

THE $1.6 MILLION CAP

The Change

As at 1 July 2017, an individual can only commence a pension with up to $1.6 million. For those existing pensions, the excess must be converted back to $1.6 million as at 1 July 2017. In addition, the limit applies to any death benefits received.

Why is this a problem?

Treasury announced that this change would impact less than 1% of superannuation balances, and in the first instance, this is probably quite true. However, the problem that is far less understood is the application of this on death benefits that are sometimes received from a spouse.

If a couple both have **$900,000** in superannuation pensions, they will exceed the **$1.6 million** cap when one passes away if the benefit is transferred to the spouse as is almost always the case.

Recent research has shown that the average SMSF balance is just under $800,000 per member, meaning far more people will be impacted by these changes on the death of a member than was initially understood. For the first time in over 10 years we are facing a future where assets may need to leave superannuation on death.

The flow-on impact of this begs the question – what do you do when the assets owned by the SMSF are 'lumpy', real estate assets, particularly farmland or business properties? According to December 2017 research[2], a quarter of SMSFs own commercial property and a further 20% own residential property, meaning that the risk of not having cash to pay out a death benefit is quite high. Insufficient SMSF estate planning after these changes means the risk that the farmland or business property might end up with the wrong person is far higher than you would want.

[2]Class Super December 2017 Benchmark Report

What do you need to do?

The impact of these changes in relation to estate planning will continue to be felt for a number of years. One of the big advantages to SMSFs over the years has been its ability to hold your business property, but the reforms force a new consideration about the best way to get a property out, at the right time and with minimal taxes.

SOME KEY QUESTIONS THAT YOU SHOULD ASK YOURSELF INCLUDE:

1. **Do you know where your superannuation benefits are going to end up?**
   Too often we hear the comment that it has been covered by the will. In reality, superannuation is not automatically covered by the will and it may be left up to the trustee of the fund to decide where that goes.

2. **Is it better for your pensions to auto-revert to your spouse, or is it better to allow some discretion on your death?**
   There is no blanket answer that will apply to everyone, and the different timing impacts on the new $1.6 million cap can be significant.

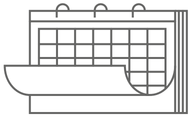
3. **Have you thought about how to transfer the farming, investment or other significant assets in your SMSF to the next generation?**
   Is it best for this to happen on your death, or earlier? Capital gains tax, stamp duty and uncertainty may suggest it is better to address these issues before the death of the member.

4. **What impact will it have if you have to cash out part of your business premises, and do you actually know where that will end up?**
   Too often a great deal of planning goes into how a property will get into super, and not enough on how to get it back out.

REPORTING AND ADMINISTRATION

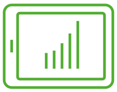
The Change

As part of the introduction of the $1.6 million cap on pensions, superannuation funds will now need to report certain events to the ATO, including the starting and stopping of pensions, and when any partial commutations of pensions are done. The rules for SMSFs mean that if any member has a total superannuation balance of $1 million or more, this reporting will need to be done on a quarterly basis.



Why is this a problem?

The requirement to provide more frequent reporting may be both a positive and negative for SMSF trustees. For those trustees who still provide manual data to their accountant or administrator, this may force far more work than would usually be necessary. Automation and the electronic capturing of data has eased a number of these burdens but a surprising number of SMSF trustees do not utilise these services. Never has an SMSF trustee said they enjoy the process of compiling information for their annual audit, and the idea of having to do that more regularly may be more of a headache than anything else. And electronic data feeds may be helpful to those who can get them, but they aren't available for all accounts and all assets.



"I love compiling information for my annual SMSF audit," said no one.

What do you need to do?

These changes are not all bad news. It will mean a greater engagement and knowledge of superannuation balances than has ever been had before. Only certain events will need to be reported, which may mean that most won't need to report often at all. However, for those that have a total superannuation balance of $1 million or more, it will be important to put things in place to be prepared to report when needed. Ensuring that administrators have the ability to capture information and report when needed will ease trustees into the reforms with minimal fuss.

FINAL THOUGHTS

Stability of our superannuation system

Since 2007, superannuation members have faced years of constant tinkering in the rules, culminating in the reforms in 2017. The significance of the changes, and the fact that it addressed so many of the concerns and issues that had existed meant that it suggested members might finally be given some breathing space. However, before some of the changes had even been properly implemented, further updates were being proposed by the Opposition. These changes, including the removal of the refunding of franking credits and the additional comments around potential changes to the taxation of superannuation withdrawals have unsettled SMSF trustees everywhere.

The fundamental issue here is that while the government is attempting to encourage people everywhere to plan early and make decisions about their retirement, they are providing no assurances and guarantees that their plans will even be valid in two years' time. Is the system perfect? Probably not. But should it be treated as the cash cow every time there are Federal budget concerns? Absolutely not.

To read more on Superannuation investment and broader financial planning implications, click here.

CASE STUDIES

1

JAMES (53) AND LISA (51) HAVE JUST SEEN THEIR LAST CHILD OFF TO UNIVERSITY AND OUT OF THE HOUSE, AND ARE STARTING TO THINK ABOUT WHAT THE FUTURE HOLDS FOR THEM.

James has been running his own machinery business for a number of years, and has been throwing all available money back into the business to keep building. This has started to pay off, and the business is making good profits. He is starting to feel tired though, and is thinking about retiring in 10–15 years. Lisa has been working part time for the last 10 years to help pay off their mortgage.

NEVER BEEN A FAN

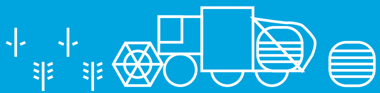
JAMES HAS NEVER REALLY BEEN A HUGE FAN OF SUPERANNUATION BECAUSE HE DIDN'T WANT TO TIE UP HIS MONEY WHEN HE COULD USE IT BETTER IN HIS BUSINESS.

He has made some contributions in big profit years to save tax, but only has a balance of about **$380,000.**

Lisa worked before having kids, and has received some superannuation from the business and her part time job, and has a balance of about **$120,000.**

They both want to retire comfortably and think that selling the business will be key to their retirement, but they also want to start making contributions to super between now and retirement. They are also nervous about losing all their hard-earned profits in tax.

James and Lisa will be impacted by the reduced concessional and non-concessional caps. They might be able to use the catch up of concessional contributions in the future, but they will need to seek advice as to whether to make additional contributions or invest in the business. **The key for James and Lisa will be to make sure they have thought about the advice and assistance they will need early enough to maximise the tax concessions that may be available for them.**

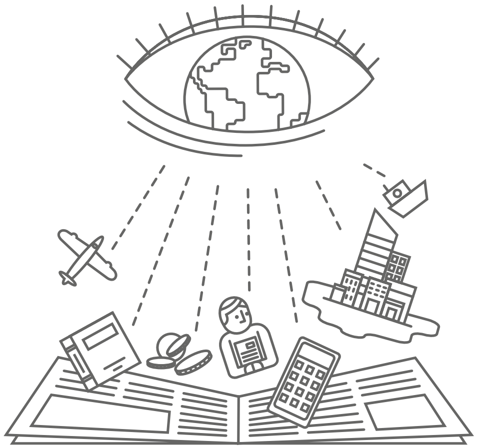


2

BOB (66) AND DEBRA (67) HAVE BEEN FARMING FOR YEARS, BUT THE TIME HAS COME FOR THEM TO START HANDING THE FAMILY FARM ACROSS TO THEIR DAUGHTER MARIE AND SON-IN-LAW ROBERT, WHO HAVE BEEN FARMING ALONGSIDE THEM FOR THE PAST 10 YEARS.

Bob and Debra have held part of the farm inside their SMSF for the last 15 years, and have worked hard to build their SMSF to be worth just over $2.2 million (with the farmland worth $1.2 million and their other assets worth $1 million). Bob and Debra also have another daughter, Michelle, who isn't involved in the farm. They want to make sure that the farmland in their SMSF is passed to Marie, and that the remaining assets are left to Michelle when both of them pass away.

Bob and Debra are both drawing pensions from their SMSF, but haven't really thought about how the new changes are going to impact on them as their individual balances are less than $1.6 million. However, if something happens to Bob or Debra, there will be more than $1.6 million left in superannuation. They will need to carefully consider how to deal with the excess, and what assets (if any) will need to be cashed out of the SMSF.



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