AIA Member Briefing:
What the proposed changes to superannuation mean to you

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The changes announced in the Budget in relation to superannuation are profound. They will impact on many AIA members, from those aspiring to build superannuation balances to take care of their financial needs later in life, individuals in transition to retirement and to retirees in full pension mode. The proposals are disruptive to many current financial plans and personal aspirations as they challenge many of the assumptions on which those plans have been built.

The abrupt manner in which the changes have been introduced creates uncertainty and reduces confidence in superannuation as a method to provide for future provisions in retirement.

Peter Costello provided this advice on 7 Jul 2015 on the ABC. *"Give it certainty. I think during the last government there was something like I counted up 33 different changes in budgets and mid-year reviews to superannuation. People just don't trust superannuation as being a long-term vehicle anymore. They know the rules are going to vary from year to year. They're afraid to lock voluntary money into the system, which is why it's just running on the compulsory contributions at the moment. And, you know, if you want to put money away for 20, 30 or 40 years, you gotta have some certainty it's going to be there when you retire and I think the Government's got to give it some certainty."*

In its 2016 budget, the Government said it would legislate the purpose of superannuation as "to provide income in retirement to substitute or supplement the Age Pension", and went on to say that superannuation would "not allow for unlimited wealth accumulation and estate planning." This philosophy underpins the proposed changes. Yet the announced changes were much greater than many had expected. Furthermore, some of the changes may be regarded as retrospective, and will severely impact the retirement planning of many individuals.

Here are some of the key points of the new superannuation rules, as we understand them today. You may need to obtain independent financial advice for your own particular circumstances. The new rules will:

Limit the amount that can be saved in superannuation for retirement

- Concessional (pre-tax) contributions reduced to $25,000 pa for everyone (including people over age 50), still taxed at 15% on the way in.
- However unused contributions can be rolled forward for five years as long as other caps are not exceeded and provided that your super balance is less than $500,000.

Concessional tax rates depend on income

- The temporary measure of 30% on combined incomes is to be made permanent and starts at the reduced level of $250,0000, not $300,000 as before.
- Individuals with an adjusted taxable income of $37,000 or less will receive a refund of the 15% tax paid on their concessional contributions, up to a cap of $500.

Non-concessional (after-tax) contributions are lifetime limited and backdated to 2007.

- Prior to 2007 there were no limits, more recently limits have been $180,000pa or a 3-year bring forward limit of $540,000. The new lifetime limit for non-concessional contributions is $500,000 commencing from 1 July 2007.

Pension fund accounts capped, therefore limiting the size of a super pension

- The total amount that an individual can transfer into retirement phase accounts will be capped at $1.6m from 1 Jul 2017.
- Investment returns that increase the total amount over $1.6m can remain in the pension account.
- However if the fund drops below $1.6m it cannot be topped up.

Accumulation accounts taxed at 15%.

- Amounts in excess of $1.6m that cannot be moved to pension phase can be transferred into an accumulation account where the income is taxed at 15% and capital gains taxed at 10%.
- Alternatively, funds can be moved outside the superannuation system.

Transition pension accounts – the fund paying the pension loses its tax-exempt status and so it is to be taxed at 15%.

- This impacts funds with as little as $150,000. Previously these accounts were untaxed.

Reversionary pensions received from a spouse will need to be converted back to accumulation phase if the $1.6m cap is breached.

New rules to apply to defined benefits schemes

- The superannuation tax reforms will be applied commensurately to members of defined benefit schemes and constitutionally protected funds. The Government will consult on implementation of these changes to avoid unintended consequences.

There were some further changes which might be considered beneficial:

Work test removed.

- Individuals under 75 can claim tax deductions for personal contributions.
- Contribution acceptance rules are the same for those aged up to 75 from 1 Jul 2017.

Spouse tax offset extended.

- Income threshold increased to $37,000 and contributing spouse offset of 18% up to $540.00.

Tax exemption extended to deferred lifetime annuities and group self-annuitisation products.

Potential issues for members.

What the changes mean will depend on each individual's situation. Here are some issues that you may need to consider:

1. Disruption of retirement plans and costs associated with updating financial advice and planning.

2. Uncertainty regarding the operation of the $1.6m capped pension accounts, including issues such as valuation and asset segregation.

3. Urgent need to calculate total non-concessional contributions made since 1 Jul 2007. In particular, individuals should ensure they do not exceed the $500,000 cap as of 3rd May 2016 to prevent financial penalty of 47% on excess contributions.

4. Those with real assets greater than $1.6m need to ascertain whether rents and income can provide for the compulsory payment of pensions from the pension account and mandatory tax from the accumulation account or whether those assets will need to be liquidated.

5. Those who have transition pensions drawn from an accumulation account and are working will need to assess their position given that from the Budget date their earnings will be taxed in the fund. This could significantly change retirement plans for some people.

6. Those who have paid a deposit on purchase of property inside their SMSF and who intended to make a large non-concessional contribution before settlement may need to obtain urgent legal advice.

In essence the changes have greatly limited the flexibility of superannuation as a tool for people to plan for their retirement, particular those who wish to build up larger balances to fund their expected lifestyle in retirement. Treasury estimates that the $1.6m can generate a pension about four times that of the single old age pension, a figure the AIA disputes. Restricting the balance of the pension account to $1.6m increases the likelihood that superannuation will not last for a person's lifetime, and thus they will need to fall back on the old age pension in later years when their medical expenses are likely to be higher. The magnitude of the changes and the precedence set will reduce the confidence people have in super as a retirement vehicle. They are more likely to move their funds to other tax-advantaged structures such as family trusts or negative gearing, which will bring other risks to the economy.

We would be interested to hear your views or the issues you see in these changes as we build our advocacy on this matter during the election campaign. Please send any comments to *aia@investors.asn.au*