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SuperGuardian

Technical Bulletin: Keeping up with an ever-changing contribution environment

In the world of superannuation contributions, the maze between what is the law and what is not yet law and what factors influence the law will often lead to confusion, genuine mistakes and missed opportunities. Whether it be the anticipation of legislation working its way through parliament, the expectation of indexation occurring at a future date or the uncertainty of future market performances, all of these matters impact the capacity for clients to undertake various contribution strategies. This bulletin will look at what impact constant change has, and will continue to have, on contributions and contribution strategies.

Since superannuation reforms, and the resetting of contribution caps, came into effect on 1 July 2017 there has been a minimum of one new contribution measure or impact item come into effect from each 1 July since. With indexation pending, 1 July 2021 and perhaps 1 July 2022 could see us resetting our contribution navigational tools 5 years in a row, and that's without any further Government announcements.

Whilst some of these measures impact concessional contributions, it is non-concessional contributions that carry the load of uncertainty especially when contemplating non-concessional contributions versus tax-free contributions that are excluded from the non-concessional contribution cap and which are impacted by the transfer balance cap and the total superannuation balance.

With the Federal Budget now behind us let's unwind the contribution confusion and work out what we can do now and what is still awaiting finalisation, and while we are at it let's identify what options are available if someone does the wrong thing, because the chances are high.

Non-concessional contribution cap

From 1 July 2020 the non-concessional contribution cap remains at $100,000, or more accurately, the concessional contribution cap remains at $25,000 and the non-concessional cap remains at four (4) times the concessional cap.

The non-concessional contributions cap will generally apply to:

- all personal member contributions for which no tax deduction is claimed;
- any spouse contributions; and
- any benefit transferred from an overseas superannuation fund within 6 months of moving to Australia permanently and any non-taxable portion of a foreign transfer received outside this period.

Amounts that are specifically excluded from the non-concessional contributions cap include:

- Government co-contributions;
- CGT small business concession contributions (i.e. eligible proceeds using the 15-year exemption and $500,000 of gains under the retirement exemption) up to a lifetime limit, currently $1,565,000 for 2020/21, known as the 'CGT cap';
- Downsizer contributions; and
- Structured settlement contributions.

CGT small business concession contributions and downsizer contributions may very well be the big ticket items out of some of these super changes. As a point, roll-over superannuation benefits do not count towards the non-concessional contributions cap, regardless of their components.

Transfer balance cap & total superannuation balance

Since 1 July 2017, a member's ability to contribute non-concessional contributions is subject to their total superannuation balance being less than the general transfer balance cap. Their ability to utilise the bring-forward provisions is subject to **how much** their total superannuation balance is **below** the general transfer balance cap!

By virtue of no change to the concessional contribution cap at 1 July 2020, the maximum three year bring-forward amount currently remains at $300,000. Therefore, subject to the member's total superannuation balance at the preceding 30 June the bring-forward rules work as follows:

- if less than $1.4m - bring forward $200,000, maximum contribution = $300,000
- if between $1.4m & $1.5m - bring forward $100,000, maximum contribution = $200,000
- if between $1.5m and $1.6m - bring forward $0, maximum contribution = $100,000

The ability to make non-concessional contributions and use the bring-forward provisions are not proportionate based on how much under these limits an individual is. For example, an individual with $1,599,999 at 30 June can contribute $100,000 the following year assuming they meet the age and/or work test requirements.

The trap for anyone considering contributing in future years is that all future contributions are subject to the total superannuation balance test immediately prior to the year of contribution. If in those subsequent years, the total superannuation balance is over the general transfer balance cap threshold then any contribution will be in excess of non-concessional contribution cap. The member's age is also relevant, more so in 2020/21.

The indexation dilemma

Before we get strategic it's important to recognise that the future indexation of the contribution and transfer balance caps is a key factor in how we advise clients and importantly how much we advise clients to contribute.

These two critical indexation calculations for contribution purposes are calculated under the same premise but both use different factors.

Concessional contribution cap

As stated above, the concessional contribution cap, currently $25,000 is the driver behind the non-concessional cap. The concessional contribution cap is indexed based on the following formula:

Current Cap x <u>AWOTE December quarter immediately prior to financial year</u>

AWOTE Base quarter (December 2016)

AWOTE is Average weekly ordinary times earnings for an adult. The Base Quarter factor from December 2016 is 1,533.40.

The concessional cap is indexed in amounts rounded down to the nearest $2,500.

To achieve indexation of the contribution caps the target factor for AWOTE = 1686.00 which means this is the number the industry wants to see when the December quarter for 2020 are release, likely in February 2021. This would result in the following calculation:

1686.0/1533.40 = 1.0995 (round to 3 decimal points) = 1.100

$25,000 x 1.100 = $27,500

As it stands, AWOTE for the June quarter 2020 was 1713.90. AWOTE for the year from June 2019 to June 2020 increased by 3.8% which is basically unheard of in the past decade, the factor is most definitely skewered by the impacts of COVID-19 but nonetheless this means even with a slight drop of these skewered numbers for December and we will see indexation of the concessional cap resulting in the non-concessional cap increasing to $110,000.

General Transfer Balance cap

The indexation of the General Transfer Balance cap is achieved by using a similar formula but instead of AWOTE, the factor used is linked to the Consumer Price Index (CPI) based on the all groups weighted average of 8 capital cities. The General Transfer Balance Cap is indexed in amounts rounded down to the nearest $100,000. The formula is as follows:

General Transfer Balance Cap x <u>CPI December quarter immediately prior to financial year</u>

CPI Base quarter (December 2016)

The Base factor = 110.0 (December 2016)

To achieve indexation of the cap the target factor = 116.9, which is the number we need to keep our eye out for following the December 2020 quarter as that would look like this:

116.9/110.0 = 1.0627 (round to 3 decimal points) = 1.063

$1,600,000 x 1.063 = $1,700,800 – Transfer Balance Cap of $1,700,000

However, recent CPI information from June 2020 indicate a factor of 114.4, compared with a March Quarter factor of 116.6. Given that CPI is based on consumer spending it may very well be that the extended lockdown in Victoria and restrictions on travel don't see us hitting that indexation mark.

COVID-19 has had an opposing impact on our indexation factors and we need to be patient to see what that amounts to. For the purposes of the bring-forward provisions it means from 1 July 2021 we could have exactly the same requirements as we currently have or we may have one of the following two tables to follow:

Table 1 indicates indexation of the contribution cap but not the transfer balance cap:

Total superannuation balance previous 30 June	Non concessional contributions cap for the first year	Bring forward period
Less than $1.38 million	$330,000	3 years
$1.38 million to less than $1.49 million	$220,000	2 years
$1.49 million to less than $1.6 million	$110,000	No bring forward period, general non concessional contributions cap applies
$1.6 million or more	Nil	N/A

Table 2 indicates what the bring-forward rules would look like if both caps are indexed:

Total superannuation balance previous 30 June	Non concessional contributions cap for the first year	Bring forward period
Less than $1.48 million	$330,000	3 years
$1.48 million to less than $1.59 million	$220,000	2 years
$1.59 million to less than $1.7 million	$110,000	No bring forward period, general non concessional contributions cap applies
$1.7 million or more	Nil	N/A

Just focussing on the bring-forward rules is complex enough, however, we also need to factor in changes to the contribution age rules.

Age is a factor

Age is a factor that complicates the non-concessional rules and bring-forward provisions. From 1 July 2020 anyone under the age of 67 is eligible to make non-concessional contributions without having to satisfy the work test. However, as it currently stands, any member who is aged between 65 and 74 on 1 July can only utilise the standard non-concessional cap of $100,000, with those 67 and over having to meet the work test. This means for now these members are not entitled to use the bring-forward provisions, well not yet anyway. However, there are also some quirks if the member has triggered the bring forward rules prior to their 65th birthday, as highlighted in the below example.

NOTE: legislation is currently before parliament to align the bring-forward rules with the contribution age limit rules and so the hope is that before too long individuals will be able to 'trigger' the bring-forward at any time prior to their 67th birthday. Passage of the law will remove one complication.

<u>Example – Current application of the 'bring forward' provisions – 64 on 1 July – single contribution</u>

Jock, born on 1 February 1956, has recently received some money following the sale of an investment property.

He retired in July 2020 and would like to know the maximum amount of personal superannuation contributions he can make in the 2020/21 year. Jock has not made any personal contributions in previous years.

As Jock is under 67 he is not required to meet the work test, so assuming his total superannuation balance as at 30 June 2020 was less than $1.4m, he may make non-concessional contributions of up to $300,000 at any time in the 2020/21 year.

A common misunderstanding that existed prior to the 1 July 2020 changes centered on the timing of the contribution. Now, Jock only needs to meet the work test if he is making any contributions after turning age 67. Therefore, as Jock doesn't turn 67 until 1 February 2023 he can contribute up to $300,000 any time in the year he turns 65 without having worked. It is only if he wants to contribute after his 67th birthday that the Trustee must be satisfied that he has met the gainful employment requirement i.e. the work test. That of course is also subject to the work test exemption rules that apply in certain circumstances and are discussed below.

Trigger year one and balance in future years

What if Jock only has the capacity to contribute $110,000 in the 2020/21 year? When he makes the $110,000 contribution he triggers the bring-forward provision giving him the ability to contribute a further $190,000 up until 30 June 2023, subject of course to his total superannuation balance.

For the 2021/22 year Jock will be 65, turning 66. Given the contribution age increase Jock will be able to contribute the balance in that year without having to satisfy the work test at all, just the total superannuation balance test. It is only if Jock wants to contribute the balance in the 2022/23 year that further. Let's assume in 2022/23 Jock has the capacity to contribute the $190,000 remaining of his bring forward amount. Depending on the date of the contribution, he may now have to satisfy the work test in order to utilise the remainder of the bring forward limit. This will be the case if Jock wishes to contribute after 1 February 2023.

Prior to 1 July 2017 the fund could not accept an amount that exceeded what was called the fund capped contribution limit, which for someone previously over the age of 65 was the single year non-concessional cap. This meant that previously Jock could not contribute $190,000 in a single contribution after his birthday but rather would have to split the amount into separate transactions. However, this impediment has been removed ensuring Jock can contribute the full remainder of the bring forward amount, subject to the work test and the total superannuation balance at the preceding 30 June, as long as the bring-forward has been triggered in the appropriate year.

As a further comment. it is not a requirement for the member to have met the work test requirements after turning 67, it is a financial year test so even if Jock only satisfied the requirement for a couple of months at the start of the financial year then he can contribute the $190,000 at any time up until 30 June 2023. Additionally, the work test conditions should be prospective meaning that at the time of the contribution the trustee must be satisfied that the member has met the test prior to accepting the contribution. Of course in Jock's case if he has the money before his 67th birthday then that makes everything a whole lot easier.

Once legislation has passed and the bring-forward age moves to 67 this will mean that a client can trigger the bring-forward as long as they are under 67 on 1 July but any contribution made after their67th birthday will be subject to the work test.

Work Test Exemption from 1 July 2019

The introduction of the 12 month work test exemption can cause confusion and result in mistakes being made, however, it could also prove to be extremely valuable for some. It is important to distinguish this measure from the increase in the contribution cut out age from 65 to 67.

Available for contributions made since 1 July 2019 an individual who is now 67 or over and no longer working can make superannuation contributions subject to satisfying two conditions.

The first condition is that the individual must have satisfied the work test in the financial year immediately prior to the year of the contribution and the second requirement is that the individual's total superannuation balance at 30 June immediately prior to making the contribution is less than $300,000.

To satisfy the work test in the previous financial year, the individual must have been gainfully employed for at least 40 hours in 30 consecutive days.

What this means from an SMSF strategy point of view is that on the assumption that that bring-forward rules are changed as indicated, someone who turns 67 during the financial year could conceivably contribute up to $300,000 having retired in the previous year subject to their balance being below $300,000 the previous year.

Who does this measure impact?

This measure is going to have the capacity to impact 3 distinct groups of people, all of course subject to them having less than $300,000 in superannuation at the previous 30 June.

The first group is those individuals who turn 67 during the financial year. Historically the emphasis on this group was that they had to make sure they worked during the year of their 67th birthday in order to make a contribution or they had to make the contribution prior to their 67th birthday. Now, so long as they worked the previous year, the timing of the contribution is not so critical. The added bonus, as stated above, is that if they turn 67 after 1 July they are entitled to the full $300,000 and given their total superannuation balance is less than $300,000, are not at risk of failing the bring- forward criteria.

The second group will be those who trigger the bring-forward in a previous year but did not contribute to the maximum capacity. Whilst this group may exist, it is unlikely that someone who contributes more than $100,000 in a prior year will have less than $300,000. However, it isn't unrealistic to apply this to individuals who haven't contributed significantly to super through their employment lifecycle and have come into surplus funds as they approach retirement. In any case, for this group they have the capacity to maximise any triggered bring-forward amount without having to meet the work test in year three.

The final group is those who have worked past 67 and no longer avail themselves to the bring-forward provisions. For them this measure provides the capacity to contribute a further $100,000 to superannuation as a non-concessional contribution.

Importantly, this work test exemption does not limit itself to non-concessional contributions. If an individual has passive income in the 12 months post-retirement then the concessional contribution cap is also available.

One impact item for both this measure and the movement of the contribution age from 65 to 67 may be the use of the small business CGT contribution. It is conceivable that an individual has had limited capacity to contribute to super due to putting all their resources into their business. Timing and capacity to make these contributions is linked not only to the sale of an active asset but also satisfying the work test, so this 12 month extension could prove valuable.

Example

Susan runs a small business and has had limited capacity to contribute to super over her working lifetime. At 66 Susan retires with $250,000 in super but small business assets worth $2m with a capital gain of $1m. Under the small business concessions assuming that Susan has not held the assets for 15 years she would apply the 50% CGT reduction resulting in a gain of $500,000. That $500,000 is equal to the lifetime retirement exemption of $500,000 meaning Susan could contribute $500,000 tax-free to super and offset her entire capital gain. Further, as Susan's total superannuation balance was $250,000 she could contribute an addition $300,000 from the proceeds of the sale in the year she turned 67 as she had satisfied the work test the previous year. The trick would be making sure she didn't make the CGT contribution in one year and the non-concessional in the next.

The opportunities whilst not endless can be considerably significant particularly when paired with downsizer contributions and concessional carry forward contributions.

Doing the wrong thing

People make mistakes and mistakes can be fixed. Superannuation contributions are subject to two distinct set of rules. Contributions that exceed the contribution cap are subject to excess contribution rules and contributions that are not entitled to be made are subject to refunding rules.

Importantly, only those contributions that are not able to be received in the first instance are able to be directly returned to the contributor, primarily because they should not be recognised as contributions. However, contributions that result in an excess contribution cannot be returned directly to the contributor, they must be washed through the ATO under the appropriate release authority. The onus of proof as to whether a contribution made prior to turning 67 is a mistake will fall with the trustees and as such it is a risky proposition to refund a mistaken contribution prior to age 67 without having substantial proof that the amount was not a contribution in the first instance.

These two distinct sets of rules are where these new measures can be beneficial but also complex for trustees.

We have all come across individuals who make a contribution after age 67 (previously 65), not having satisfied the work test. In very simple terms, the trustee cannot accept this contribution. The amount must be returned within 30 days of being aware of the contribution. The non-release of this amount within 30 days is a direct violation of the SIS Regulations. We can all argue about when the 30 days commences but the ATOs historical position is that for SMSF trustees the 30 days starts from the day of the contribution because of the direct link between member and trustee.

What this means is that for SMSFs that have members over the age of 67 who make a contribution and don't satisfy the work test, or the work test exemption, or the downsizer contribution conditions then the fund can't accept the contribution. As a result any amount put in needs to be taken out. Other contributions will be subject to the excess contribution regime.

Concessional contributions

Where a client may get caught out is when they make a concessional contribution as these are not linked to total superannuation balances. If a member makes a personal contribution, and claims a tax deduction and the deduction is denied then the amount will be considered non-concessional. Similarly, if the member exceeds their concessional cap and elects not to refund the excess it will be deemed non-concessional. If their balance is greater than $1.6m then they have exceeded their non-concessional cap, which would now be nil and it will result in the excess non-concessional rules being applied.

Considerations

The conundrum that people face is not whether to make contributions but whether to make them now and how much to make. Waiting for indexation can create a problem as a member's balance may increase and the result is they can't use certain contribution measures. Of course many contributors are not impacted by the transfer balance cap and as such have greater freedom in what they do.

What is far more relevant than indexation is what combination of contribution strategies can be used to maximise an individuals benefit. This bulletin has identified some without going deep on downsizer, concessional catch up, spouse contributions and re-contribution strategies. All of which are made more viable by the increase in contribution age to 67. Of course the devil will be in the future detail and the failures of waiting can often be about opportunities lost due to the introduction of new measures. There have been enough new measures over the past 15 years that suggest certainty is the best time to act.

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