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HEFFRON SMSF SOLUTIONS

Implementing Super Reforms

The $1.6m Pension Cap

CGT Relief

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SMSF Solutions *Problem solved*

Introduction

Since the first round of legislation was released in November 2016, Heffron's focus has been understanding the new rules, identifying the strategies, working with Treasury and the ATO where we have identified gaps or issues with the practical aspects of the new rules.

As 1 July 2017 approaches, it's time to turn to implementation.

This article looks at this in detail for those affected by the two major pension reforms – the $1.6m pension cap and CGT Relief:

- What needs to be done urgently?
- What must be documented before 30 June 2017?
- What can be left until the new financial year?
- What myths are emerging that we should simply stop worrying about?

The $1.6m pension cap

Some decisions will need to be made in the lead up to 30 June 2017:

- Determine whether the pension is to be partly rolled back to accumulation phase or whether the excess over $1.6m is to be cashed out of the fund. A key point to note here is that even if a client ultimately intends to cash the balance out, rolling back to accumulation phase first (on 30 June 2017) might be simpler – the subsequent payment out of super can then happen at any time, including after 1 July 2017.
- Where a client has multiple pensions, decide the order in which those pensions should be rolled back); and
- Decide whether any changes should be made to the reversionary arrangements for those pensions remaining in place

The decisions on rolling back existing pensions need to be made before 30 June 2017 but the minute can be worded to reflect the fact that actual balances are not known at that time.

Documenting Instructions prior to 30 June 2017

What is important in documenting the instructions before 30 June 2017 is that the member's intentions (and the trustee's actions) are unambiguous, do not depend on any discretions or subsequent actions or choices by the member or any other party and the only unknown is the actual value of an account balance or a superannuation pension. The resolution also needs to be irrevocable.

In our practice, we will generally be recommending that this happens on 30 June 2017 after all income has been received for the year so that:

- The fund is in pension phase as long as possible;
- All pension payments have been made;
- There is no chance that the pension account can grow after the roll back (accidentally exceeding the $1.6m cap);
- If the fund is a segregated fund, this date will be the date on which cost bases are re-set under the CGT relief. 30 June 2017 is therefore a convenient date from a record keeping perspective; and
- Many funds will be able to avoid getting an actuarial certificate for 2016/17

Myth

If a fund has a mixture of pension and accumulation accounts even for just 1 day on 30 June 2017, it will be forced to obtain an actuarial certificate.

This is not the case. Actuarial certificates are a tax requirement not a compliance requirement – so you only need to get one if you want to claim a tax exemption on income the fund earned during the period when it had that mix of accumulation and pension balances.

If there was no income earned on that day, don't bother getting the actuarial certificate. If the fund did receive a lot of taxable income on that day, get the certificate!

Myth

Funds that are currently segregated (e.g. 100% in pension phase) only get CGT relief on the assets transferred back to accumulation phase rather than the whole fund.

This is not the case. In fact, the trustee generally won't know the exact balance being transferred back to accumulation phase at the time – making this requirement almost impossible to meet.

Generally, we expect funds to minute a proposed roll back to accumulation phase of an amount calculated in a certain way (e.g. the excess over $1.6m) and the entire fund will become pooled at that point.

Under that scenario, all assets of the fund that meet the conditions (e.g. held throughout 9 November 2016 – 30 June 2017) will be eligible.

Myth

You must do something about the CGT relief for every pension client. This is not the case.

Remember that broadly speaking the relief is only available for those affected by the $1.6m transfer balance cap or who have transition to retirement pensions (of any size). Clients who have less than $1.6m each, no other super and are fully retired cannot get the CGT relief in any case.

Opting in for CGT Relief

The key action before 1 July 2017 is to take whatever action is required to be eligible for the relief and be clear on the date the cost base is re-set (called the "cessation time").

For a fund claiming the relief under the "segregated" method, this could include:

- Resolving to partly commute an account-based pension so that assets cease being "segregated" (in which case the cessation time will be whatever date that roll back occurs); or
- Accepting a contribution that is not kept apart from the remainder of the fund's investments (in which case the cessation time will be the date the contribution is accepted – even if this was back in January 2017); or • For funds which have only transition to retirement pensions, no action is required as long as new amendments to the legislation (drafts were released for comment on 12 April 2017) are passed (in which case the cessation time is actually 1 July 2017 not 30 June 2017 in the draft changes).

For a fund claiming the relief under the "proportionate" method, this could include:

- making sure the fund doesn't become 100% pension phase at any time during the period 9 November 2016 – 30 June 2017; and
- Maximizing the Fund's actuarial % for 2016/17 (e.g. making contributions and pension payments late in the year).

There are some steps that are vitally important but don't need to be carried out before 30 June 2017:

Choosing the assets

Choosing which individual asset, the trustee will "opt in" to the CGT relief does not need to be made until the fund's 2016/17 income tax return is due for lodgment and it is reported to the ATO at that time.

Importantly, however, remember that if the fund is required to lodge its return early (e.g. often funds that have lodged late in the past are required to lodge before 31 October rather than 15 May) – it must be ready to also opt into the CGT relief at that time and lodging late will risk the fund's ability to claim the CGT relief.

Adjusting the cost base of fund assets where CGT relief has been adopted

While this takes effect from 30 June 2017 or another cessation date for certain funds using the segregated method, it does not need to be specifically reported to the ATO. Since the Fund is not actually required to make any decision about CGT relief until the 2016/17 return is due for lodgment, they can delay any cost base re-sets until that time.

One practical point, however, if the trustee, broker or adviser decide to sell assets in (say) August 2017 they will be unable to accurately determine the capital gains tax if they have not yet decided whether to opt into the CGT relief for that asset.

Those who need accurate reporting immediately after 1 July 2017 will therefore need to bring this decision forward, decide which assets should have their cost bases re-set and have that reflected in their investment systems as soon as possible.

For funds adopting the CGT relief on the proportionate method (which relies on the actuarial % for 2016/17) it will be impossible to determine precisely how much gain is being carried forward to future years until the 2016/17 accounts are prepared.

Market Linked Pensions

There are a range of challenges presented by market linked pensions – There are some steps that should be taken before 30 June 2017:

- It will be beneficial for some clients to set a shorter or longer term for their market linked pension (see our paper "SMSF Strategies for 2016/17 and beyond", April 2017). Subject to the trust deed and pension contract this can be achieved by fully commuting and re-commencing the pension (with new terms applying to the new pension).

  This can be done on 30 June 2017 without knowing the actual balance of the market linked pension at that time – it would simply be expressed in a way that makes it clear the commutation represents the entire pension at the time;

- The legislation governing how the "special value" is determined (for the purposes of the $1.6m pension transfer cap) places enormous importance on the first payment for 2017/18. Essentially the law works by taking that first payment, identifying the number of days to which it relates and "reverse engineering" an annual amount.

  This makes sense where the regular pension payments are fixed (e.g. $5,000 per month) but not where there is no direct link between an individual payment and the period to which it relates.

  Someone who intends to take the bare minimum from their market linked pension might draw that in ad hoc amounts at different times during the year. Furthermore, the actual amount would be dependent on an account balance which is unlikely to be known at the time they take any payments early in the year.

In our practice, we are recommending that:

- Those who take regular payments should just continue to do so and the special value will be worked out using that amount (although note that the way the formula works, the amount used will not simply be (say) the July payment x 12).

- Those who always take the minimum should minute that in a way that ensures the minimum payment (once known) will be used to determine the special value of the pension

Conclusion

There is undoubtedly a lot to do between now and 30 June 2017 for pension clients. Bear in mind, however, that those with SMSFs have some valuable breathing space and flexibility when it comes to implementing events such as pension roll backs.

Heffron has developed a range of tools and templates to assist Accountants, Trustees & Advisers in relation to documenting and implementing the super forms. For more information, please visit: https://www.heffron.com.au/heffron/legislative-hub

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About Heffron

Australia's leading independent SMSF administrator

At Heffron, we're passionate about raising standards.

When the business started back in 1998, SMSFs were often seen as complicated, hard work and even a distraction from real financial planning and accounting work. Trustees that had decided to explore this new horizon were brave trail blazers and SMSFs certainly weren't discussed at BBQs!

The business's founders, Martin and Meg Heffron, both worked as superannuation experts for large public and corporate superannuation funds. They set up Heffron SMSF Solutions to bring that professional superannuation expertise into the hands of SMSF trustees, accountants and financial advisers. It's been a wonderful journey so far. SMSF trustees and the professionals that support them have more information and better services available to them than ever before. We like to think we've played a small part in raising standards to make SMSFs more accessible, safer and simpler today.

But there is still much more to do!

Whether it's running your own fund or helping someone else manage theirs, let us help you focus on the exciting opportunities with SMSFs rather than spending your time on compliance.