SUPERCENTRAL

The impact of Transfer Balance Indexation

Starting 1 July 2021, the transfer balance cap (TBC) will be indexed from $1.6 million to $1.7 million ("Indexed TBC"). Although this change sounds like good news, it does come with quirks not everyone is aware of and not knowing them can lead to adverse outcomes.

Before 1 July 2017 there was no limit on the amount in accumulation phase which could be placed in retirement phase pensions and members could, consequently, enjoy tax exemption on their entire super balance. However, the TBC (which was introduced on 1 July 2017) put a cap of $1.6 million on the amount of super which can be placed in retirement phase. This was done to limit the tax concessions given to income from assets supporting these pensions.

Any income from investments in a retirement phase pension will not be counted as part of the TBC and any loss will not reduce the TBC. Equally any pension payment from a retirement phase pension will not reduce the TBC.

For example, if Bob has a pension of $1.6 million and the investments supporting the pension earned $100,000, Bob's TBC will remain at $1.6 million. If Bob lost $100,000 from the investments in his pension, he cannot claim that as a deduction and say his TBC is now $1.5 million. His TBC will remain at $1.6 million. Finally, if Bob's pension payment $50,000 for a financial year, he cannot claim that his TBC is now reduced by $50,000.

The TBC will be indexed in increments of $100,000 based on the Consumer Price Index (CPI). The TBC indexation to $1.7 million which is set to occur starting on 1 July 2021 will be the first indexation since its introduction. Here are some things a member should know about the upcoming indexation:

1. Not everyone can avail of the full Indexed TBC

The full Indexed TBC will be available to members who did not have a retirement phase pension or have never used their TBC. Depending on the circumstances of the member, they may choose to wait for 1 July 2021 to start their retirement phase pension with a full Indexed TBC rather than the current $1.6m cap.

Members who already have a retirement phase pension but have maxed out their TBC will be unable to take advantage of the full Indexed TBC. Accordingly, they cannot transfer another $100,000 on 1 July 2021 to retirement phase.

2. Every pensioner will have their own personal TBCs

Members who already have a retirement phase pension but have only partially used the TBC will still be able to take advantage of the Indexed TBC. Consequently, their personal TBC is calculated as the percentage of their unused portion of the TBC to the total TBC multiplied by the amount of the TBC increase (i.e. $100,000).

For example, if Bob had used up $1.2 million of the TBC, his personal TBC as at 1 July 2021 will be n calculated as follows:

a) deduct the used-up TBC from the current TBC to calculate the unused cap. ($1.6 million - $1.2 million = $400,000).
b) calculate the percentage of the unused portion of the TBC to the current TBC ($400,000/$1.6 million = 25%).
c) multiply the percentage in b) to the amount of TBC indexation increase (25% x $100,000 = $25,000).
d) add the figure in c) to the current TBC to come up with Bob's new personal TBC ($1.6 million + $25,000 = $1.625 million) which applies from 1 July 2021.

As each member will have varying amounts transferred to retirement phase, each member will also have a new but different personal TBC (unless they had already used up all their TBC).

3. High water mark of the TBC is the basis for purposes of calculating the personal TBC

The basis of calculating personal TBC is the highest it has ever been (that is the high water mark of their TBC), not the TBC at the end of a financial year. Therefore, a member who already has a pension cannot commute all of it so that there is zero balance in their TBC on or before 30 June 2021 and restart a new pension on or after 1 July 2021 relying on the indexed TBC of $1.7 million. Their personal TBC will still be either $1.6 million (if they have maxed out their TBC) or between $1.6 million and $1.7 million depending on the amount of their unused TBC.

The same is true if the highest TBC it has ever been was only for a day (e.g. retirement phase pension regularly had $600,000 but $1,000,000 was added one day and commuted the next day – $1,600,000 will be the high-water mark of the TBC).

Transition to Retirement Income Stream (TRIS) beware

A TRIS does not start out as a retirement phase pension and it does not enjoy tax concessions of retirement phase pensions. Consequently, a TRIS is not (at least initially) counted against the TBC. Once a TRIS enters retirement phase, it will be automatically counted against the TBC.

Hence, members who are currently maintaining TRIS should be keep a watchful eye on when their TRIS will enter retirement phase and making sure this happens on or after 1 July 2021. As an example, if a member reaches 65 years of age on, say, 20 June 2021 (one of the instances when TRIS enters retirement phase), the pension balance will be counted against the $1.6m TBC. The indexation increase in the TBC will only apply to the member to the extent the member has not entirely used up the $1.6m TBC. In contrast, if the member returned the TRIS to accumulation phase on or before 30 June 2021 and commenced retirement phase pension on or after 1 July 2021, they would have the benefit of the full indexation in the TBC.

Members are advised to discuss with professionals on which is the best way to plan for their pensions.

For more information on any aspect covered in this article, please call SUPERCentral on 02 8296 6266 or email info@supercentral.com.au.