SUPERCENTRAL

Federal Budget 2021 – Super Changes

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1. Budget 2021 Super Changes - Overview

The 2021 Budget can be summarised in one line – as a great budget for superannuation. The Budget sets out major beneficial changes for superannuation covering both contributions, legacy superannuation products, first home super saver scheme and residency issues for SMSFs.

The contribution rules changes are:

- Downsizer contributions – the age from which these contributions can be made will be reduced to age 60 (currently it is age 65); and
- Work test abolition for voluntary super contributions – super members in the age group 67 to 74 will no longer have to satisfy the work test for before they can make voluntary (that is, non-deductible) contributions.

The legacy income stream/pension product changes are that market linked pensions, life expectancy pensions and lifetime pensions will have a 2-year window in which to convert to account-based pensions.

The First Home Super Saver Scheme changes are:

- Increasing the maximum releasable amount to $50,000 (currently this amount is $30,000)
- Relaxing the admin rules relating to releasing amounts under the Scheme.

The SMSF residency rule changes are:

- to adopt a 5-year safe harbour instead of the current 2-year rule for "central management and control" of an SMSF or small APRA regulated fund; and
- the abolition of the "no active member/no majority active members" requirement in the definition of "Australian superannuation fund".

Additionally, there are superannuation related changes including:

- Retaining the low and middle income tax offset for 2021-22 (this offset was due to cease at 1 July 2021)
- Removal of the $450 per month threshold currently applying before an employer is required to pay Superannuation Guarantee contributions.

The Government expects that these changes will apply from 1 July 2022 (assuming the relevant legislation is enacted before 30 June 2022). However, the relaxation of the admin rules relating to the First Home Super Saver Scheme are intended to apply from 1 July 2018 (being the start date of the scheme).

2. Planning implications of the Budget 2021 Super Changes

If the changes are implemented, and implemented by the intended date of 1 July 2022, two significant superannuation planning areas will arise.

The first area is wealth transfers into the super environment for individuals aged 60 -74. The second area is restructuring legacy pensions during the two year window which commences on 1 July 2022.

Wealth transfers for those aged 60 to 74

Given the reduction in the minimum age at which downsizer contributions can be made, the abolition of the work test for non-employer superannuation contributions, and the previously announced extension of the age at which the bring forward election ceases to apply from age 65 to 67, individuals will have considerably more flexibility to transfer wealth into the super environment.

This increased flexibility will require a detailed consideration of the interaction between the new contribution rules, the taxation treatment of wealth transfers into super and the Age Pension implications of such transfers.

The increased flexibility may permit a couple to transfer $2m into super once they attain age 60. This transfer is achieved by multiple applications of the “bring forward election” and use of the downsizer contribution exception as illustrated below.

Consider a couple both aged 60 at 1 July 2022 and each having an initial super balance of $500,000. This couple could use the “bring forward election” at age 60 ($330,000 each) and again at age 64 ($330,000 each) and then use the downsizer contribution exception for $300,000 each. Over 4 financial years, the couple could increase their respective total super balances from $500,000 to $1,460,000 (an increase of $960,000 each). The couple would then have an aggregated super balance of $2,920,000. They would still have contribution cap space to make further contributions from age 65 of up to $240,000 of voluntary non-concessional contributions spread over 3 financial years. This illustration ignores the effect of investment earnings and assumes that there is no increase in the $1.7m transfer balance cap and the cut off age for the “bring forward” election is age 67.

Re-structuring of legacy pensions: two-year window

Legacy pensions are pensions issued before 20 September 2007 which, because of their terms, had special treatment either for social security purposes (they had either a 100% or 50% exemption from the pension asset test) or for taxation purposes (the pensions had special treatment under the then maximum super benefit rules – called reasonable benefit limits). Generally, new legacy pensions cannot be issued on or after 20 September 2007 (though previously issued legacy pensions could on or after 20 September 2007 be converted to market linked pensions – at the loss of any pension asset test exemption).

The restructure window will apply to lifetime pensions, life-expectancy pensions and market linked pensions issued by SMSFs and small APRA regulated funds. The restructure window will not apply to flexi-pension products.

While legacy pensions can be currently restructured there are significant adverse taxation consequences (unless the capital supporting the pension – including pension reserves are transferred to a market linked pension) as well as loss of asset test exemption (if any). Any pension capital not transferred into a market linked pension becomes "trapped" in the fund and can only be allocated to other members in accordance with the strict rules applying to allocation of reserves and having the allocated amount counted as a concessional contribution for the receiving members.

The window, when it opens, will allow the capital supporting legacy pensions (including the pension reserves – which can be a significant value of the pension) to be transferred to accumulation phase. The only downside will be a 15% tax on the amount of the pension reserve (which is a relatively small price to pay compared to the current treatment if the reserves are paid out in their entirety). Once in accumulation phase the pension capital could be paid out from the fund, retained in the fund for the member or used (subject to the transfer balance cap rules) to commence an account-based pension for the member.

If a legacy pension which has had asset test exemption status is restructured in accordance with the window, then while there will be a loss of that status, there will be no retrospective re-assessment of pension entitlements. Under current rules a restructure of an asset text exempt legacy pension will normally (except in very limited circumstances) trigger a re-assessment of the age pension paid in the previous 5 years on the basis that the legacy pension had no asset test exempt status.

Every individual who currently has a legacy pension to which the window applies, should seriously consider using the window: this proposal is really a once in a lifetime opportunity to exit legacy pensions at minimal cost.

As this will be a complicated area of taxation, social security, superannuation and financial services law, professional advice should first be obtained as to whether the window applies to the legacy pension and whether the benefits arising from the restructure exceed the benefit of continuing with the legacy pension.

3. Downsizer Contributions

Details of the change

Currently, the entitlement to make these contributions (which are subject to a life-time cap of $300,000 per member) are subject to a number of qualifying contributions, including an age condition.

The age condition is that the individual for whom the contribution is made must be aged 65 or more at the time the contribution is made.

The Budget proposal is to substitute age 60 for the current age 65 condition. If the change is implemented, then a couple aged 64 and 62 could sell their current family home and transfer up to $300,000 each to super without having to wait 3 years to sell their family home when the younger reaches age 65.

When will the change apply?

The Government intends that this change will apply from 1 July 2022 (assuming that that necessary amending legislation is enacted on or before 30 June 2022).

This change will have to be implemented by amending legislation and, as such, must be passed by both the House and the Senate. Consequently, the implementation of this change depends upon the Government either obtaining the support of the Labor senators or the senate cross benchers.

Assessment of the change

For older super investors, who have not had the benefit of a lifetime of compulsory super contributions, being able to transfer wealth contained in the family home into super before age 65 provides enhanced retirement planning opportunities. In short, they may be able to implement their tree/sea change strategy when the younger member of the couple has attained age 60 rather than age 65.

Caution

There are a number of conditions to be satisfied to be qualified to make Downsizer Contributions. Individuals will need to carefully consider their position and should obtain appropriate advice. However, three points should be made.

The first is that despite the terminology of “Downsizer” – there is no requirement that you must downsize in value or house size.

The second point is that downsizer contribution will still be counted for the purposes of the transfer balance cap; they are not excluded from the cap and do not increase the cap by the amount of the downsizer contribution. However, as Downsizer Contributions are not counted as non-concessional contributions, they can still be made even if the non-concessional contribution cap is zero.

The final point is that transferring wealth from an asset test free environment (because it is in the family house) to assets tested environment will generally result in an adverse age pension position – either a partial reduction or even a total reduction in the age pension entitlement.

4. Removal of the Work Test for ages 67 to 74

Details of the change

The work test will be removed for voluntary contributions (including salary sacrifice contributions) for individuals aged between 67 and 74. The work test will remain for deductible contributions. The work test does not apply to individuals aged 66 or younger.

The work test must be satisfied before voluntary contribution can be made by an individual. The test is requirement that the individual must have been in gainful employment for at least 40 hours during 30 consecutive days of a financial year. Once the work test is satisfied for a financial year, then voluntary contributions at any time during the balance of the financial year.

When will the change apply?

The Government intends that this change will apply from 1 July 2022 (assuming that that necessary amending legislation is enacted on or before 30 June 2022).

This change will have to be implemented by amending legislation and, as such, must be passed by both the House and the Senate. Consequently, the implementation of this change depends upon the Government either obtaining the support of the Labor senators or the senate cross benchers.

Assessment of the change

For older super investors, who have not had the benefit of a lifetime of compulsory super contributions, being able to transfer their wealth into the superannuation environment without having to satisfy the work test is a considerable improvement on the current position.

5. First Home Super Saver Scheme Changes

Details of the change

Two changes are proposed to the First Home Super Saver Scheme which permits individuals to access their superannuation in order to assist in the purchase of a first home. The first is to increase the maximum releasable amount from $30,000 to $50,000. The second is to remove unnecessarily restrictive admin rules which apply to the Scheme to increase the Scheme's workability and to clarify the operation of the Scheme.

When will these changes apply?

The Government intends that the increase in the maximum releasable amount to $50,000 will apply from 1 July 2022 (assuming that that necessary amending legislation is enacted on or before 30 June 2022).

The second change will have a backdated commencement date of 1 July 2018 (being the start date of the Scheme).

These changes will have to be implemented by amending legislation and, as such, must be passed by both the House and the Senate. Consequently, the implementation of this change depends upon the Government either obtaining the support of the Labor senators or the senate cross benchers.

Assessment of the change

Clearly $30,000 is not a realistic amount to assist individuals to acquire their first home. Even $50,000, given current home price increases, may not be realistic – but it is better than $30,000. With this change a couple could access up to $100,000 from their superannuation accounts to assist in the purchase of their first home.

In order to ensure the integrity of the super saver scheme, various rules were imposed to prevent the scheme being used as a de facto early access arrangement. However, these various rules constituted a significant hindrance to the easy operation and practical effect of the scheme.

6. Tax Residency for SMSFs & Active Member Test

Details of the change

The proposed changes are to change the "2 year" safe harbour rule to a "5 year" safe harbour rule. The other proposed change is to remove entirely the "no active member" test from the definition of "Australian superannuation fund". These changes will apply to both SMSFs and small APRA regulated funds.

When will these changes apply?

The Government intends that both changes will apply from 1 July 2022 (assuming that that necessary amending legislation is enacted on or before 30 June 2022).

These changes will have to be implemented by amending legislation and, as such, must be passed by both the House and the Senate. Consequently, the implementation of this change depends upon the Government either obtaining the support of the Labor senators or the senate cross benchers.

Assessment of the change

These changes are significant and beneficial. At a time when some Australian residents are not able to return to Australia and also (pre-Covid days) in light of the increasing international mobility of the workforce, these changes are welcome.

The first change (5-year safe harbour rather than a 2-year safe harbour) simply means that the central management and control of the fund will be presumed to be in Australia even if the central management and control is temporarily outside Australia for less than the safe harbour period. Once enacted, this change means that actual control of a fund can be outside Australia for up to a five-year period so long as the control is only "temporarily" outside Australia during that period.

The second change (removal of the "no active member" requirement) in the definition of Australian superannuation fund means that members of an SMSF or small APRA regulated fund while they are non-residents can make contributions to the fund. Without the removal of the "no active member" test, members making contributions to their SMSF while they are non-resident may cause the SMSF to cease to be an Australian superannuation fund and thereby incur significant tax liabilities.

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