KPMG

Federal Budget 2016

Superannuation

A review of the Budget's major business implications

3 May 2016

kpmg.com.au

Contents

Introduction 1

Objective of Superannuation 1

Taxation of earnings 5

Taxation of benefits 6

KPMG Insights 7

Contact us 8

Introduction

Most significant superannuation tax changes since 2007

It has been some years since the Budget has included changes to the tax settings for superannuation in both number and significance as those forming part of the 2016 Budget.

Indeed the present proposed changes are almost certainly the most significant tax changes affecting superannuation since the simplified superannuation changes in 2007.

Changes to tax settings always carry the risk of undermining the confidence of individuals in saving for their retirement through superannuation.

However, the government's commitment to enshrine the objective of superannuation in legislation has meant that the present changes, whilst significant, can all be seen as improving equity within the context of this objective.

We note that, with the exception of the new lifetime cap for non-concessional contributions (which applies from Budget night), all of the other tax changes apply from 1 July 2017.

Objective of Superannuation

Summary

	Pre-Budget	Post-Budget
Legislating an objective of superannuation	FSI recommended legislating the objective of superannuation	Objective of superannuation to be legislated
Definition of objective	FSI recommended the objective should be "to provide for income in retirement to substitute or supplement the Age Pension"	Objective is "to provide income in retirement to substitute or supplement the Age Pension"

Objective

The government has re-confirmed its commitment to enshrine the purpose or objective of superannuation in legislation.

Definition of objective

Following consultation, the government, in agreeing with the recommendation of the Financial System Inquiry (FSI), has defined the purpose of superannuation as "to provide for income in retirement to substitute or supplement the Age Pension".

KPMG comment

There are two welcome initiatives here – firstly, defining the objective, and secondly, how that objective has been defined.

Defining the objective of superannuation is an important step in providing a framework within which tax and other policies in relation to superannuation may be meaningfully accessed.

Defining the objective as "to provide income in retirement to substitute or supplement the Age Pension" shines a spotlight on members with "excessive" balances in their superannuation.

For example, in the context of this objective, it is reasonable to query whether members with balances in excess of the amount required to substitute or appropriately supplement the Age Pension should continue to receive tax concessions in respect of the entirety of their balances.

From a tax perspective, defining the objective has a clear consequence, being that policy settings that were more consistent with wealth accumulation or estate planning in a concessionally taxed environment, are no longer justifiable.

Taxation of contributions

Dana Fleming
National Leader,
Superannuation Tax

"The changes to the tax settings for contributions are all in the direction of improving the equity outcomes from the distribution of tax concessions. The retention of tax concessions for contributions for low income earners, and catch-up contributions for members with broken work patterns, including many women, are particularly welcome."

Concessional contributions

Summary

Concessional Contributions	Pre-Budget	Post-Budget
Tax Rate	Taxed in fund at 15%	No change
Division 293 15% additional tax	Threshhold starts at $300,000	Threshhold starts at $250,000
Low income superannuation contribution (LISC)	Current, but legislated to be abolished from 30 June 2017	Low Income Superannuation Tax Offset (LISTO), broadly equivalent in its effect to the LISC, to apply from 1 July 2017
Annual contribution cap limits	Under 50 - $30,000 50+ - $35,000	Reduced for all to $25,000, but with a 5 year rolling catch-up for balances under $500,000
Work test for making contributions	Broadly 10 hours per week work test for age 65-74	Abolished
Deduction for personal contributions	10% test for substantially self-employed applies	Abolished, but all employer and deductible personal contributions to count towards cap

Superannuation fund taxed on concessional contributions

Concessional contributions continue to be taxed within the superannuation fund at the rate of 15 percent.

Reduction of threshold for Division 293 tax

The threshold for the additional 15 percent Division 293 tax, currently applying to those with adjusted taxable income of $300,000 and over has been reduced to $250,000, such that those members in the $250,000 to $300,000 tax bracket, will be effectively subject to 30 percent tax on their concessional contributions.

Presently, taxpayers in the $180,000 to $300,000 tax bracket enjoyed the most significant tax concession on concessional contributions – being the difference between the top rate of tax and 15 percent. Reducing the Division 293 threshhold such that it applies to those with adjusted taxable income above $250,000, improves the sustainability and fairness of the system.

Prior to the Budget, some commentators suggested taking the taxation of concessional contributions out of fund taxation and instead applying tax on the individual at their marginal rate of tax, less a tax rebate.

A change to a system of this kind would have entailed significant administrative costs, and yet depending on the quantum of the rebate would have done little to increase the equity outcomes from the concessions.

This can be seen from the following table, based on the position after the lowering of the Division 293 threshold to $250,000, and excludes the effect of the Medicare Levy and the Temporary Deficit Levy.

Income $	Effective tax concession for superannuation contributions
0 – 18,200	0% depending on extent of LISTO
18,200 to 37,000	Up to 19% depending on extent of LISTO
37,000 to 87,000	17.5%
87,000 to 180,000	22%
180,000 to 250,000	30%
250,000 and above	15%

Introduction of the low income superannuation tax offset

The government has previously announced that the present Low Income Superannuation Contribution (LISC) would be abolished on 30 June 2017.

Absent a concession for superannuation contributions for low income earners such as the LISC, these members would pay more tax on their contributions than they would if they earnt the same income as salary and wages.

The superannuation industry has made numerous representations to government to retain the LISC or introduce a similar concession. These representations all noted that a concession of this type is necessary so as to avoid the situation where low income earners are more highly taxed on superannuation contributions than on salary whilst higher income earners receive significant tax concessions.

The government has responded to the industry's concerns, by introducing the Low Income Superannuation Tax Offset (LISTO), which is to apply from 1 July 2017.

The LISTO is broadly equivalent to the LISC, the main difference being that the LISTO will be claimed as an offset in the superannuation fund tax return whilst the LISC is a government superannuation payment. Whilst this will still require ATO administration to determine the members who qualify as low income earners, the new system will avoid the need for the ATO to administer the actual payment of moneys to the funds. Instead, the funds will claim the offset through the usual income tax return procedures.

The retention of a concession such as the LISC (or now the new LISTO) is an important step in improving the equity of the tax concessions in superannuation.

Annual concessional contribution caps have been maintained but the limits reduced

The reduction in the annual concessional cap to $25,000 is consistent with the newly defined objective.

This level of concessional contribution would appear to still allow a member to accumulate a sufficient balance in retirement.

However, the government may need to review the $25,000 cap as the Superannuation Guarantee (SG) rate rises towards 12 percent, particularly as the maximum contributions base (MCB) for SG also increases by indexation. The present MCB for SG is $51,620 per quarter (or $206,480 per annum), and 9.5 percent of this is $19,616, which is less than the $25,000 cap. However, 12 percent of this would be $24,778, and depending on the indexation of the MCB, could easily exceed $25,000.

It would seem to be an odd situation if mandatory SG contributions from a single employer were to result in excess concessional contributions.

New 5 year rolling catch-up

Together with the reduction in the annual concessional cap to $25,000, the government has announced a 5 year rolling catch-up for members with balances less than $500,000.

This catch up will apply to those individuals that have not utilised the full $25,000 cap in previous years.

This catch up mechanism appears very well targeted, and should improve the superannuation outcomes for members with variable work patterns, particularly women and carers.

The government intends that the measure will also apply to defined benefit schemes, and will consult with industry to minimise any additional compliance impacts for these schemes.

Deductible personal contributions

Presently, deductions are only available for personal contributions to superannuation funds if a member satisfies the "substantially self-employed" test. Broadly, this means that the member cannot have income from employment that exceeds 10 percent of his or her total income.

The government has announced that it will allow all individuals up to age 75 to claim an income tax deduction for personal superannuation contributions, subject only to the concessional contributions cap.

This measure should particularly benefit:

- Individuals whose employers do not allow salary sacrifice contributions, who cannot presently use more of the concessional contributions cap than is represented by the SG contributions from their employers; and
- Individuals who are partially self-employed and partially employees, where the present 10 percent rule operates to deny them the ability to use the full concessional contributions cap.

Non-concessional contributions

Summary

Non-Concessional Contributions	Pre-Budget	Post-Budget
Annual non-concessional contribution caps	Yes	Lifetime caps replace annual caps
Annual non-contribution cap limits	$180,000 per year 3 year bring forward rule - $540,000	Lifetime cap of $500,000
Spouse contributions	Tax offset of up to $540 Income threshold $10,800	Tax offset of up to $540 Income threshold $37,000

Non-concessional contribution caps

Currently, a member may make a non-concessional contribution to a fund of $180,000 per year, or under the "bring forward rule", up to $540,000 in a year.

The government has announced a $500,000 lifetime non-concessional cap to improve the sustainability of the system.

All contributions made on or after 1 July 2007 will count towards this cap. This early date was selected as this is the date from which the ATO maintained reliable contribution records.

The lifetime cap will commence from Budget night (that is, from 7.30pm AEST on 3 May 2016).

Contributions made before this time cannot result in an excess. However, any excess contributions made after this time will need to be removed or subject to penalty tax.

The ability of some members to make significant non-concessional contributions each year, is one mechanism that allows members to build up balances in their superannuation fund that may be considered inconsistent with the now-defined objective of superannuation.

The new lifetime non-concessional cap of $500,000 is more consistent with the defined objective.

In particular, the combination of the $25,000 concessional cap, catch-up contributions where available, and the lifetime non-concessional cap, should still enable members to build balances in superannuation sufficient to substitute or reasonably supplement the Age Pension.

Spouse contributions

Presently, individuals are entitled to a tax offset of up to $540 for superannuation contributions made on behalf of their spouses. The offset is available at the rate of 18 cents per dollar of contributions, and thus the maximum $540 applies for $3,000 of contributions or more.

One of the conditions for the offset is that the spouse's income is below a threshold, presently $10,800.

The government has announced that this threshold will be increased to $37,000.

Taxation of earnings

Damian Ryan

Partner, Tax Advisory - Superannuation and Funds Management

"Prior to these changes, the distribution of tax concessions for superannuation earnings was heavily skewed to members with large superannuation balances, particularly those in pension phase. The announced changes go a significant way to improve the equity of these concessions."

	Pre-Budget	Post-Budget
Taxation of income in accumulation phase	Taxed at 15%	No change
Taxation of income in pension phase	Taxed at 0%	No change, but note new maximum balance
CGT discount	One third	No change
Franking credits	Utilised and refundable	No change
Maximum balance that can be transferred to pension phase	None	$1,600,000

Taxation of income in accumulation phase

Income in accumulation phase continues to be taxed at the rate of 15 percent.

Taxation of income in pension phase

Income in pension phase continues to be taxed at the rate of 0 percent.

New limit of $1,600,000 on the balance that may be transferred into pension phase

The Henry Review had recommended reducing the rate of taxation in accumulation phase and introducing that same reduced rate of income in pension phase. One of the observations underlying this recommendation was that, over time, the moneys in pension phase were expected to increase, and may ultimately have been unsustainable.

The government has responded to these concerns in an alternative way, by limiting the balance that can be transferred into pension phase to access the 0 percent tax rate to $1,600,000.

Subsequent earnings on the amounts transferred to pension phase will not be restricted.

Where an individual has accumulated more than $1,600,000, he or she will be able to maintain this excess amount in accumulation phase (where earnings will be taxed at the concessional rate 15 percent) or, subject to the usual conditions of release, withdraw the excess from the superannuation system.

For existing members in pension phase with balances of greater than $1,600,000, the excess will be required to revert to accumulation phase no later than 1 July 2017 or to be withdrawn from the fund.

Equivalent changes will be made for members in defined benefit funds, through changes to the tax arrangements for pension payments where these exceed $100,000 per annum.

Most of the superannuation industry has accepted that there needed to be some limits placed on the tax concessions for earnings within superannuation funds, particularly in the pension phase.

The size of the cap was somewhat unexpected, as most industry representations had suggested a cap of $2.5 million.

However, the government's approach to capping would appear to be both equitable and relatively simple to administer. The government estimates that a $1,600,000 balance should generate an annual pension equivalent to approximately four times the present single Age Pension.

Taxation of benefits

Ross Stephens

Director, Tax Advisory - Superannuation and Funds Management

"The draw down phase of superannuation remains the big unfinished element of Australia's system, which is otherwise recognised as a leading system round the world. The Government's Paper agrees that present tax and regulatory settings impede the development of products better suited to retirees' needs, is a big step towards removing these impediments."

	Pre-Budget	Post-Budget
Preservation age	55 increasing to 60 depending on year of birth	No change
Transition to retirement	Available	Changes to improve integrity
Taxation of tax-free components	Tax free	No change
Taxation of taxable components	Generally, no further tax if over 60	No change
Anti-detriment deduction	Available	Abolished

Transition to retirement

The transition to retirement provisions were intended to assist Australians to gradually move from full time work to retirement, by supplementing their part-time salary and wage income with pension payments from their superannuation funds.

Over time, many members have used these provisions primarily to alter the tax components of their superannuation balances, for example, through "re-contribution" strategies.

The government has announced changes to the rules for transition to retirement pensions to improve their integrity. Firstly, these pensions will not qualify for the 0 percent tax rate on earnings in the fund, and secondly, the ability for members to elect that the pensions be taxed as lump sums will be removed.

As a result of these changes, it is likely that the only persons likely to access their pensions whilst still working will be those that genuinely want to top up their incomes whilst scaling back their employment incomes, that is, in line with the original policy intent of the provisions.

Anti-detriment deduction

The anti-detriment deduction is a mechanism through which funds could pay additional death benefits to spouses and children of deceased members, to compensate them for the 15 percent contributions tax that was paid by funds whilst the member was alive.

It reflected the fact that, when superannuation funds commenced to pay tax at 15 percent in 1988, the then tax on lump sum payouts was reduced from 30 percent to 15 percent, but death benefits paid to dependants were tax free both before and after this change.

The removal of tax on lump sum payouts to persons aged 60 or more in 2007 rendered the anti-detriment deduction somewhat redundant.

In any case, the deduction:

- Was poorly targeted (it was available for payments to adult children and not just restricted to dependants).
- Favoured lump sum death benefits over pensions (as it was unavailable if the death benefit was paid as a pension).
- Was outdated (it was not available for newer similar benefits such as terminal illness benefits).

In summary, the deduction had largely outlived its usefulness, and its removal may be seen as a simplicity measure.

Retirement Products

Deferred annuities and similar products

As part of the papers released on Budget night, the government has released a paper in response to the consultation on the regulatory barriers currently restricting the availability of relevant and appropriate income stream products in the Australian market.

The government's response confirms that the present annual minimum draw down rules are consistent with the objective of superannuation and should be maintained, but subject to review by the Australian Government Actuary every 5 years, and in other extreme circumstances such as significant economic shocks.

The government has also agreed to extend the tax exemption on earnings in the retirement phase to deferred lifetime annuities and other lifetime products, provided that they meet a declining capital access schedule.

The government's response to the consultation is particularly welcome in an environment where superannuation funds are seeking to develop appropriate products and solutions for retiring members, and will likely foster the development of better retirement products.

KPMG Insights

What should employers be doing?

Given the extent of the changes to the superannuation tax settings, employers will need to:

- consider the impact on broader salary packaging and remuneration arrangements
- consider the need for potential communication material or presentations to employees
- consider the impact of the changes on any defined benefit arrangements.

What should superannuation funds be doing?

The changes will affect funds across the whole spectrum of their operations, including:

- Planning for potential improved retirement income products arising from the government's response to industry consultations.
- Reviewing all website, PDSs, and other member communication material.
- Considering the implications for administration systems, and whether the necessary data to report members' balances, and transfers of balances from accumulation phase to pension phase and vice versa, is readily available.
- Considering whether part of pension phase assets, especially for segregated funds, may be required to be transferred back to accumulation phase, and the broader tax implications of this.
- Potential development of strategies by funds to retain member balances above $1,600,000.

What should individuals be doing?

The changes will have their most direct effect on individuals' plans in respect of contributions and timing of draw downs of benefits:

- Members already in pension phase with balances greater than $1,600,000 will need to decide whether to keep the excess in their funds (and utilise the concessional tax rate of 15 percent on earnings) or remove part or all of this excess from the superannuation system.
- Members with balances less than $500,000 may wish to consider whether top-up contributions in future years may assist them in reaching their retirement objective.
- Partly self-employed members, or members whose employers do not allow salary sacrifice contributions, may wish to consider whether deductible personal contributions may assist them in utilising a greater portion of the concessional contributions cap.
- Members aged 65 to 74 may wish to consider making contributions to the extent that the present work test may have impeded them from doing so.
- Members aged over preservation age that had been considering commencing transition to retirement pensions may wish to reconsider whether these are suitable for their purposes.

Contact us

Dana Fleming
+61 3 9288 5871
dfleming@kpmg.com.au

Damian Ryan
+61 2 9335 7998
dryan@kpmg.com.au

Connie Van Werkum
0417 648 260
cvanwerkum@kpmg.com.au

Neil Lamb
+61 3 9838 4088
nlamb@kpmg.com.au

Nick Kallinikios
+61 3 9288 6714
nkallinikios@kpmg.com.au

Anthony Versace
+61 3 9288 5934
aversace@kpmg.com.au

Ross Stephens
+61 3 9288 6619
rdstephens@kpmg.com.au

Abbey Pearce
+61 3 9838 4896
abbeypearce@kpmg.com.au

Peter Oliver
+61 2 9455 9520
peteroliver@kpmg.com.au

Bernard Finnegan
+61 2 9335 7016
bfinnegan@kpmg.com.au

Natalie Raju
+61 2 9335 7929
nraju1@kpmg.com.au

kpmg.com/au/budget