CST

Tax Advisors

Superannuation

Australian Budget Implications and Current Issues for Australian Expatriates

Personal Advice. Global Perspective

Contents

Introduction

The proposed changes announced in the 2016 Australian Budget are the most significant changes impacting superannuation since 2007.

The budget introduced a raft of measures aimed at high income taxpayers, with the majority of changes impacting the top 4% of income earners.

The Government has announced changes to tax concessions to support the 'objective' of the superannuation system, which is defined as "to provide for income in retirement to substitute or supplement the Age Pension". Defining the objective of superannuation in this manner targets members with "excessive" superannuation balances.

The announced tax measures have a clear purpose of preventing superannuation being used as a wealth accumulation and estate planning vehicle. The changes will force the wealthy to seek alternative ways to structure their finances, and superannuation may no longer be the primary retirement savings vehicle.

Many of the announced measures will be effective from 1 July 2017, while some measures will be effective immediately and apply retrospectively. It is important to note that there are a number of hurdles which must be overcome before these measures become law, including the Government being re-elected on 2 July 2016.

The measures will impact not only Australian resident taxpayers, but also Australian expatriates looking to transfer their foreign pension balances back into the Australian superannuation system and careful consideration should be given to such transfers to avoid unintended consequences and penalties.

This paper further explores the current pension and tax issues faced by expatriates in the UK, including the recent changes announced by the UK in relation to Qualifying Recognised Overseas Pension Schemes (QROPS) in Australia, which will have a significant impact on those looking to transfer UK pensions to Australia.

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Concessional Contributions

Summary of changes

Measure	Pre - Budget	Post - Budget
15% additional tax	Threshold commences at $300,000	Threshold lowered to $250,000
Annual contributions cap	$30,000 (under 50), $35,000 (50+)	Lowered to $25,000 for all ages. However, new 5 year rolling catch-up introduced.
Tax rate in super fund	15%	15% (no change)
Low income superannuation contribution	To be abolished from 30 June 2017	Low Income Tax Offset to apply from 1 July 2017

15% additional tax (Division 293)

The threshold for the additional 15% tax which currently applies to taxpayers with taxable income of $300,000 and over has been reduced to $250,000. Therefore, those earning in excess of $250,000 will effectively be subject to tax at 30% on concessional contributions.

This measure will have the greatest impact on those individuals earning between $180,000 (highest marginal tax rate) and $300,000, as previously taxpayers in this tax bracket benefited from tax concessions on concessional contributions being the difference between the top rate of marginal tax of 48% and 15% on their concessional contributions.

This measure is to apply from 1 July 2017.

Reduction in annual contributions caps

The annual contributions cap on concessionally (pre-taxed) contributions has been reduced from $30,000 (or $35,000 for those over 50) to $25,000, limiting the amount which may be salary sacrificed into superannuation.

This measure is to apply from 1 July 2017.

New 5 year rolling catch-up

The one sweetener that was announced in the budget was a five year rolling catch-up for members with superannuation balances of less than $500,000.

Previously, if the annual concessional superannuation cap was not used on an annual basis, it was not able to be carried forward and was lost. However, the annual concessional cap will now apply on a cumulative basis over five years, i.e. the catch up will apply to those individuals that have not utilised the $25,000 cap in previous years.

This measure will improve superannuation outcomes for those who have variable work patterns, such as working mum's, or individuals that receive year-end bonuses as it allows decisions in relation to super contributions to be made when the cash is available as opposed to being forced into making annual contributions.

Introduction of the low income superannuation tax offset

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

Without a concession for superannuation for low income earners, such taxpayers would end up paying more tax on their super contributions than what they would pay on salary and wages. Consequently, in response to concerns from the superannuation industry, the government has introduced the Low Income Superannuation Tax Offset (LISTO), to apply from 1 July 2017.

The LISTO is to be claimed as an offset in the superannuation fund tax return. Such a concession is an important step in improving the fairness and equity of the superannuation system.

Non-concessional contributions (after-tax contributions)

The most significant and immediate change introduced is a lifetime non-concessional contributions cap of $500,000 effective immediately.

Currently, the annual non-concessional contribution limit is $180,000 (or $540,000 over three years if under 65) and therefore the $500,000 lifetime cap is far less generous than the existing rules.

Importantly, the lifetime cap will apply retrospectively and take into account all non-concessional contributions made on or after 1 July 2007. However, contributions made before the commencement date will not result in an excess and can remain in superannuation. Excess contributions made after budget night will need to be removed or be subject to penalty tax.

The ability of high income earners to make significant non-concessional contributions each year is one mechanism that allowed members to accumulate 'excessive' superannuation balances. The measure prevents superannuation being used as a wealth accumulation tool as opposed to a source of retirement income. Wealthy individuals will now be prohibited from selling investments and moving the gains into superannuation and benefiting from paying no tax once they reach retirement.

The immediate and retrospective impact of this measure has drawn significant criticism. Depending on the election results, and composition of both houses of parliament, we may see the introduction of transitional rules.

Taxation of Pension Balances

Summary

Measure	Pre - Budget	Post - Budget
Taxation of income in accumulation phase	15%	15% (no change)
Taxation of income in pension phase	0%	0% (no change) but note cap below
Maximum that can be transferred into pension phase	No cap	$1.6m

New cap of $1.6m on balance that can be transferred into pension phase

In an effort to "better target tax concessions to ensure the superannuation system is sustainable, and improve confidence in the system by reducing the extent superannuation is used for tax minimisation and estate planning", a transfer cap of $1.6m on the amount of superannuation savings that can be transferred from accumulation phase to tax-free pension phase will be introduced from 1 July 2017.

Subsequent earnings on the amounts transferred to pension phase which result in the $1.6m cap being exceeded will be allowed to remain in pension phase, however if the full $1.6m transfer cap has been used, any reduction of balances below the $1.6m cap cannot be topped up from accumulation accounts or contributions.

One of the biggest surprises in the budget announcement was that individuals already in pension phase with a balance of greater than $1.6m will be required to move any excess back into accumulation phase (and taxed at 15%) or withdrawn from superannuation by 1 July 2017.

The $1.6m cap was somewhat of a surprise to the superannuation industry, with the majority of superannuation industry representations suggesting a higher cap of $2.5m would be appropriate

Transition to Retirement

Pension accounts that are being used for transition to retirement will no longer be tax-free and will attract a 15 per cent tax.

The transition to retirement provisions were intended to assist individuals to gradually move from full-time work to retirement, by supplementing their part-time employment income with pension payments from their superannuation funds. However, it was found that individuals in this phase where using the transition to retirement phase to improve their superannuation tax outcomes, for example through "super re-contribution strategies".

Implications and what steps should taxpayers be taking

•Individuals in pension phase with balances of greater than $1.6m will need to decide if they are going to move the excess into their superannuation fund (and be taxed at the concessional rate of 15%) or remove part or all of this excess from superannuation all together.

•Retirees who have a balance in excess of $1.6m and decide to transfer money back into accumulation phase will need to carefully consider which assets to transfer:

- Once inside pension phase, assets are allowed to grow in value and therefore high-growth assets, such as shares may be left in pension phase;

- However, retirees will also need to consider the drawdown rules so that the pension account retains sufficient liquid assets;

- Consideration should also be given to leaving certain Australian shares that generate franking credits outside of the pension to offset the 15% contributions tax.

•Members will need to ensure they track non-concessional contributions back to 2007 to ensure they have not breached the lifetime non-concessional contributions cap of $500,000.

•Discretionary family trust structures will likely become more widely used.

The family trust structure provides asset protection, while the income and capital of the trust can be distributed to family members in a highly tax-efficient manner.

Family trust structures also come with less rules and restrictions than self-managed superannuation funds.

Foreign pensions and superannuation- current issues

UK
QROPS update

In order to transfer a UK pension to an Australian superannuation fund without incurring UK exit tax charges, the Australian superannuation fund must be recognised as a Qualifying Recognised Overseas Pension Scheme (QROPS). Where the Australian fund has been recognised by HMRC in the UK to comply with specified requirements, the Australian fund will be approved on the QROPS list.

In a controversial measure, on 6 April 2015, the UK enacted changes to its pension laws, effectively prohibiting access to a pension before the age of 55 unless for reasons of "serious ill health". As a consequence, HMRC contacted QROPS funds in Australia to confirm they complied with this requirement. However, Australian superannuation funds generally do allow access to funds before the age of 55 in situations other than "ill health", for example situations of "severe financial hardship". Therefore, in order to comply with the new UK laws, Australian superannuation funds would be required to make changes to their trust deeds.

While several public Australian superannuation funds have made changes to their trust deeds in an attempt to comply with UK law, many public funds have declined to do so given the impact the changes would have on their members as a whole. When HMRC issued its updated QROPS list on 1 July 2015 following the 6 April 2015 law change, only one Australian superannuation fund- the Local Government Superannuation Scheme in Queensland was on the list, with all the remaining Australian QROPS removed.

However, over the last few months, several Australian Self-Managed Super Funds (SMSFs) have been successfully added to the QROPS list (The list is updated on the 1st and 15th of every month). These SMSF's have made changes to their trust deeds so that membership is restricted to those aged 55 and above. However, we note that the QROPS list contains very few Australian public superannuation funds. We understand that Australian public superannuation funds are still in negotiation with HMRC and Australian Treasury in an attempt to find a solution given their unwillingness to alter their trust deeds.

Significantly, UK pension transfer to funds that are not QROPS compliant are subject to a 55% UK tax exit charge.

What does this mean for pension transfers pre- 6 April 2015?

If a pension transfer has been completed prior to 6 April 2015, then we understand that HMRC will not charge tax in respect of the transfer. However, this position should be confirmed.

What does this mean for pension transfers post 6 April 2015?

Unless the Australian superannuation fund is on the approved QROPS list, then the transfer may constitute an unauthorised payment as the funds have been transferred to a non-QROPS fund. We understand that discussions between the HMRC and the Australian Treasury are continuing in order to find a solution, including negotiating an "exemption period" in respect of amounts transferred between 6 April 2015 and 2 July 2015 (the date HMRC updated the QROPS list to remove most Australian superannuation funds).

The new UK rules also provide that transfers above £30,000 will be required to be approved by a UK adviser with a pension transfer qualification.

Given the uncertainty, it is recommended that professional advice is received prior to undertaking a transfer, or to confirm the position in respect of a transfer undertaken after 6 April 2015.

Budget measures and the lifetime $500,000 non-concessional contributions cap

For those expatriates living in the UK wishing to transfer a UK pension into an Australian superannuation fund, an issue that will need to be considered as a result of the budget measures is whether the transfer will be treated as a non-concessional contribution and count towards the $500,000 lifetime cap.

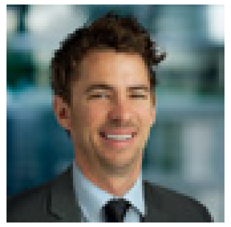
Prior to the budget announcement, a lump-sum amount transferred to an Australian complying superannuation fund was considered to be a 'non-concessional contribution'. It is not yet clear at this stage if this treatment will continue to apply such that lump sum transfers will be counted towards the $500,000 lifetime non-concessional contribution cap to the detriment of taxpayers. Individuals will need to carefully monitor these rules once enacted to ensure the $500,000 cap is not breached when transferring a foreign lump sum pension to an Australian fund. It is hopeful that QROPS compliant pension transfers will be afforded "rollover" treatment and not counted towards the cap.

It should be noted that once an individual has made the decision to transfer their UK pension to Australia, there is a strong incentive and urgency to complete the transfer within six months of the individual becoming an Australian resident for tax purposes. Transfers completed within this period are generally free from tax implications in Australia. However, practically, this may be difficult to achieve as transfers can often take several months.

Transfers to an Australian complying superannuation fund more than 6 months following resumption of Australian tax residency will be subject to tax in Australia. However, in broad terms, only the increase in value of the fund between the date of transfer and the date you resumed residency is subject to tax (at a rate of 15% to the super fund) where a complying election is made.

Contact Us

We look forward to you contacting one of our directors as follows:



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