Six key things to know about super in 2021

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The super rules change regularly, and this year is no exception. We are waiting on changes currently before the parliament, anticipating some of the changes announced in last year's budget, and understanding the impact of SuperStream on self-managed superannuation funds (SMSF), as well as the indexation of the Transfer Balance Cap.

Currently before the parliament

The superannuation legislation in parliament impacting on financial planning for clients includes:

the increase in the maximum number of members of an SMSF from four to six members;

an increase in the age to access the bring forward non-concessional contributions to the age 67, and;

changes to determining the exempt current pension income of a fund.

1. Proposed increase in the maximum number SMSF members from four to six

The increase in the maximum number of members for an SMSF may seem simple, but running an SMSF can involve complex decisions no matter how many members are involved. The proposed amendments, which are currently in the Senate, not only increase the maximum number of members but also include changes to the signing requirements for documents and other issues which currently relate to funds with less than five members. This includes the acquisition of some assets from related parties and the in-house asset rules as they apply to small funds.

How many members is a good idea?

Irrespective of the maximum members for a small fund, the main question is to decide how many members is ideal given the circumstances. Most SMSFs have one member (23%) or two members (70%). There is only a small portion of funds with three or four members, suggesting that an increase to a maximum of six members of an SMSF is unlikely to result in a large number of new funds.[1] Nonetheless, the proposal can provide greater flexibility for families with more than four members to benefit from the change. In some situations, there may be special reasons to have up to six members.

Main advantages of the increase

The main advantages of the proposed increase to six members are:

Larger families can be catered for;

There is most likely a reduction in operating costs compared to a family that would require two or more funds to achieve the same outcome;

A corporate trustee would be preferred to assist with administration under the one fund name to cater for members who may join or leave the SMSF; and

Greater ability for the SMSF to qualify as an Australian superannuation fund when one or more members travel overseas for prolonged period, allowing for saving in administration costs.

Some possible disadvantages of the increase

Disadvantages of a six member fund may include:

Ensuring the fund's trust deed can cater for the increase in member numbers as some state trust law may not accept more than four individual trustees, and may require the appointment of a corporate trustee;

Difficulty in the administration of an SMSF amongst individual trustees;

Reduced efficiencies in decision making; and

Overall control and management of the fund, for example, the ability of the trustees/members to concur on the decision to appoint or remove trustees.

Fund investments

The positives for making fund investments could be that the additional investing power of six members in an SMSF should have greater negotiating and purchasing power, and taxation strategies may be implemented more efficiently.

The negatives around fund investments may be the need to for it to be managed properly. In some situations, investment considerations may be indecisive, investment choice may vary significantly due to the members' ages and naming conventions may hold up the final decision.

Benefit payments

The main positives from a benefit payments perspective is that estate planning can be streamlined with a greater number of members, and the ability to assist with the intergenerational transfer of wealth. This can provide taxation advantages as family members pass through the superannuation fund.

However, some negatives may arise from the increase in members, such as relationship breakdowns between the members in the fund, lack of clarity when it comes to the distribution of death benefits to nominated beneficiaries, and potential financial abuse.

Looking forward to the increase?

The increase in the minimum number of members of an SMSF may not be for every fund, but it may be something others have been looking forward to for some time.

2. Proposed change in the bring forward rule for non-concessional contributions from the age of 65 to 67.

From 1 July 2020 the work test was abolished for anyone under 67 years of age, which meant a person did not have to work at least 40 hours in 30 consecutive days before personal concessional and non-concessional contributions could be made. This was a relatively easy change as all it meant was a change to the regulations.

At the time the change was announced, it was also proposed to change the bring forward rule for personal non-concessional contributions from 65 to 67 years of age. This allows a person to contribute up to three year's non-concessional contributions at any time during a fixed three-year period. The first year in the fixed period commences when the person makes non-concessional contributions of greater than the standard non-concessional contributions cap amount, currently $100,000. The bring forward rule also depends on the amount of a person's total superannuation contribution as at 30 June in the previous financial year.

Planning opportunities may arise for clients between the age of 65 and 67 years old who may wish to use the bring forward rule and maximise the amount of non-concessional contributions they wish to make. It is useful for anyone who has reached 65 years of age as they are able to withdraw lump sum benefits from their super and recontribute it as a non-concessional contribution.

The main benefit from this strategy is for estate planning purposes when an adult child may become entitled to a death benefit. If the lump sum withdrawn from the fund includes a taxable component, it is possible to convert that component to a tax-exempt amount at the time the non-concessional contribution is made to the fund. The tax-free component will be received by an adult child tax free, but any taxable component may be taxed at 15% plus Medicare. However, there is a catch and that is, the individual must be able to make a non-concessional contribution to the fund. Whether that is possible will depend on their total super balance.

3. Proposed change to tax exempt fund income

Whilst there were a number of changes to superannuation that commenced on 1 July 2017 for members, trustees and advisers to absorb, one of the most substantial changes was the calculation of a fund's tax-exempt income, which was a significant shift from what was considered a reasonably balanced approach. For example, one change was that if a fund that was wholly in pension phase for the whole year was required to provide an actuarial certificate, although its taxable income was wholly exempt from tax.

The original start date of the changes was 1 July 2020, however, was deferred to commence at the beginning of the 2020/21 financial year on 1 July 2021. As these changes are not far off there would be some things to consider. The main change is to allow trustees of super funds that are in both accumulation and retirement phases to choose the appropriate method to calculate the fund's current pension income. This should allow funds to use the method that applied prior to the change from 1 July 2017, or as it applied under the new rules.

4. Reduction in duplicate super accounts – Federal Budget 2020

When the Federal Budget was handed down in October 2020, a package of superannuation reforms was announced to see significant changes in the way employees were allocated to default super funds. This was as a result of the Productivity Commission and the Financial Services Royal Commission which were concerned at the multiple super accounts that some members had.

From 1 July 2021, where a person commences work or changes jobs, they will retain the superannuation account they have been allocated so it is 'stapled' to the member, thus avoiding a new account being created. Also, the ATO is currently developing systems for new employees to select a super product from a YourSuper portal.

Under the current rules where an employee changes employer and they don't exercise a choice of fund option, any Superannuation Guarantee (SG) contributions are paid to their employer's nominated default fund. However, from 1 July 2021 any SG contributions made for an employee will be required to be paid to the employee's most recent superannuation fund account, unless the employee makes a choice of fund.

The importance of this change is to improve the integrity of the system by improving efficiency and to reduce the number of individuals who may have unwanted multiple accounts.

5. SMSFs and the introduction of SuperStream

SuperStream is a data and payment standard which is used for digital super transactions and is already used by many SMSFs to accept employer contributions. It enables transactions to be made more efficiently with less errors. Currently, rollovers between funds involving an SMSF are slow and cumbersome as there is a deal of paperwork required for a fund to make or receive a rollover from another fund. From 1 October 2021 it will be mandatory for SMSFs that are making and receiving rollovers to be registered for SuperStream. However, from 31 March 2021, it is possible for SMSFs to voluntarily register to enable rollovers to be made electronically.

The most common situations where a member rolls over a benefit between funds is around the time an SMSF is established or being wound up. But it may also take place during the operation of the fund as part of consolidating benefits or where a member may be transferring from or joining the SMSF. As part of the process to register for SuperStream, the SMSF requires an Electronic Service Address (ESA), an ABN (Australian business number) and a bank account for the rollover to take place.

6. Getting the balance caps right

The big superannuation change that must be understood by advisers this year is the indexation of the Transfer Balance Cap (TBC) and the Total Superannuation Balance (TSB) Cap which applies from 1 July 2021. Understanding the changes to a client's situation is important for anyone moving into retirement phase for the first time, or who has already commenced an income stream that was counted against the client's TBC from 1 July 2017.

For anyone who had an income stream in retirement phase when the super changes commenced on 1 July 2017 or started one after that time the initial value of the pension is counted against their Transfer Balance Cap (TBC). Most people who are currently in receipt of a pension have a TBC of $1.6 million, but a small number who are in receipt of defined benefit pensions, such as life expectancy or lifetime pensions, may have a higher TBC.

The role of the TBC is to place a cap on the amount that can be transferred into a retirement phase income stream so that any income on investments supporting the pension remains tax exempt. Any change in the balance of the pension due to pension payments or fluctuations in the value of the underlying value of investments do not impact on the amount counted for a person's TBC. However, converting some or all of the pension to a lump sum (commutation) will reduce the amount that has been counted against the person's TBC.

The TBC is not to be confused with a person's TSB, which is calculated on the total amount a person has in all superannuation funds as at 30 June in the previous financial year. The TSB determines the amount of non-concessional contributions that can be accepted by the fund. It also links to whether a person qualifies for other types of contribution concessions, such as the co-contribution or bring forward concessional contributions. For example, a person with a TSB greater than $1.6 million will be penalised if they make non-concessional contributions to the fund.

Since 1 July 2017, the TBC has been $1.6 million. However, from 1 July 2021 it is to be indexed as required by the tax legislation. Indexation of the TBC is increased by in the Consumer Price Index and takes place in increments of $100,000. The first increase in the cap is from $1.6 million to $1.7 million.

The main issue with the indexation of the TBC is that anyone who has already used up the whole of their $1.6 million cap will not get access to the increased cap. However, anyone who has not used all of their $1.6 million cap will be entitled to a proportional increase in the indexed amount. For those who have not commenced a pension from their super fund, they will have access to the increased TBC amount of $1.7 million. If that sounds confusing then here are a few case studies to show you how it works:

Case Study 1

Let's assume someone was receiving an account based pension from their super fund which had a balance of $1 million on 1 July 2017 when the new rules commenced. At that time the balance would have been counted as a credit against their TBC. On 1 July 2020 another account-based pension commenced with $600,000, which is also credited to their TBC. As the total amounts counted against the person's TBC is $1.6 million all of their cap has been used up and they won't get access to the $1.7 million increased threshold.

Case Study 2

In this case study a person commenced a pension on 1 September 2019 with $1.2 million and has not commenced another pension since. With the increase in the TBC on 1 July 2021, they will be entitled to a proportional increase in their TBC. As they have used up 75% of their TBC when they commenced the pension, they will be entitled to 25% of the indexed increase in the TBC. This means their TBC will increase by $25,000 (25% of $100,000) to $1,625,000 in view of the unused proportion of the TBC they have not used. As they have used $1.2 million of their cap, they could commence a second pension with $425,000 ($1.625 million less $1.2 million).

Case Study 3

This case study involves someone aged 60 years of age who plans to commence their first pension from super on 31 December 2021. As they haven't used any of their TBC they are entitled to access, the whole of the indexed cap of $1.7 million.

As you can see from the above case studies, whether someone is entitled to a higher TBC due to indexation depends on the proportion of the cap that has been used previously. Anyone who is yet to commence a retirement phase pension has access to the full indexed cap amount - but anyone who has had a pension in place since 1 July 2017 may only get access to a proportion of the indexed amount.

From an advice angle you may find that clients who are currently drawing a pension from their fund may end up with different amounts as their Transfer Balance Cap due to indexation rather than one standard cap applying to everyone.

What to look out for

These changes, whether proposed or in place, will make an impact on advice for all members of super funds. However, the most important need for an adviser is to understand the impact of the indexation in the Transfer Balance Cap and Total Super Balance from 1 July 2021 in view of the number of clients impacted by the change.

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1. https://data.gov.au/data/dataset/self-managed-superannuation-funds/resource/29576970-3135-46c1-9364-2ec5f6a90842