

# Super 2020 and beyond: New rules, strategies and opportunities

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Death benefits

UK state pension

Concessional  
contribution caps

Segregation  
and streaming

# Introduction

Now that the dust has settled on the changes made to super in 2017, it is time to begin planning for the future.

This guide aims to give you an understanding of four strategic areas that will allow you to work with your clients to better position them to benefit from the new rules and opportunities.

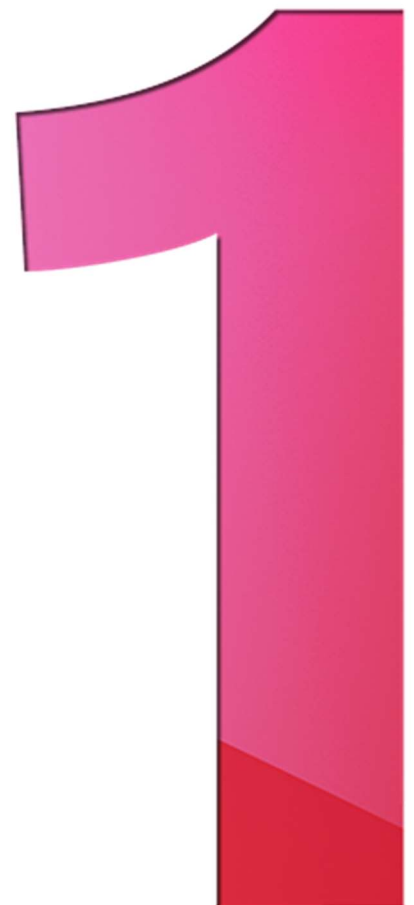
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# Death is a super pain (and a super worry)

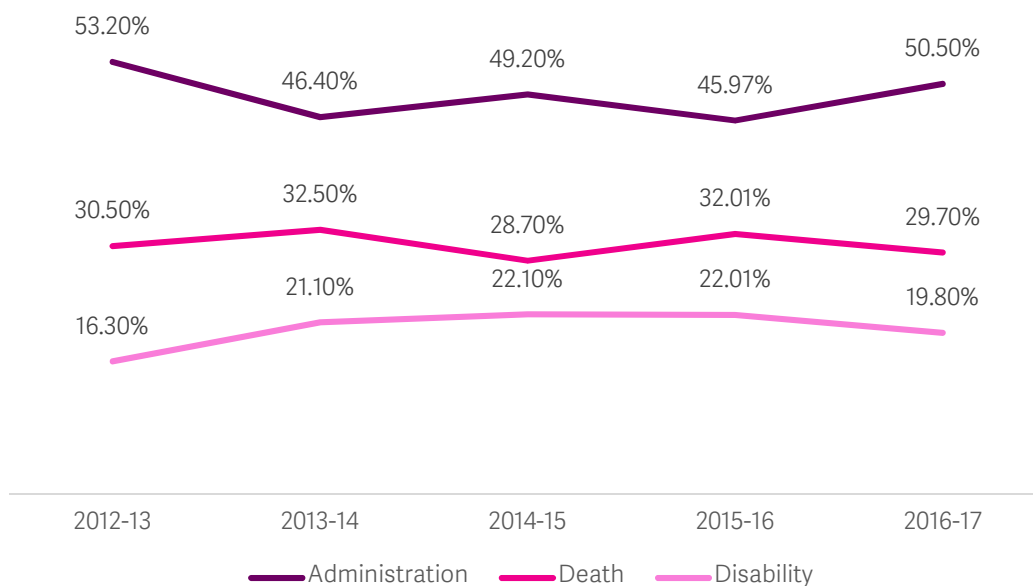


## Death is a super pain (and a super worry)

Super death has always been a complicated and confusing area and the recent changes have simply added to this manifold over! Just how

complex and confusing is shown by the fact that 29% of the cases dealt with by the Superannuation Complaints Tribunal in the 2016-17 year were specifically related to death claims. This chart, from the latest Annual Report, shows the recent trends:

Trend over time in nature of complaints received by Super Complaints Tribunal\*



\*Superannuation Complaints Tribunal Annual Report 2016-17

As financial advice professionals, it is vital that we understand the various options, concepts and implications to provide the most appropriate advice. This paper summarises the various terms, highlights the new and old rules and concepts to help you navigate the new death benefits landscape.

### Death benefit payments

Are made on the death of the member to one or more of the deceased member's super dependants (at the date of death) or their Legal Personal Representative (LPR) and:

- Death benefits must be paid as quickly as practicable (see section on Cashing and Nominations); and
- These payments can include the member account balance plus insurance proceeds
- In certain circumstances (see section on Tax on Super Death Benefits), payments may be taxed
- Can be paid as a lump sum (exit super environment) or a death benefit income stream (or pension) if received by an eligible person
- Prior to death, the member can provide binding or non-binding instructions to the trustee on how the benefit is to be paid:
  - If in pension mode, the pension can be made reversionary to an eligible dependant

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- If no instructions or reversionary, then the trustee has discretion (within the parameters of the law) on how and to whom the benefit is paid.

### New - Once a death benefit always a death benefit

From 1 July 2017, once a death benefit, always a death benefit. There is no longer any prescribed period, the old 6/3 months rule is abolished and therefore a death benefit **never** can become a member benefit:

- If paid as a lump sum it must be paid out of super
- If paid as a death benefit pension, it must remain as a separate pension and can **never** be amalgamated with the beneficiary's own pensions
- If paid as a death benefit pension, it can **never** be rolled back to accumulation
- If the death benefit pension is commuted at any date after its commencement, it must be paid out as a death benefit lump sum
- As a death benefit, it is always tax free to (tax) dependants.

### New - Transfer Balance Account (TBA)

- From 1 July 2017, the government has introduced the new concept of a transfer balance account which tracks the amounts transferred into or out of retirement phase – that is, pensions (any) where the earnings tax exemption applies. There is a limit on how much can be transferred into retirement phase and receive the earnings tax exemption known as the transfer balance cap. The TBA is used to determine if the transfer balance cap is exceeded.

### New - Transfer Balance Cap (TBC)

- From 1 July 2017, it is the total amount of superannuation that can be transferred into a tax-free retirement account. Currently set

at \$1.6m and will be indexed to the CPI in \$100,000 increments.

### New - Retirement phase

- From 1 July 2017, an income stream is in retirement phase when a condition of release has been met and a superannuation income stream (pension) is currently payable. An earnings tax exemption applies to a pension in the retirement phase.

### New - Retirement phase income stream

From 1 July, retirement phase income streams (pensions) include all super pensions other than:

- Transition to retirement pensions (TTR) where the recipient has not met one of the following conditions of release:
  - Retirement
  - Reaching age 65
  - Terminal medical condition
  - Permanent incapacity
- Other non-commutable allocated pensions or annuities that have not met one of the above conditions of release
- Deferred income streams not yet taken and not have met one of the above conditions of release
- Income streams where commutation authority regarding an excess TBC has issued and not been complied with in the designated time.

### To whom can a death benefit be cashed?

- One or more of the member's (superannuation) dependants; or
- The member's legal personal representative (LPR) (the executor of the will or administrator of the estate of the deceased member); or



## Death is a super pain (and a super worry)

- Another person in circumstances where no dependant or legal personal representative can be found.

### Dependant definition

There are two separate definitions of “dependant” which are slightly different for:

- **Who you can pay** a death benefit to (superannuation law)
- **How the death benefit will be taxed** (taxation law).

For the purposes of who can receive a death benefit payment, you are a **superannuation law death** benefit dependant of the deceased if at the time of their death you were:

- The deceased's spouse or de facto spouse
- A child of the deceased (regardless of age or financial dependency)
- Any person financially dependent on the member at the time of the member's death
- A person in an interdependency relationship with the deceased
  - This is a close personal relationship between two people who live together, where one or both provides for the financial, domestic and personal support of the other.

For tax purposes (how much tax they will need to pay), you are a **taxation law death** dependant of the deceased if at the time of their death you were:

- The deceased's spouse or de facto spouse
- The deceased's former spouse or de facto spouse
- A child of the deceased under 18 years old
- A person financially dependent on the deceased

- A person in an interdependency relationship with the deceased.

### Super is not necessarily part of the deceased's estate

Unless the member makes a valid binding nomination or direction, or, in the case of an income stream, there is a reversionary beneficiary nominated, the distribution of the deceased member's account is at the discretion of the super fund trustee. Super law dictates that, generally, trustees can only pay out the deceased members benefit to super dependants or the LPR or a combination of both. This means:

- A deceased member's benefit will not automatically flow to their estate to be dealt with by their will
- If you wish to ensure that the deceased's account does go, fully or partially, to the estate, make a binding nomination to this effect
- Check the rules of the fund to see if there are any “hard wired” fund rules. For example, many retail fund rules state that where there is no nomination or reversionary, the trustee must pay the benefit to the deceased member's LPR
- An SMSF will normally allow the surviving trustee to exercise full discretion unless the fund rules explicitly allow a binding nomination or direction or reversionary nomination to be made. While this maximizes flexibility, it can also create problems where family members disagree with the trustee decisions.

If the member has died and the trustee is unable to find either a LPR or a dependant, the trustee may cash the benefits in favour of another individual, subject to the fund's governing rules. The trustee must make a decision in relation to the benefit that is fair and reasonable to the circumstances of all parties who have, or are likely to have, an interest in the death benefit.

## Cashed - what does this mean?

- A deceased member's benefit must be cashed as soon as practical. Cashed means they can be paid in one or more of the following forms:
  - A single lump sum in respect of each person to whom benefits are cashed;
  - An interim lump sum and a final lump sum in respect of each person to whom the benefits are cashed;
  - One or more pensions that are in retirement phase.
- A retirement phase pension can only be paid to a member's dependant beneficiary (special conditions may apply to children). TBA and TBC's may also impact on the amount of death benefit pension that the beneficiary can take without penalty.
- There is no change to who can be a child pension recipient. To recap, they must be:
  - Under 18 years old, or
  - Between 18 and 25 years old and were financially dependent on the deceased, or
  - Have a permanent disability.
- The child pension must cease:
  - Upon reaching age 25, unless the child has a permanent disability, or the funds have previously been exhausted or commuted to a lump sum. This means the pension must be cashed and the balance of capital withdrawn from the super system. At this time, their transfer balance account and transfer balance cap will cease.
  - If the child subsequently starts receiving a super pension (other than as a child recipient), a new transfer balance account begins based on the cap at that time.
- There is no legislation definition of "as soon as practicable" so a "common sense" approach should be adopted – if asked, could the trustee justify the time delay?

## Death benefit nominations

Members have the ability, if the fund rules provide, to dictate how their benefit should be dealt with on their death – to whom, how much, lump sum, death benefit pension or a combination. For this to operate successfully upon the members death, the instructions must be valid, conform to both the law and the fund rules and the beneficiary must be able to be paid the benefit under the law and fund rules. The most common situations are:

- The member dies with **no directions** or instructions given:
  - The trustee has full discretion to distribute the deceased benefits to super dependants or LPR as they see fit or as the fund rules dictate.
- The member dies with an **invalid or illegal** nomination or direction or reversionary:
  - The trustee has full discretion to distribute the deceased benefits to super dependants or LPR as they see fit or as the fund rules dictate.
- The member has made a **valid non-binding** death benefit nomination or direction:
  - The trustee will take the request under consideration but is not bound to follow it. Under normal circumstances, it is likely the trustee will follow the request.
- The member has made a **valid binding** death benefit nomination or direction:
  - The trustee is bound to follow the members instructions and distribute the benefit according to those instructions. The LPR cannot change the instruction after the death of the member.
- The member is in pension mode and has nominated a **reversionary pensioner** and that person is still a super dependant at the time of death:
  - The pension continues uninterrupted to the reversionary beneficiary. The trustee has no discretion.

### New - Reversionary pension started before 1 July 2017 and rolled over on or after 1 July 2017

If a member received, or was entitled to, a reversionary income stream prior to 1 July 2017 and after 1 July 2017 rolls that interest over to start an income stream in another fund:

- It is no longer a reversionary pension as the beneficiary has voluntarily ceased it
- It is considered to be a new death benefit pension and the new rules will apply.

### New - Reversionary transition to retirement pension (TTR)

Please note that on 12 February 2018, The Government released exposure draft legislation to ensure that a reversionary Transition to Retirement Income Stream will always be allowed to automatically transfer to eligible dependants upon the death of the primary recipient. Depending on its final form and if it is passed into law, there may be different outcomes and strategies to those discussed next.

Because of the requirement that a death benefit pension must be a retirement phase income stream, and the legislative definition that excludes TTR's where the beneficiary has not met certain conditions of release (retirement, reached 65, terminal medical condition or permanent incapacity) from being a retirement phase income stream, it is possible that:

- Where the deceased had a TTR that was in retirement phase (e.g. the deceased was over 65) and the reversionary beneficiary has **not** met a designated condition of release, the TTR will not be in retirement phase and reversionary nomination is deemed invalid
- As it is a death benefit payment, it cannot be rolled to accumulation and is subject to compulsory cashing

- The fund rules should be checked to see whether it must be cashed out of the super system or if it can be rolled over to a death benefit account-based pension which by definition is in retirement phase.

### New - Interaction with the TBA & TBC

TBA and TBC are relevant only to retirement phase income streams and therefore have no implications where a death benefit is taken as a lump sum.

From 1 July 2017:

- Where the death benefit is taken as a pension – elected by beneficiary, directed under trustee discretion or deceased's nomination – it is a credit to the beneficiaries (recipients) transfer balance account and tested against the beneficiary's transfer balance cap immediately from the date it becomes payable.
- Because a death benefit must be paid "as soon as practicable", the beneficiary pension could begin immediately soon after a short period of time from the date of death.
  - Critically, this means that any earnings – positive or negative – achieved between the date of death and the commencement of the pension are captured and tested under the beneficiary's TBC.
- Where there is a **reversionary** beneficiary, the credit to the beneficiary's TBA occurs 12 months after the date of death and the credit is the value of the interest as at the date of death.
  - This means that any earnings – positive or negative – achieved in the 12 months from reversion date are **not** captured and are not tested under the beneficiary's TBC.
  - The beneficiary has 12 months to re-arrange their affairs to best advantage.



## Death is a super pain (and a super worry)

Where the death benefit pension credit takes the beneficiary above the TBC:

- An amount at least equal to the excess must be removed out of retirement phase. This may be by a commutation of the income stream to either accumulation phase or exiting the super environment via a lump sum depending on the circumstances of the beneficiary
- Either way, the commutation is debit to the TBA and acts to reduce the beneficiary member balance to be below the TBC.

Different options to bring any excess within the TBC may exist depending on the beneficiary's circumstances:

- If the **death benefit pension** must be commuted, it **must** be commuted to a death benefit lump sum and exit the superannuation environment
- If the beneficiary has their **own retirement phase pension** which is contributing to the excess, this can be commuted to create sufficient cap space to bring the total in retirement phase pensions under the TBC. In this case, the beneficiary's own pension can be commuted to either accumulation and be retained in the super environment or to a cash benefit lump sum out of the system.
- Any combination of the above is permissible.

### New - Modified TBC for Child Pensions

From 1 July 2017, child pensions continue to be allowed but they have a special treatment when it comes to TBA reporting:

- Child recipients of a death benefit pension may have a modified transfer balance cap, rather than the general transfer balance cap.

- The normal transfer balance account rules apply, but the modified transfer balance cap depends on the deceased parent's super interests.
- The modified cap is the total amount of the 'cap increments' to which a child recipient is entitled. Their future general cap will not be impacted.
- Child recipients will be entitled to retain super pension(s) up to the amount of the cap increment(s) without exceeding their transfer balance cap.

For child pensions commenced on or after 1 July 2017:

- Where the deceased parent had no transfer balance account at the date of death (generally this means the deceased parent only had an accumulation account):
  - The child will receive the death benefit income stream from the parent's accumulation phase interest
  - If there is one child, their cap increment is equal to the general transfer balance cap (\$1.6 million in 2017–18)
  - If there is more than one child, their cap increment is a proportion of the general transfer balance cap, reflecting their share of the parent's super interests
    - E.g. - If there are 2 children each left 50% of the parent's super, their cap increment is \$800,000 each.
- If the deceased parent had a transfer balance account, that is, had a super pension in retirement phase, before they died:
  - The child cap increment is equal to the share of the deceased parent's interest:
    - E.g. If the deceased parent had a super pension of \$800,000 at death and there was only a single child, the child's cap increment is \$800,000
    - E.g. If the deceased parent had a super pension of \$800,000 at death and there are 2 children, their share of the super interest is 50/50, they

will have a cap increment of \$400,000 each

- E.g. If the parent commenced a super pension with \$800,000 but the account value had reduced to \$600,000 at death because of pension drawings and poor investment performance, then the parent has a TBA (\$800,000) but the retirement income stream value is \$600,000 at death. In this case, if there was one child recipient, the cap increment would be \$600,000 or if two children, \$300,000 each.
- If the deceased parent had both an accumulation account and a super pension in retirement phase (i.e. a TBA), then the cap increment can only come from the retirement phase pension. The cap increment from the accumulation fund is \$nil and if used to start a child pension will create an excess transfer balance and must be cashed out as a lump sum. It cannot be rolled back to accumulation as it is a death benefit lump sum.
- Other key points for child pensions include:
  - The modified TBC is the addition of all the cap increments to which the child is entitled. A child could have two cap increments if both parents died with a super pension in retirement phase.
    - For example, if both parents died and they each had \$1.8 million in accumulation benefits, then their child could receive a \$1.6 million pension from each parent. The remaining \$400,000 would need to be taken as a lump sum death benefit.
  - If the child pension is a reversionary pension, the TBA credit arise 12 months after death
  - Where the deceased parent had a super pension in retirement phase (had a TBA), the cap increment includes any earnings accrued on the income streams between the date of death and until a death benefit pension is paid.

## New - Rolling over death benefits

From 1 July 2017, the definition of “rollover” has been modified to allow a super lump sum death benefit to be rolled over where the deceased’s beneficiary is a dependant **and** is eligible to take a death benefit pension. This means:

- The beneficiary can rollover the death benefit to another fund to begin a death benefit pension.
- Commute and rollover an existing death benefit pension to another fund to begin a death benefit pension.
- Commute and rollover multiple death benefit pension to consolidate to a single death benefit pension (either within the same fund or to another fund) for ease of management and cost efficiencies.

However, as the compulsory cashing rule continues to apply, it is not possible to:

- Rollover a death benefit entitlement to accumulation
- If the beneficiary is not entitled to a death benefit pension, the death benefit is not a rollover and must be cashed out of super
- Death benefit pensions can be combined with other death benefit pension **but not** with the members own super pension.

## New - Anti-detriment payments

From 1 July 2017, funds may only include an anti-detriment payment as part of a death benefit if the member has died on or before 30 June 2017:

- The fund must make this payment by 30 June 2019.
- From 1 July 2019, no anti-detriment payment will be available for funds members, regardless of when the member has died.

## Tax on super death benefits

No changes were made to either the rates or way in which tax is imposed on death benefits. The table below summarises the current rules:

### Lump sum tax rates (excludes Medicare levy)

Recipient	Tax Free component	Taxable component (taxed element)	Taxable component (untaxed element)
Death benefit dependant	0%	0%	0%
Death benefit non-dependant	0%	15%	30%

Table 1 - Where paid via the Estate, tax is payable according to whom is receiving it. Medicare levy not payable.  
Low rate cap does not apply to death benefit lump sums.

### Pension tax rates (excludes Medicare levy)

Age of Deceased	Age of Recipient	Tax Free proportion	Taxable proportion (taxed element)	Taxable proportion (untaxed element)
60 & above	Any Age	0%	0%	0%
Under age 60	60 & above	0%	0%	MTR - 10% tax offset
	Under 60	0%	MTR - 15% tax offset	MTR with no offset

# Managing a death in super

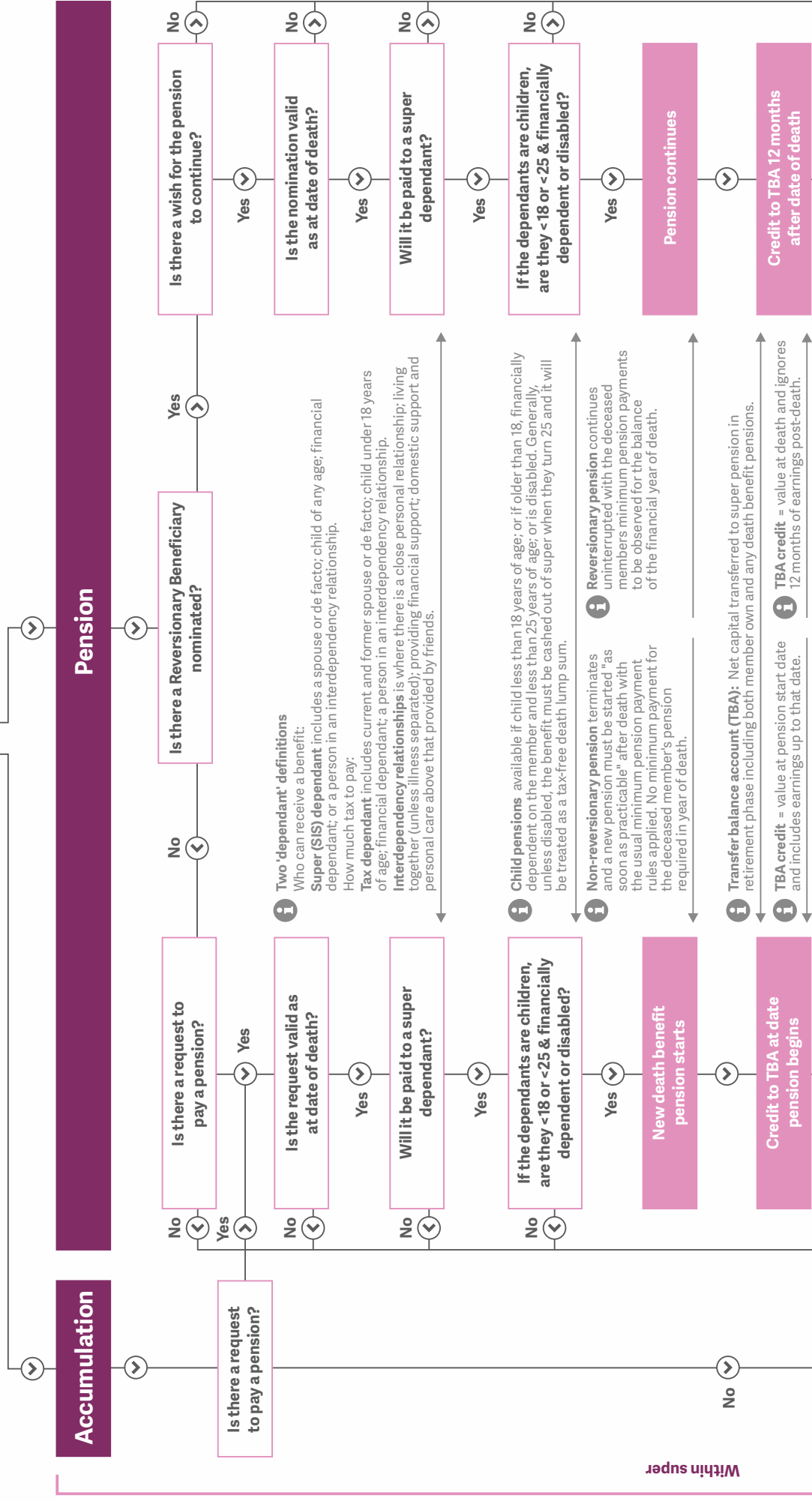
- Consideration
- Outcome
- Action required

**i** Upon death, benefits must be cashed as soon as practicable - either taking a lump sum or, if a dependant, a lump sum or a pension. Subject to Fund rules, one can choose at any time before death how the death benefits are to be dealt with - binding or non-binding nomination, a reversionary pension, or do nothing and allow trustees discretion.

**i** If the trustee cannot find a dependant or Legal Personal Representative (LPR), subject to Fund rules, it may pay the benefit to another person on a fair and reasonable basis to those likely to have an interest in the payment.

**i** Where reversionary pension is in place, member should not overlay with a binding nomination.

## Did the death\* occur in accumulation or pension phase?



**i** If excess to Transfer Balance Cap (TBC): Amounts in excess of TBC (currently \$1.6m and indexed from time to time) must be transferred out of retirement phase. If the beneficiary has own pension, it can be rolled back to accumulation or cashed as a lump sum, to make sufficient cap space to take the death benefit pension. If not possible or unable to make sufficient cap space, the death benefit pension must be commuted to a death benefit lump sum to the extent that it exceeds the TBC.

#### Modified TBC for child pensions

If parent was not in retirement phase: the TBC = \$1.6m. If more than 1 child, each child gets the proportionate share of the deceased super interests multiplied by the TBC. If parent was in retirement phase: the TBC = their portion of the deceased super interests that were in retirement phase that the child received as a death benefit pension. Excess amounts (any amounts sourced from accumulation interests) must be paid out as a death benefit lump sum. The modified TBC ends when either the child turns 25 or the capital is exhausted, whichever ever is earlier; or if disabled, when the capital is exhausted. If later the child starts their own pension, they start with a new TBC.

Yes  
Is there an excess TBC amount?

#### Pension payments

**i** From 1 July 2017, a death benefit pension must be kept as a separate super interest. They cannot be combined with the members own benefit. Normal minimum and pro-rata pension payments need to be observed. Pension payments **do not** impact on the TBA.

#### Death benefits

**i** Death benefits can never be rolled over into accumulation, if not taken as a death benefit pension then must be cashed out. On being cashed out, partial or full, commuted amount will always be treated and taxed as a death benefit lump sum.

Yes  
Will there be excess TBC amount in 12 months time?

No

Pension continues within TBC

If member wishes to commute - partial or full - at any time

## Death Benefit Lump Sum

### Outside super

- Payable on the death of a member and able to be paid directly to a super dependant (by-passes deceased's estate) OR to the legal personal representative (through deceased's estate) OR in combination in the above.
- From 1 July 2017, anti-detriment payments are no longer payable. If the member died before 1 July 2017, the fund has until 30 June 2019 to pay the benefit.
- Where an individual dies in the pension phase, the pension tax free earnings exemption continues after death until as soon as practicable to pay a lump sum.

- Payable on the death of a member and able to be paid directly to a super dependant (by-passes deceased's estate) OR to the legal personal representative (through deceased's estate) OR in combination in the above.
- From 1 July 2017, anti-detriment payments are no longer payable. If the member died before 1 July 2017, the fund has until 30 June 2019 to pay the benefit.
- Where an individual dies in the pension phase, the pension tax free earnings exemption continues after death until as soon as practicable to pay a lump sum.
- A death benefit is always tax free to a tax dependant. Non-tax dependants will pay tax on

### Lump sum tax rates (excludes Medicare levy)

Recipient	Tax free component	Taxable component (taxed element)	Taxable component (untaxed element)
Death benefit dependant	0%	0%	0%
Death benefit non-dependant	0%	15%	30%

### Pension tax rates (excludes Medicare levy)

Age of deceased	Age of recipient	Tax free proportion	Taxable proportion (taxed element)	Taxable proportion (untaxed element)
60 & above	Any age	0%	0%	0%
Under age 60	60 & above	0%	0%	MTR - 10% tax offset
	Under age 60	0%	MTR - 15% tax offset	MTR - with no tax offset

\*Excludes death considerations for those who die with a TRIS, TAP or an unfunded scheme.

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# The UK State Pension: An opportunity overview



## The UK State Pension: An opportunity overview

This guide only applies to individuals who reach UK State Pension age on or after 6 Apr 2016.

### What is the UK State Pension Age?

The UK State Pension Age is the earliest age that an eligible individual can claim State Pension payments (UK version of Centrelink) from the UK government. The State Pension age depends on when an individual is born. The UK State Pension ages have been undergoing radical changes (like many countries around the globe including Australia) since 2010. The changes will see the State Pension age rise to 65 for women (aligning with the men) between 2010 and 2018, and then to 66, 67 and 68 for both men and women beyond that.

Unlike Australia, the eligibility for the UK State pension is based purely on the individuals National Insurance contributions record throughout their working lives, there is no assets or incomes testing requirements.

To work out the State Pension age for an individual, a calculator is available on the UK government website: <https://www.gov.uk/state-pension-age>

### Eligibility – new UK State pension rules

The new State Pension is claimable by a man who is born on or after 6 April 1951 or a woman born on or after 6 April 1953.

(For those who reached State Pension age before 6 April 2016, the old rules apply. The old rules are not being discussed in this paper).

Under the new rules, there is a requirement for an individual to have a National Insurance record of at least 10 National Insurance (NI) qualifying years. This means for 10 years at least one or more of the following applies:

- Worked and paid National Insurance contributions of at least equivalent to the qualifying amount for the year - National Insurance contribution is payable based on

employment until the individual's State Pension age

- Received National Insurance credits for the year because an individual e.g. was unemployed, was a carer etc.
- Paid voluntary National Insurance contributions at the specified amount for the year.

An individual can claim the UK State Pension from abroad (there is no residency test at the start nor on a continuous basis) provided sufficient UK National Insurance contributions (as measured by the number of NI qualifying years) have been made. The State Pension can be paid into a bank account in the overseas country of residence or alternatively a bank or building society in the UK.

### How much pension is payable

The current new full State Pension is worth £159.55 per week (or £8296.60pa or approx. \$14,934pa). The actual amount received depends on the individual National Insurance record and whether the qualifying years were accrued before or after the new rules came into force on 6 April 2016 – see below. A higher amount than the new full State Pension may be possible if the individual defers taking the State Pension when due or alternatively, inherit certain amount of Additional State Pension transition from the old rules.

#### For an individual with no NI contributions or credits before 6 April 2016

The State Pension will be calculated entirely under the new rules (subject to meeting the minimum 10 years of qualifying years). To get the full pension, 35 qualifying years will be required. An individual will get a proportion of the new State Pension if the number of qualifying years is in between 10 and 35 years.

For example, if an individual only has 15 qualifying years after 6 April 2016, the State Pension payable would be  $15/35 \times £159.55 = £68.38$  per week.

State Pension is payable even if the individual continues working post State Pension age or receives other personal or workplace pensions. In fact, if an individual is working past the State Pension age and chooses to defer the claiming of the pension until a later date, the pension is increased for the period of deferment.

**For individuals with some NI contributions or credits (resulting in qualifying years accruing) before 6 April 2016**

Subject to meeting the overall minimum requirement of 10 qualifying years, the National Insurance record as at 6 April 2016 will be used to calculate the 'starting amount' as at that date to reflect the amount accrued under the old rules.

The 'starting amount' will be the higher of either:

- The amount an individual would get if calculated under the old rules
- The amount an individual would get if calculated as if the new rules were in place right from the start.

If the 'starting amount' is more than the full new State Pension, any part (known as protected amount) which is above the full new State Pension will be paid on top of the full new State Pension. Any further qualifying years after 5 April 2016 will not add further to the amount of State Pension received.

If the starting amount' is less than the full new State Pension, adding more qualifying years (by way of further contributions) to the National Insurance record can increase the amount of State Pension (at the rate of 1/35 of the new full State pension for each additional qualifying year accrued). This can be done until the full new State Pension amount or the State Pension age is reached, whichever is first.

## Annual increases

The new State Pension is indexed and increases each year by whichever is the highest:

- Earnings – the average percentage growth in wages (in Great Britain)

- Prices – the percentage growth in prices in the UK as measured by the Consumer Prices Index (CPI)
- 2.5%.

Any protected payment (as discussed previously above) is increased each year but only in line with CPI.

However, it should be noted that once the pension has commenced, an individual will only get the increase every year if living in:

- The European Economic Area (EEA), Gibraltar or Switzerland
- A country that has a social security agreement with the UK that allows for cost of living increases to the State pension.

Unfortunately, Australia does not fall into one of the above criteria, and therefore the amount of pension for an Australian resident will be calculated and fixed (and will not be indexed going forward) as at the date when the State Pension payment commences.

## Gaps in National Insurance record

Under the new rules, full pension will be achieved with a NI record of 35 qualifying years. This may not be achieved if there are 'gaps' in the National Insurance record due to an individual not paying National Insurance or not getting National Insurance credits. This could happen if an individual at some point during their working life was:

- Being employed on low earnings
- Unemployed and not claiming benefits
- Self-employed but didn't pay contributions as below profit threshold
- Living abroad.

These gaps may result in not enough NI qualifying years being accumulated to get to the full State Pension. Where gaps exist, subject to meeting various conditions, voluntary contributions may be made to fill any gaps.

## Checking National Insurance record for gaps

It is crucial as a first step to check if there are gaps in an individual's National Insurance record before requesting to make additional contributions. For an individual living abroad, this can be obtained either online

<https://www.gov.uk/check-national-insurance-record> or alternatively ring the International Pension Centre based in the UK on +44 0191 218 7777.

## Deciding if voluntary contributions should be made

An individual who doesn't have enough qualifying years to get the full State Pension may wish to pay voluntary contributions in order to maximise the amount of State Pension. Voluntary contributions may also be made to ensure that the minimum 10 qualifying years requirement is met to at least get some benefit. For the specific purpose of the State Pension only (there may be other UK benefits of making the contribution), at any point in time when sufficient contribution has been made to achieve the full pension there is no longer any incentive to make further contribution and the contribution can be stopped.

## Main classes of National Insurance to pay from outside the UK

Generally, the 2 main classes of National Insurance contributions that can be made by an individual residing outside the UK are Class 2 and Class 3. Class 2 is cheaper than Class 3 and is payable by someone who is employed or self-employed. Class 3 is payable by someone who is not working.

**Class 2 – £148 for the current 2017/18 year (this amount changes slightly each year and for each year of payment an additional qualifying year is accrued)**

An individual can pay Class 2 if employed or self-employed outside the UK so long as the following conditions are satisfied:

- Have lived in the UK for a continuous 3-year period at any time before the period for

which the National Insurance contributions are to be paid.

- Before leaving the UK, have paid 3 years of National Insurance contributions.
- Immediately before leaving the UK, was ordinarily employed or self-employed.

**Class 3 – £741 for the current 2017/18 year (this amount changes slightly each year and for each year of payment an additional qualifying year is accrued)**

An individual can pay Class 3 regardless of whether the person is working or not if an individual is required to and has paid Class 1 NI for the first 52 weeks of employment abroad.

Alternatively, an individual can pay Class 3, regardless of whether the person is working or not, if they can satisfy either of the following conditions:

- Have lived in the UK for a continuous 3-year period at any time before the period for which NI contributions are to be paid. (living or working in another EEA country or in Turkey might help meet this condition).
- Before leaving the UK, have paid a set amount of NI contributions for 3 years or more (this will be checked when the individual request to pay Class 3 NI).

## Making voluntary contributions (to buy back years)

Every qualifying year that an individual is able to 'buy back' will provide an additional 1/35 of the full pension per week (providing £4.56 per week extra) for life. Given that there is usually a 6 year time limit for paying NI contributions, on application it may be possible to back pay the last 6 years of NI to immediately gain 6 qualifying years with a single lump sum payment (for example based on Class 2 NI, make a single payment of  $6 \times £148 = £888$  (approx. as each year may be slightly different in amount payable) to provide additional 6/35 of full pension per week = £27.35 per week extra for life).

## Applying to make voluntary contributions

The right to make voluntary contributions is not automatic but must be applied for in writing to the HMRC. The form required for this purpose can be found in HMRC brochure NI 38: Social Security abroad. It is only when the form has been processed and accepted by HMRC that an individual can make voluntary NI contributions

from the acceptance date for future contributions up to State Pension age, including the ability to 'back pay' earlier years if so requested and provided those years are still within the time limits for contribution.

Copy of NI 38 can be found on this website link:  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/414910/NI38\\_CF83.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414910/NI38_CF83.pdf)



## Catch-up concessional contribution caps: Use it or lose it



## Catch up concessional contributions caps – use it or lose it

### Overview

Legislation was passed, and received Royal Assent, in November 2016 to allow catch-up concessional contributions from **1 July 2018**. This will allow individuals to make additional concessional superannuation contributions in a financial year by utilising unused concessional contribution cap amounts from up to five previous financial years, providing that the individual's total superannuation balance just before the start of the financial year is less than \$500,000.

The same legislation removed the requirement that an individual must earn less than 10 per cent of their income from employment-related activities in order to be able to make a concessional contribution and take the personal tax deduction for the contribution made. This change is operational from **1 July 2017**.

The combination of these two changes provide a number of very powerful financial planning strategies which may apply to your clients.

### In detail

The new catch-up arrangements will allow individuals with a total superannuation balance of less than \$500,000 just before the beginning of a financial year to utilize any carry forward unused concessional contribution cap from the five previous financial years thereby allowing concessional contributions above the annual \$25,000 cap.

The amount able to be carried forward will depend on the amount contributed in previous years starting from **2018–19 financial year**. Any unused amounts of concessional contributions caps from the previous five years can be utilized in a financial year if the total superannuation balance is less than \$500,000 at the end of 30 June of the previous financial year.

For example, if in the 2018–19 financial year the concessional contributions cap is \$25,000 and an individual contributes \$15,000, they will be able to carry-forward and utilize the remaining \$10,000 for the next five years (but only if the total superannuation balance is less than \$500,000 on the 30 June of the year prior to the contributions).

At an extreme, where an individual makes no concessional contributions and has no SG contributions for 5 consecutive years, this could allow a \$150,000 concessional contribution in the 6<sup>th</sup> year – the annual cap of \$25,000 in year 6 + 5 x \$25,000 for the previous 5 years.

To be eligible to make these carry forward contributions, all of the following criteria must be met:

- Concessional contributions for the year would otherwise exceed the concessional contributions cap for that year; and
- Have a total super balance \*of less than \$500,000 as at 30 June of the previous financial year in which the concessional contribution is made; and
- Have previously unapplied unused concessional contributions cap amounts that have accrued in one or more of the previous five financial years.

\*Total Super Balance at a particular time is defined as the accumulation phase value of their superannuation interests + if they have a transfer balance account, the transfer balance account (adjusted to reflect the actual value of any account-based pensions at a particular time) + any rolled over superannuation benefits that are in transit and not reflected in the above balances.

An individual cannot have unused concessional contributions cap for a financial year earlier than the 2018-19 financial year. This means that the first year in which an individual will be able to make additional concessional contributions by applying their unused concessional

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contributions cap amounts is the 2019-20 financial year.

Amounts of unused concessional contributions cap are applied to increase an individual's concessional contributions cap in order from the earliest year to the most recent year. Unused amounts not utilised after five financial years fall away, that is, will no longer be able to be carried forward.

**Deducting personal contributions from 1 July 2017**

Prior to these amendments, the requirements for an individual to deduct a contribution included a requirement that, broadly, less than 10 per cent of the sum of the individual's assessable income, reportable fringe benefits and reportable employer superannuation contributions were attributable to employment related activities

The new rules allow an individual to deduct personal contributions, making these contributions concessional contributions, regardless of whether they earn 10% or more of their income from employment related activities.

All the other normal contributions rules such as the work test for those 65 or older, providing a valid section 290-170 - Notice of intent to claim a tax deduction - to the fund trustee, continue to apply.

Not all contributions are deductible. Contributions to defined benefit Commonwealth public sector superannuation schemes and untaxed superannuation funds are prevented from being deductible.

**Powerful new strategy**

The combination of these two new rules provides many planning opportunities. These strategies revolve around the forward planning to stockpile the unused concessional contributions for up to five years to be then utilized in a year with a significant tax liability thereby allowing deductions to be taken against assessable income which would otherwise be subject to the higher rate of tax.

For example:

- A husband and wife hold a real property asset in a **family trust**
- The husband is on the highest marginal tax rate
- The wife does not work
- They plan to sell the asset at some future date making a significant capital gain
- Assume asset has a cost base of \$300,000
- Assume both are under 65 throughout the period.

Being a discretionary trust, generally the income and capital gain when realised would be distributed to achieve an optimum tax position.

This is further enhanced as under the new rules the non-working spouse could carry forward the excess concessional contribution amounts over 5 years thereby giving herself a \$150,000 personal deduction in the sixth year. If the sale of the asset and distribution of the proceeds are timed correctly, significant tax savings could be made available.

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If we were to assume a sale price of \$600,000 giving a \$300,000 profit to be distributed, the following scenario is possible:

Strategy	1-Jul-19	1-Jul-20	1-Jul-21	1-Jul-22	1-Jul-23	1-Jul-24
Available Unused Cap	\$25,000	\$25,000	\$25,000	\$ 25,000	\$ 25,000	\$ 25,000
Cumulative available unused cap	\$25,000	\$50,000	\$75,000	\$100,000	\$125,000	\$150,000

Results	With super deduction	Without super deduction
Capital gain in family trust (distributed to wife)	\$300,000	\$300,000
Accessible gain to wife (after 50% discount)	\$150,000	\$150,000
Super deduction taken (\$150k - \$18.2k)	\$131,800	-
Tax-free threshold	\$18,200	\$18,200
Taxable income	-	\$131,800
Personal tax payable (includes ML)	-	\$46,132
Contributions tax payable	\$19,770	-
<b>Estimated tax payable</b>	<b>\$19,770</b>	<b>\$46,132</b>

## Conclusion

This strategy is applicable to a wide range of people including:

- Self-employed with no super support and had not utilised fully their concessional contribution caps in the past
- Those with family trusts or in receipt of income from other sources
- Those with significant CGT events in the near future looking at reducing tax impact on realizing gain all in one year

- Those with broken work patterns and wanting to catch-up on their contributions
- Employees with no ability to salary sacrifice, including those who may receive one off bonuses and not able to salary sacrifice.

Regardless of who this strategy applies to, the important point is planning ahead to allow the accumulation of unused concessional contribution caps of up to five years to be utilized in a year when it matters most.

## Segregation and streaming





## Segregation and streaming

### Segregation and “disregarded small fund assets”

Segregation is basically a term to define the practice of allocating specific assets to member pension and accumulation accounts, with the corresponding earnings being accounted for separately for tax purposes. Thus, the super fund ended up with 2 different pools of specific assets where each pool accounted individually for its income, capital gains, with tax applied on the accumulation pool whilst earnings in the pension pool remained tax free. In an ideal world, each pool had its own bank account so that dividends and distributions, realized capital gains, expenses, pensions etc were all able to be easily identified and accounted for separately.

Segregation “automatically” occurs in cases where a fund is in 100% pension mode, i.e. all the fund assets are supporting pension liabilities. However, if the member had both pension and accumulation accounts, segregation is still possible but requires a specific minuted decision by the trustee to segregate the assets – sometimes known as active segregation - and to identify the specific assets supporting the pension.

Where there are accumulation and pension accounts and no “active segregation” of assets, the fund will be treated as having one pool of assets and the tax liabilities dealt with on a proportional basis, with the proportion determined on an annual basis by the actuary of the fund.

This promulgated a number of strategies usually aimed at maximizing the exempt current pension income (ECPI) – earning tax exemption – by transferring assets with big capital gains to segregated pension accounts to be sold in a 100% tax free environment rather than not segregating and having a portion of any realized capital gain taxed as part of the accumulation account.

From 1 July 2017, new rules apply such that where SMSFs and small APRA funds trigger the criteria below, they will not be able to use the

segregated method to determine their earnings tax exemption (ECPI) for an income year if:

- at a time during the income year, there is at least one superannuation income stream interest in the fund that is in the retirement phase; and
- just before the start of the income year:
  - a person has a **total superannuation balance** that exceeds \$1.6 million; and
  - that person is a retirement phase recipient of a superannuation income stream (whether or not the SMSF is the superannuation income stream provider for the superannuation income stream).

Assets of funds covered by the new rules are known as disregarded small fund assets. Such assets cannot be segregated current pension assets or segregated non-current pension assets for the purposes of applying the earnings tax exemption (ECPI). As a result, these funds must calculate their ECPI by applying the proportionate method with no assets taken to be segregated to pay current or future pension liabilities.

There are number of things to note:

- The measure used is **total super balance** (not retirement phase pension account balance) of \$1.6m which is the accumulation phase value of their superannuation interests **plus** if they have a transfer balance account, the transfer balance account (adjusted to reflect the actual value of any account-based pensions at a particular time) **plus** any rolled over superannuation benefits that are in transit and not reflected in the above balances.
- The threshold of \$1.6m is **not** the transfer balance cap. There seems to be no provision to index the \$1.6m threshold.
- It does not matter whether the member balance is spread over a retail fund and an SMSF, it is still caught.

- This rule does **not** apply to retail funds – segregation is alive and well in the retail fund world.

There have been suggestions that using two SMSF's – one 100% pension with the high growth assets and one 100% accumulation – might effectively defeat this rule. However, while the legislation does not prohibit investors from establishing a second SMSF, the ATO has specifically warned that it will crack down on any deliberate attempts through using this strategy to avoid tax, and funds found to have broken the law could be fined or disqualified.

### Possible strategy

An older client with an SMSF with (say) \$3.2m was 100% in pension mode before 1 July 2017. Close to half of the fund assets (\$1.5m) is represented by a property with good growth potential and the other half comprises of liquid assets and cash. On 30 June 2017, they rolled back \$1.6m to accumulation to comply with the transfer balance cap. From 1 July 2017, as the SMSF is caught under the new rules, the fund will be taxed on a proportional basis.

Perhaps, given the increasing complexity of tax and superannuation pension rules, the increasing regulatory oversight, reporting requirements and regulation of SMSF's, the increasing penalty regime applicable where breaches occur, coupled with possible diminishing mental agility and as an older person simply not wishing to continue to take on these responsibilities, it may be prudent to rollover \$1.6m of the SMSF pension account to accumulation in a retail fund to manage. The property (as it is not able to be rolled to a retail fund) and cash together amounting to \$1.6m unfortunately need to remain in pension mode in the SMSF.

This strategy effectively achieves segregation without establishing a second SMSF and is quite justifiable for the reasons above should that be necessary. For the purposes of calculation of the tax, the proportional method is still applied but as the SMSF is 100% in pension mode, it is technically 'segregated'. The result is the retail fund accumulation account is proportionately

100% taxable and the SMSF pension is proportionally 100% tax free.

Of course, the client's financial goals and complete financial situation should be investigated thoroughly prior providing any advice.

## Streaming of investment earnings

As the segregation of assets is no longer possible for SMSF members with a total super balance that exceeds \$1.6m, it is important to look at the actuarial proportion that determines the amount taxable each year.

This brings into consideration the concept of Income streaming whereby certain assets are "segregated" to specific member accounts for the purposes of allocating income (but not for the purpose of calculation of tax which still adopts the proportionate method).

The relevant legislation/law is Superannuation Industry (Supervision) Regulation 5.03 that makes allowance for the ability to distribute earnings. The higher the actuarial proportion that represents the pension part of the fund, the lesser the tax liability on the fund would be.

This strategy relies on SISR 5.03(2) which says:

- "... the trustee of a superannuation fund ... must determine the investment return to be credited or debited to a member's benefits ... in a way that is fair and reasonable ..."

The strategy operates by:

- Allocating or "segregating" certain assets to specific member accounts (perhaps according to risks) for the purposes of allocation of income. Effectively, this amounts to running separate tailored investment strategies for each member. Each member as a result will have a different rate of return
- Proportionate method for calculating tax (ECPI) continues to be used based on the actuarial proportion

- Where there is a higher rate of return (representing a higher streamed earnings) assigned to the pension account compared to the accumulation account, the tax-free earnings (pension) proportion will progressively increase. The opposite may be true in a falling market environment.


Essentially, this strategy suggests that being fair and reasonable as required by legislation, when it comes to distributing earnings, allows one to argue that in situations where a member has (say) a different risk tolerance to another member, they should have different investment strategies. As such, one member can hold assets that are different or inappropriate for the other member. Therefore, when different investment strategies apply, specific assets should be allocated (segregated) to a specific member reflecting this, and the returns - positive or negative - that accrue to those investments should be allocated to that particular member's account only - rather than based on pooled assets and pooled returns.

Ideally, the rate of return on the designated pension assets is higher than the accumulation assets which should then positively improve the actuarial proportion. Of course, if it turns out that the 'pension assets' generated a lesser or negative return, that would unfortunately have a detrimental impact on the proportion.

Under this scenario, even though the earnings for accounting purposes are streamed to the members account according to their risk profiles, the proportionate method for tax purposes (ECPI) i.e. the actuarial proportion, continues to be used and therefore not breaching the anti-segregation rules.

An improved pension proportion over time as a result of the streamed earnings could result in a materially better outcome for the member. As a word of caution, this could be looked at as an aggressive tax avoidance strategy from the ATO point of view, and as such it is recommended that legal advice be sought before putting any aspects of this strategy in place.



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