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Case Study

Death, Taxes & The $1.6 Million Transfer Balance Cap

SMSF Specialists
Investment Management
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Death, Taxes & The $1.6 Million Transfer Balance Cap

In our Trade Secrets edition (October 2017), we outlined some of the advantages and disadvantages of holding excess funds above $1.6 million within superannuation following the introduction of the Transfer Balance Cap (TBC) from 1 July 2017.

We also explored the taxation implications of holding funds in excess of the $1.6 million TBC in a couple's personal names as an alternative to retaining funds within the accumulation phase of superannuation.

In addition, we briefly alluded to another important consider- ation that needs to be taken into account in the decision-making process - estate planning implications.

Estate Planning and Superannuation

Superannuation does not automatically form part of an individual's Estate. An individual needs to ensure the correct paperwork is in place for their superannuation benefits to be certain that this asset is distributed as per their wishes, just like the rest of a person's Estate.

There are two estate planning tools an individual can use within superannuation to ensure their superannuation benefits are distributed in accordance with their wishes.

Firstly, most superannuation Trust Deeds allow members to make a death benefit nomination. Depending on the Trust Deed, this nomination can be binding or non-binding, non-lapsing or have a predetermined time frame.

Secondly, where a pension is commenced by a member, the pension can be either reversionary or non-reversionary.

A reversionary nomination generally allows the pension to continue being paid to another person (usually a spouse), upon the member's death. It also allows for continuity on death where there is a surviving spouse. Subject to the Trust Deed, a reversionary nomination can take precedence over the death benefit nomination.

However, it is very important to note that the death benefit nomination is relevant when a member has an accumulation phase balance, or if the reversionary beneficiary nomination is no longer applicable.

Case Study

In the earlier edition of this case study, we met Peter and Jo. Peter (age 68) had an Account Based Pension (ABP) of $2.6 million. Peter's wife, Jo (age 65), had an ABP of $1.7 million. At 1 July 2017, they exceeded the $1.6 million TBC by $1 million and $100,000, respectively. To comply with the TBC, they needed to make some decisions regarding these excess funds.

There were two scenarios that Peter and Jo considered. These were:

- Scenario 1: Withdraw the excess out of superannuation and invest the $1.1 million in their personal names; or,
- Scenario 2: Retain the $1.1 million excess within superannuation in the accumulation phase.

Scenario 1: Peter and Jo decide to withdraw the $1.1 million excess funds and invest personally

Under the first scenario, on 1 July 2017, Peter and Jo elected to withdraw the funds they respectively held in excess of $1.6 million and to invest the money personally.

This resulted in $1.1 million invested in their joint personal names and $1.6 million in an ABP each.

Unfortunately, Jo dies. What options does Peter now have in these circumstances?

As per Jo's Will, upon her death, the $1.1 million held in their joint personal names is transferred to Peter's individual name.

Jo's ABP is reversionary to Peter. Peter, therefore, inherits Jo's $1.6 million ABP. However, Peter does not inherit Jo's TBC – he still has to comply with the $1.6 million TBC. He, therefore, has to decide what to do with Jo's ABP.

The two options Peter has are:

- **Option 1 – Peter elects to withdraw Jo's member balance and invest personally**

  Under this option, Peter's elects to withdraw Jo's $1.6 million ABP from superannuation. This results in $2.7 million being invested in Peter's personal name. He retains his $1.6 million ABP.

- **Option 2 – Peter elects to receive Jo's member balance and commute his existing ABP to accumulation phase**

  Under this option, Peter elects to transfer his current $1.6 million ABP back into the accumulation phase.

  Peter is then in a position to accept Jo's $1.6 million ABP, and remain within his $1.6 million TBC. He can also keep his existing member balance within the superannuation environment meaning he maintains $3.2 million within superannuation and $1.1 million in his personal name.

Peter's comparable income taxation consequences, under each of these two options, are as follows. We have assumed an earnings yield of 5% on assets held.

Taxation Entities	Description	Option 1	Option 2
SMSF	Assessable Income from funds (existing accumulation phase money)	Nil	Nil
	Assessable Income from funds (accumulation phase money)	$0	$80,000
	Total Assessable Income - SMSF	$0	$80,000
	Tax on Assessable Income in Super (15% in Accumulation)	$0	$12,000
Peter	Assessable Income from Funds (existing personally held money)	$55,000	$55,000
	Assessable Income from Funds (new personally held money)	$80,000	$0
	Total Assessable Income - Personally	$135,000	$55,000
	Estimated Tax on Assessable Income	$37,582	$9,422
	Plus: Estimated Medicare Levy	$2,700	$1,100
	Tax Personally	$40,282	$10,522
	Total Tax (Peter & SMSF) - approx.	$40,282	$22,522
	Difference		$17,760

As noted, the option of transferring Peter's existing ABP into the accumulation phase, therefore allowing him to receive Jo's ABP, provides a greater taxation advantage compared to withdrawing the excess from superannuation.

Scenario 2: Peter and Jo elected to retain the $1.1 million excess within superannuation in the accumulation phase

Rather than withdrawing the excess and investing it personally, Peter and Jo decided to retain their respective excess amounts above the $1.6 million TBC in the accumulation phase.

This resulted in each of them having a $1.6 million ABP. Peter's $1 million excess is commuted into his individual accumulation phase, likewise for Jo's $100,000 excess which is transferred into an accumulation phase for her.

Unfortunately, Jo dies.

Jo's ABP is reversionary to Peter. Jo also has a death benefit nomination to Peter, which ensures Peter inherits the $100,000 in Jo's accumulation phase.

With Jo's death, Peter has some decisions to make. What options does Peter have in these circumstances?

- **Option 1 – Peter elects to withdraw all of Jo's member balance and invest it personally**

  Under this option, Peter's elects to withdraw Jo's total member balance (her $1.6 million ABP and $100,000 accumulation phase balance) and invest this in his personal name.

  He retains his $1.6 million ABP and $1 million accumulation phase balance within superannuation.

- **Option 2 – Peter elects to commute his existing ABP to accumulation phase, receive Jo's ABP and withdraw Jo's $100,000 accumulation balance**

  Under this option, Peter decides to transfer his existing $1.6 million APB into to the accumulation phase, to combine this with the $1 million he already holds in accumulation phase.

  This allows Peter to accept Jo's $1.6 million ABP and remain within the $1.6 million TBC.

  However, Jo's $100,000 accumulation account has to be withdrawn from superannuation. Based on her death benefit nomination, this is paid to Peter personally.

The income taxation consequences for Peter, under each of these options, are below. We have assumed an earnings yield of 5% on assets held.

Taxation Entities	Description	Option 1	Option 2
SMSF	Assessable Income from funds (existing accumulation phase money)	$50,000	$50,000
	Assessable Income from funds (accumulation phase money)	$0	$80,000
	Total Assessable Income - SMSF	$50,000	$130,000
	Tax on Assessable Income in Super (15% in Accumulation)	$7,500	$19,500
Peter	Assessable Income from Funds (existing personally held money)	N/A	N/A
	Assessable Income from Funds (new personally held money)	$85,000	$5,000
	Total Assessable Income - Personally	$85,000	$5,000
	Estimated Tax on Assessable Income	$19,172	$0*
	Plus: Estimated Medicare Levy	$1,700	$0
	Tax Personally	$20,872	$0
	Total Tax (Peter & SMSF) - approx.	$28,372	$19,500
	Difference		$8,872

Similar to the differences under the first scenario, where the maximum amount of funds can be retained in superannuation, the total amount of income tax payable is less.

So what if I individually don't have $1.6 million...

Even if a couple's respective member balances do not exceed the $1.6 million TBC as at 1 July 2017, the individual's balance at 1 July 2017 does dictate what additional funds a person can receive, and retain, in superannuation tax-free.

It is critical to plan for the estate planning implications of the new TBC, even if you have less than $1.6 million in superannuation.

Other points of note:

- Only the implications from an income tax perspective have been taken into consideration in the above calculations. Capital gains tax is also another factor that needs to be considered.

  Capital gains within the accumulation phase are taxed at a flat 10% if held for more than 12 months, or 15% if held for less than 12 months.

  This compares to the capital gain tax implications within a person's added a person's assessable income, and taxed at their marginal tax rate. If assets are held in for less than 12 months, 100% of the gain is added to a person's assessable income; whereas if the shares were held for longer than 12 months, then 50% of the total gain is added to a person's assessable income.
- Funds held within the accumulation account are excluded from the minimum pension payment that is required to be taken each year. This retains capital in the account until it is required, for example for Aged Care costs.
- Where a reversionary pension exists, a person has 12 months from the deceased member's date of death to deal with the TBC excess the reversion may create. In contrast, balances within an accumulation account or non-reversionary pension accounts need to be dealt with 'as soon as practicable' according to the ATO.
- In some situations, children may receive deceased member's superannuation entitlements. However, there are complications with what a child's TBC may be – it may not be the standard $1.6 million figure. Professional advice needs to be sought in this area.

Conclusion

There are a number of decisions that have to be made from a superannuation perspective when one member of a couple dies. As indicated, the choices that have to be made include decisions on the structure within which to hold the funds. These decisions can make a substantial difference in the amount of tax paid by an individual.