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Case Study

The $1.6 Million Transfer Balance Cap – Do I Leave The Excess Funds In Superannuation Or Not?

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The $1.6 Million Transfer Balance Cap – Do I Leave The Excess Funds In Superannuation Or Not?

Prior to 1 July 2017, an individual could have an unlimited amount of money invested in superannuation and if running a pension, pay no tax on any income or realised capital gains.

This created an attractive investment vehicle, especially when comparing the taxation rates in other entities, such as an individual's personal taxation rate or company taxation rates.

With legislative changes from 1 July 2017, this ceased for individuals who held more than $1.6 million in superannuation and are running Account Based Pensions (ABPs). Individuals are now restricted to having ABPs of up to $1.6 million. Any member balances that exist over this amount, as at 1 July 2017, can remain in superannuation, but are required to be moved back into the accumulation phase.

Alternately, the funds can be withdrawn from superannuation and invested elsewhere.

Choices therefore have to be made with what to do with these 'excess' funds – leave the excess funds in the superannuation accumulation phase or withdraw the funds from superannuation and invest in your personal name?

To recap, the taxation rates of these respective entities are outlined below:

Owner:	Income Tax	Capital Gains Tax for assets held less than 12 months	Capital Gains Tax for assets held more than 12 months
Personally – tax can be up to:	47%	47%	23.5%
Super Fund in accumulation phase	15%	15%	10%
Super Fund in Pension phase (Capped at $1.6m)	Nil	Nil	Nil

The different personal taxation rates (for an Australian resident), and excluding Medicare levy of 2%, are outlined below:

Taxable income	Tax rate
$0 - $18,200	Nil
$18,201 - $37,000	Nil + 19% for each $1 over $18,200
$37,001 - $87,000	$3,572 + 32.5% for each dollar over $37,000
$87,001 - $180,000	$19,822 + 37% for each dollar over $87,000
$180,001 +	$54,232 + 45% for each $1 over $180,000

In addition to the above rates, people over the age of 65 are eligible for the Senior Australians and Pensioners Tax Offset (SAPTO). This offset, in conjunction with the $18,200 tax-free threshold, and the low income tax offset (LITO), means an eligible couple can receive income of up to $57,948 combined (2017/18 Financial Year) without paying any income tax. A single can earn up to $32,279 in the 2017/18 Financial Year, without paying any income tax.

In today's benign interest rate environment, the concept of holding excess funds personally, and not paying any income tax (compared to the 15% tax rate within the superannuation accumulation phase) on face value appears attractive.

However, before taking funds above $1.6 million out of superannuation into what appears to be a nil tax environment, a few things need to be considered. Let's explore these in the case study below:

Case Study:

As at 1 July 2017, Peter (68) has an ABP of $2.6 million and his wife Jo (65) has an ABP of $1.7 million. They both exceed the $1.6 million transfer balance cap, by $1 million and $100,000 respectively. While they plan to retain ABP's of $1.6 million each, they are considering their options for the funds in excess of the $1.6 million figure.

The two options they are considering are;

1) Retaining the excess above $1.6 million in superannuation, but in the accumulation phase; or

2) Withdrawing the excess out of superannuation and holding the funds in their personal name.

Example 1: Tax Implications:

Assuming the $1.1 million excess generates a 5% yield, if they hold no other assets in their personal name, a summary of the tax payable under both scenarios is outlined below:

Scenario:	Retain Excess in Super	Withdraw Excess from Super	
Taxation Entities	Super	Peter	Jo
Assessable Taxable income from Funds	$55,000	$27,500	$27,500
Tax on Income	$8,250	$1,767	$1,767
Less: LITO	N/A	$445	$445
Less: SAPTO	N/A	$1,602	$1,602
Net Tax Payable	$8,250	$0	$0
Plus: Medicare Levy	N/A	$550	$550
Combined Tax Payable	**$8,250**	**$1,100**	

From the above comparison, Peter and Jo are better off on an Income Tax perspective withdrawing the excess fund out of superannuation and investing in their personal name.

What if there are other sources of income?

The example above is very simple. What if we take into consideration any additional assessable taxable income that may already exist? These are explored in the examples below.

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Example 2: Increase in accumulated personal assets:

Peter and Jo are required to take a minimum of 5% from their respective ABP's. As their ABP's are now valued at $1.6 million as at the 1 July 2017, their minimum pension payment decreases to $80,000 p.a., or $160,000 p.a. combined. If their living expenses are $100,000 p.a. their savings capacity is $60,000 p.a., or $300,000 over five years.

Assuming these excess funds also generate a 5% p.a. yield, or $15,000 p.a. ($7,500 per person), this $300,000 creates an additional amount of taxable income, compared to the previous scenario.

This is highlighted below:

Scenario:	Retain Excess in Super			Withdraw Excess from Super	
Taxation Entities	Super	Peter	Jo	Peter	Jo
Assessable Taxable income from Funds	$55,000	$0	$0	$27,500	$27,500
Income from other investments	N/A	$7,500	$7,500	$7,500	$7,500
Total Taxable Income	$8,250	$7,500	$7,500	$35,000	$35,000
Tax on Income	N/A	$0	$0	$3,192	$3,192
Less: LITO	N/A	$445	$445	$445	$445
Less: SAPTO	N/A	$1,602	$1,602	$753	$753
Net Tax Payable	$8,250	$0	$0	$1,994	$1,994
Plus: Medicare Levy	N/A	$150	$150	$700	$700
Combined Tax Payable	**$8,550**			**$3,988**	

As noted, the total amount of taxable income under the scenario where the excess funds are withdrawn from superannuation and invested personally, is still less ($3,988) than the combined tax paid when the excess funds are retained in superannuation ($8,550). However, this gap will close quickly as the years of savings accumulate.

Example 3: Additional Assets:

What are the implications if further additional income is generated from other sources, e.g. personally held assets or employment income?

Let's assume Peter and Jo have a jointly held share portfolio, a cash in the bank and an investment property. These non-super investments produce $32,500 per year from dividends, interest and rent.

Suddenly, their combined tax payable amount goes from $1,100 as highlighted in the first example, to $13,079. This is more than the amount of tax paid if the excess funds were retained in superannuation.

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Scenario:	Retain Excess in Super			Withdraw Excess from Super	
Taxation Entities	Super	Peter	Jo	Peter	Jo
Assessable Taxable income from Funds	$55,000	$0	$0	$27,500	$27,500
Income from other investments	N/A	$16,250	$16,250	$16,250	$16,250
Total Taxable Income	$8,250	$16,250	$16,250	$43,750	$43,750
Tax on Income	N/A	$0	$0	$5,766	$5,766
Less: LITO	N/A	$445	$445	$101	$101
Less: SAPTO	N/A	$1,602	$1,602	$0	$0
Net Tax Payable	$8,250	$0	$0	$5,665	$5,665
Plus: Medicare Levy	N/A	$325	$325	$875	$875
Combined Tax Payable	**$8,900**			**$13,079**	

Example 4: Capital Gains

While investing funds in an individual's personal name, the tax savings from an income tax perspective may be worthwhile, this can be undone upon the sale of a well performed asset.

If an asset had the good fortune of providing large capital growth, upon sale, 50% of the gain (if held for more than 12 months, for 100% of the gain if the shares were held for less than 12 months), would be added to a person's assessable income and taxed at their MTR. This compares to gains crystallized within the superannuation accumulation phase, were the taxation rate is a flat 10% if held for more than 12 months, or 15% if held for less than 12 months.

For example, CSL shares have performed well over the short term. Approximately three years ago, CSL shares were trading at $55, and now they are trading around $133 per share.
Assuming 2,000 where purchased for $55, and are now intended to be sold at $133, the capital gains implications are summarised below:

CSL Limited (CSL)	
Purchase Price	$55
Number of Shares	2000
Cost Base	$110,000
Current Share Price	$133
Capital Gain	$266,000

For the purposes of this example, we've assumed the shares are either held personally (jointly) or in superannuation. Of Peter and Jo's total superannuation balance, $1,100,000, or 26%, is in the accumulation phase. Therefore, only 26% of the long term gain is taxed at 10%.

The result shows the assessable capital gains, when added to Peter and Jo's assessable taxable income, creates a total taxable amount that is higher than if a proportionate amount of the gain was taxed in the superannuation accumulation phase.

The tax implications are summarised below:

	Retain Excess in Super	Withdraw Excess from Super	
	Super	Peter	Jo
Assessable Taxable Income from Assets	$55,000	$27,500	$27,500
Assessable Capital Gain	$40,560	$39,000	$39,000
Total Taxable Income	N/A	$66,500	$66,500
Net Tax Payable	N/A	$13,160	$13,160
Plus: Medicare Levy	N/A	$1,330	$1,330
Tax Payable on Income	$8,250	N/A	N/A
Tax Payable on Gain	$4,056	N/A	N/A
Total Tax Payable	**$12,306**	**$28,979**	

In this instance, retaining the excess funds in superannuation provides a far more tax effective outcome.

Other points to note:

While the above examples focus on the tax paid by an individual compared to within superannuation, a number of other concepts also need to also be considered.

Holding excess funds in the accumulation phase of superannuation, rather than investing personally, may also assist in obtaining or preserving eligibility for other benefits. For the purposes of qualifying for the Commonwealth Seniors Health Care Card, superannuation accumulation phase balances are not assessed under the income test.

Estate planning implications also need to be addressed. This area is a mine field of complications, which also need to be considered prior to withdrawing excess funds from superannuation. We will address this area specifically in our next Trade Secrets addition.

Conclusion

There are a number of aspects that need to been considered before taking any money, especially funds in excess of $1.6 million, out of superannuation. There is no cut and dry answer as to whether leaving excess funds in superannuation, or withdrawing the funds out of superannuation, provides the best result.

All considerations around the implications of both scenarios, needs to be fully considered on an individual level, prior to any action being undertaken.

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