Understanding the transfer balance cap

The transfer balance cap is a limit on the amount you can transfer into the retirement phase.

You should **read this fact sheet** if you are:

- retired and have $1.6 million or more in your retirement phase income stream(s) (i.e. does not apply to transition to retirement income streams)
- making plans for how you will use your accumulated super when you retire
- receiving a defined benefit income stream, or
- expecting to receive a reversionary income stream.

What is the transfer balance cap?

A limit on the amount of super you can transfer from your super account(s) to a retirement income stream which has tax-free investment earnings.

The Australian Taxation Office (ATO) maintains a **transfer balance account** to manage and monitor your income streams to the cap.

The cap is $1.6 million and will be indexed in $100,000 increments in line with the Consumer Price Index (CPI). You can only access the benefit of indexation in respect of the unused portion of the cap.

For example, if you have $800,000 in a retirement income stream on 1 July 2017, which is half the cap, you will only be able to access half the benefit of indexation in the future.

What counts towards your transfer balance account?

Any retirement phase income stream(s) (but not transition to retirement income streams) you hold at 30 June 2017 will be added to your transfer balance account on 1 July 2017. New retirement income streams started after 1 July 2017 will be added to your account from the time they start.

If your income stream account(s) grows over time through investment earnings to more than $1.6 million, you won't exceed your cap.

Other amounts such as an income stream from a late spouse's super, or a portion of an income stream payable by a former spouse as part of a family law property settlement, will be added to your transfer balance account.

The ATO manages the cap, so it includes income streams held in all your super funds and by other providers. While it is your super fund's responsibility to calculate and report your income stream(s) and commutation(s) to the ATO, we cannot tell you your cap balance or how much cap space you have left.

Example

Sue is 65 and retires in August 2017 with a super balance of $1.7 million.

- Sue can transfer $1.6 million into a retirement income stream account.
- She can leave the remaining $100,000 in her super account, where earnings will be taxed at a maximum of 15%, or she can move the $100,000 out of super altogether.
- While Sue can't add anything further to her retirement income stream account, her balance will be allowed to exceed $1.6 million if it grows due to investment earnings.

> A lifetime limit on the amount you can transfer into the retirement phase

How is your defined benefit counted?

Under the new rules, your lifetime pension is defined as a 'capped defined benefit income stream', which means it has a 'special value' which will count towards the cap. The special value is calculated by multiplying your annual pension by 16. This means, for example, that a defined benefit pension that pays $100,000 a year would fully exhaust the $1.6 million transfer balance cap in the 2019-20 financial year.

The special value for all First State Super defined benefit pensions is calculated this way. See the ATO website for more information on these rules, and how the special value is calculated.

What reduces your transfer balance account?

If you commute your income stream (either by withdrawing money as a rollover or lump sum withdrawal), the commutation will reduce your transfer balance account. If you then re-start a pension with the proceeds, the new pension will be added to your transfer balance account.

Your transfer balance account won't be reduced by fees or charges, investment losses or pension payments.

If you pay a portion of your pension to your former spouse as part of a family law property settlement, or if you contributed a personal injury payment as part of a structured settlement, court order or lump sum workers' compensation payment to super, this will also reduce your transfer balance account.

Need more information?

Visit the ATO's website for more information and case studies about these rules.

What happens if you exceed the cap?

If you exceed the transfer balance cap, you'll generally need to either transfer the excess back into a super account or withdraw the excess amount from super altogether.

If you only hold a defined benefit pension(s) that cannot be commuted, special rules apply. This means 50% of your annual income stream amount over $100,000 will be counted as assessable income and taxed. This means PAYG tax will be deducted from your pension payments, which will reduce the amount you receive each fortnight. You will receive a payment summary at the end of each financial year showing the amount of pension you received and any tax that was deducted.

In all other cases, the ATO will work out how much you need to withdraw from your retirement income stream(s), which will include a notional amount for investment earnings from the date you first exceed the cap. They will write to you about your options and if you don't commute the excess, they will issue a commutation authority to your super fund or pension provider to commute the excess amount within 60 days. Tax is generally payable on the notional earnings calculated by the ATO. The tax rate is 15% for your first breach, and increases to 30% for subsequent breaches.

If we receive a commutation authority for an income stream you hold with First State Super, we will contact you to obtain your instructions. If we are unable to contact you, we will still be required to commute your income stream, as instructed by the ATO. If you have an existing super account with us, we will add the amount to this account (or to the account that was most recently opened if you have more than one super account). If you don't hold a super account with us, we will open a personal member account for you and transfer the amount over the cap into this super account.

Example

Jane needs to work out the special value of her lifetime pension.

- 69 years old and retired
- Commenced a lifetime pension on 1 May 2012
- No other retirement phase income streams

The special value of her lifetime pension at 1 July 2018 is 16 times her annual entitlement for 2018-19.

To work out the annual entitlement of her pension, Jane needs to 'annualise' her first fortnightly payment after 1 July 2018, which is $5,753.42.
To do this, she first works out the daily rate by dividing her gross fortnightly payment by 14. She then multiplies this amount by 365 days.

$5,753.42 / 14 x 365 = $150,000

The special value of Jane's pension is 16 x $150,000 = $2,400,000.

Although Jane exceeds her transfer balance cap of $1.6 million, because the excess is solely from a capped defined benefit income stream, she does not have an excess transfer balance.

As Jane's benefits exceed her defined benefit income cap ($100,000 for 2018-19), she may need to include amounts in her assessable income. Her entitlement to a tax offset may also be affected.

Do you need to tell the ATO when your transfer balance account should reduce?

Generally, no. Your super fund or pension provider should advise the ATO when you start or commute an income stream so that the ATO can maintain your transfer balance account. However, there are some circumstances when you will need to advise the ATO directly:

1. If you exceed the cap and commute an amount from your pension at the same time the ATO issues a commutation authority to your fund. If you don't advise the ATO, your fund will be required to action the commutation authority, even though you may already have brought your pension(s) within the cap.
2. If you contributed a personal injury payment to super before 10 May 2006. Prior to this date, these amounts were not reported by super funds to the ATO.

Reversionary income streams

Reversionary income streams are different to other death benefit income streams because they revert to the beneficiary immediately on the death of the member. If you are the recipient of a reversionary income stream, it will not count towards your transfer balance cap until 12 months after the death of the member. This gives you time to make the necessary adjustments to ensure you don't exceed your cap.

If you hold a reversionary income stream and we receive a commutation authority from the ATO for you, we will contact you to obtain your instructions. If you don't provide instructions, we will still be required to commute your income stream, as instructed by the ATO. Because these income streams cannot be transferred back to a super account, we will need to pay the excess amount to you.

Example

John has a reversionary pension worth $1 million at the time of his death on 1 August 2017. The pension reverts to his wife, Barbara, and payments from the pension continue to be made to their joint bank account. Barbara already has her own pension and a transfer balance account with a balance to $800,000.

In September 2017, Barbara is advised that she became the recipient of John's pension in August. The combined value of the two pensions will cause her to exceed her transfer balance cap.

Barbara can either commute $200,000 from her pension or from the pension she received from John. If she commutes her own pension, she can roll the amount back to a super account and keep it within the super system. However, she must take any amount she commutes from John's pension in cash.

On 1 December 2017, Barbara makes a partial commutation of $200,000 of her own pension, which brings her transfer balance down to $600,000. The $1 million credit due to the reversionary pension is included in Barbara's transfer balance account on 1 August 2018, which means she hasn't exceeded her transfer balance cap.

We're here to help!

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Super can be quite complicated and sometimes you just want to know that you're making the right decisions. Because the right decisions about your super can make a real difference to your financial future.

So if you've got any questions, or you just want the comfort of knowing you're on the right track, getting some advice can help.

StatePlus[1] is our financial planning business and is wholly owned by us. The team at StatePlus can answer simple questions about your super over the phone, or if your situation is more complex, prepare a full financial plan for you. It's all up to you, no obligation. Book online at **firststatesuper.com.au/advice** or call **1800 620 305** (Monday to Friday 8.15am to 8.15pm AEST/AEDT) to arrange an appointment.

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