Budget 2016

JOBS & GROWTH

Superannuation Reform:

Changes to defined benefit schemes

The Government will make changes so that the superannuation tax reforms apply broadly commensurately to members of defined benefit schemes and constitutionally protected funds.

The issue

Defined benefit schemes, as compared with accumulation schemes, pay benefits based on length of service and final salary. Funded defined benefit schemes are taxed on contributions and earnings but pay tax-free benefits. Unfunded defined benefit schemes pay pensions that are taxed at the individual's marginal tax rate less a 10 per cent tax offset.

Many of the superannuation tax reforms are intended to make the system more equitable and sustainable.

These goals would be undermined if the tax treatment of defined benefit schemes and constitutionally protected funds were not similarly adjusted.

Similar treatment for defined benefit schemes and constitutionally protected funds raises a range of different administrative issues in comparison with accumulation schemes, and most defined benefit schemes have been closed to new members for some time.

The details

Transfer Balance Cap

To broadly replicate the effect of the $1.6 million transfer balance cap, pensions over $100,000 per annum will be subject to additional tax. The amount of an untaxed pension over $100,000 per annum will be taxed at full marginal rates (with no 10 per cent rebate). 50 per cent of the amount of a taxed pension over $100,000 per annum paid to a person aged 60 and over will be included in the recipient's assessable income. For hybrid taxed/untaxed pensions over $100,000, the untaxed component will be stacked on top of the taxed component. Defined benefit pensioners under age 60 who also receive a death benefit pension will also be subject to these arrangements in relation to any part of their combined pension over $100,000 attributable to the death benefit pension. Less than one per cent of defined benefit fund members in retirement phase will be affected by this change.

The $100,000 threshold will be indexed in line with the transfer balance cap.

A defined benefit pension of $100,000 per annum will use up the recipient's transfer balance cap.

They will have to move other pension phase funds back into accumulation or withdraw them from superannuation. Individuals with defined benefit pensions below $100,000 per annum will have space remaining under the transfer balance cap.

Concessional Contributions

Members of untaxed schemes will have notional and actual employer contributions included in their annual concessional cap. These will not be subject to Excess Contribution Tax where they exceed the annual cap (as these schemes are taxed in the benefits stage). However they will not be permitted to make additional salary sacrifice contributions to other schemes. This will only be possible where notional employer contributions are less than $25,000 per annum.

Existing capping arrangements for taxed employer contributions to defined benefit schemes will remain unchanged.

The full notional employer contribution will continue to be used to calculate defined benefit scheme members' liability for Division 293 tax.

Non-concessional contributions

Defined benefit members will be able to make non-concessional contributions up to $100,000 per annum provided their total superannuation balance is less than $1.6 million. Individuals with balances of $1.6 million or more may be required to (or may wish to) make non-concessional contributions under scheme rules but will have zero cap space. These contributions will become excess non concessional contributions.

To ensure commensurate treatment between members of accumulation and defined benefit schemes, defined benefit members who have an excess will need to withdraw an offsetting amount from either an accumulation account (or defined benefit account if possible) to avoid the 47 per cent excess contributions tax (ECT), even if that excess has been caused solely by contributions into the defined benefit account. As a result, a person who has no remaining funds to withdraw the excess from will be subject to ECT of 47 per cent.

Cameo — Deepika

In 2017-18 Deepika, a 62 year-old former public servant, receives a pension of $120,000 from an untaxed defined benefit scheme. As she is aged over 60, Deepika's pension is taxed at marginal tax rates, however she is entitled to a capped offset of $10,000 against her tax liability.

Prior to the changes, she would have been entitled to an offset of $12,000.

Cameo — Paul

In 2017-18 Paul, a 65 year-old former academic, receives a pension of $180,000 from a taxed defined benefit scheme. As he is aged over 60, half of the amount by which his pension exceeds $100,000 (that is, $40,000), will be included in his taxable income and taxed at his marginal tax rate.