THE TRANSFER BALANCE CAP – HOW DOES IT WORK AGAIN?

In the 2016 Federal Budget, the Government introduced the transfer balance cap as part of a broader superannuation reform package. The transfer balance cap imposes a lifetime limit on the amount of superannuation that can be transferred into a tax-free retirement pension account. While it may appear straightforward, understanding its nuances is essential for effective retirement planning.

What is it?

The transfer balance cap places a restriction on the amount of superannuation savings that can be transferred into one or more retirement pension phase accounts. It is important to understand that this cap doesn't restrict the total amount a member can have in a pension account; rather, it limits the amount that can be transferred.

Currently, the general transfer balance cap is set at $1.9 million. This cap applies individually, which means that a couple can collectively transfer up to $3.8 million into the pension phase if they begin their pensions today. If a member's superannuation exceeds their personal transfer balance cap before starting a pension, the excess amount may stay in the accumulation phase or withdrawn from superannuation.

When an individual starts a retirement phase income stream for the first time, their personal transfer balance cap will be equal to the general transfer balance cap at that time. However, the personal transfer cap will change based on usage and indexation, which we'll explain in further detail.

How does it work?

The transfer balance cap comes into effect when a member moves from saving in the accumulation phase to starting a retirement income in the pension phase. When assets are held in the pension phase, the balance can grow, and the earnings will remain tax-free. It is important to remember that a member cannot top up their pension balance once they have used their personal transfer balance cap, even if the balance falls due to unrealised losses or pension payments.

The ATO maintains a record of all members' personal transfer balance caps, which is accessible through MyGov. The record includes balances from different superannuation funds. Additionally, self-managed super fund (SMSF) members must report specific events like starting an account-based pension to the ATO. This reporting must be done quarterly as part of the transfer balance account report (TBAR).

Interestingly, the transfer balance cap is not indexed in line with Average Weekly Ordinary Time Earnings (AWOTE) like other superannuation caps such as contributions. Instead, the general transfer balance cap is annually adjusted based on the Consumer Price Index (CPI) in increments of $100,000. The cap was introduced at $1.6 million on 1 July 2017, and now thanks to the recent surge in CPI, it's $1.9 million.

Now, let's dive into indexation. Since its establishment in 2017, the general transfer balance cap has been indexed twice, first to $1.7 million, and then to $1.9 million. If a member has used a portion of their personal transfer balance cap, any indexation increase is determined by the unused cap percentage. Put simply, if a member initially used 80%, they can then use 20% of any indexation increase. Members who have exhausted their personal transfer balance cap won't receive an increase. Additionally, various factors like starting another pension or taking a lump sum withdrawal can affect the remaining personal transfer balance cap.

What happens if you exceed the cap?

The complexity of the cap makes it easy to see how a member could unintentionally go over the limit. If the ATO finds that a member has exceeded the cap, they will get a notice called an 'excess transfer balance determination'. This notice will show the excess amount, the estimated earnings on that excess, the deadline to fix it, and which superannuation fund will get the commutation authority if it's not rectified on time.

Once it's corrected, the member will receive an 'excess transfer balance tax assessment', which is essentially a 15% tax on the estimated earnings to replicate what would have happened if the excess had stayed in the accumulation phase. If the member exceeds the cap again, the tax goes up to 30%.

Opportunities?

The recent increase in the general transfer balance cap means members can now transfer more funds from the accumulation phase to the tax-free pension phase where there is space in their personal transfer balance cap. When combined with the contribution changes we've discussed in previous monthly notes, such as March 2023 The benefit of inflation – indexation and October 2023 Downsizer contribution – It doesn't get much better, it's an ideal time to think about making additional contributions and moving more funds into the tax-free pension phase.

Next steps

If you're interested in exploring this topic in more detail, get in touch with your adviser, and they can connect you with a member of Bell Potter's Technical Financial Advice team.

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Bell Potter's technical financial advice team can put together a strategy designed to help you achieve your retirement objectives.

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- Identifying your approach to investment and your appetite for risk, and
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