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Blog - The winners and losers of an indexed transfer balance cap

From 1 July 2021 the Transfer Balance Cap will be indexed to $1.7 million, which is great news for any individual who hasn't started to receive a retirement phase income stream prior to that date, however, not everyone should get excited. Change brings opportunity but with that comes a requirement to understand what that change means for everyone, and in this instance everyone is different....well almost everyone.

The positives of the new transfer balance cap are clearly there for those still in accumulation with less than $1.7 million. Similarly, those in a transition to retirement income stream who are yet to trigger a condition of release to move them to retirement phase will also be smiling, plus of course the peripheral benefits for those chasing spouse contribution rebates and government co-contributions. However, for those that have already used their full cap there is little joy and for those who have used part of their cap, welcome to the world of the indexed personal transfer balance cap.

Indexing the personal cap

This is where the fun starts. For those that have already started a pension with $1.6 million it's about sitting back and not even bothering to think about more pensions. What they can think about is whether they are eligible to make more contributions because of their total superannuation balance and then whether it is worthwhile putting those extra contributions in to the fund. The problem with contributing once you have maxed out the cap is that all earnings on the contributions form part of the taxable component so there may be some estate planning considerations. There are certainly some contribution strategies worth contemplating but let's save that for another post.

For those who previously started a pension for less than $1.6 million there is the allure of indexing your personal transfer balance cap based on the unused cap space. Whilst this sounds exciting it really doesn't leave much scope for indexation if the previous pension was commenced with any amount just shy of $1.6m. Sure, if someone commenced a pension for $800,000 then they are going to get at least half of the indexed amount but it's critical people understand how the indexation works. For more on indexing the personal transfer balance cap please check out our Fact Sheet here.

But as they say, every bit helps and so if you can squeeze a few extra thousand dollars into a retirement phase and have the capacity to make a contribution to get you there then what's to say there is no real benefit.

The contribution kick

Whilst we are talking about real benefit, the real benefit for contributors will be known after 25th February 2021 when the November AWOTE figures are released. Then we will have clarity on whether the concessional cap raises to $27,500 and the non-concessional cap to $110,000 along with it, hello bring-forward of $330,000. Who would ever have thought we'd consider the bring forward amount of $540,000 as the good old days!

Even without indexation there is a contribution benefit with an increasing transfer balance cap. Anyone with a total superannuation balance of less than $1.7 million on 30 June 2021 will be able to make non-concessional contributions subject to satisfying the contribution rules. With an age increase (up to 67) and a balance increase (up to $1.7m) there will be those who will be able to make the most of this benefit from 1 July who otherwise would have missed out. If we assume the bring-forward rules eventually pass through Parliament this would be a boost for those aged 65 or 66 on 1 July 2021 as they will be able to fully maximise the bring forward provisions with a balance under $1.48 million assuming the caps are also indexed. Lot of assumptions, let's hope it doesn't make an ass out of u and me!

Could it be that there are more contribution benefits to an increased cap than there are pension benefits?

The segregation dilemma

If I had to choose one glaring anomaly with the introduction of the transfer balance cap and the total superannuation balance provisions, it was the disregarded small fund asset rules. Not to suggest that these don't have the capacity to change in time, and acknowledging that some changes are on the horizon, but to create segregation rules for SMSFs based on a fixed amount when the amount that can be put into pension is an indexed amount seems counterintuitive. That's without even contemplating growth once a pension commences.

It just seems that linking the disregarded small fund asset rules to the general transfer balance cap would be more appropriate and would allow those individuals with a total superannuation balance less than the transfer balance to commence a pension and segregate assets without cause for consideration based solely on an arbitrary figure. Segregation has its pros and cons and there will be winners and losers, but for a concept that confuses so many already why make it more complex.

In conclusion

So we can rejoice that we have a new transfer balance cap, well some of us, and we can rejoice that it may provide us some scope for contribution, pension, asset and estate planning strategies. It will also no doubt provide us with some lessons in understanding the rules. It's a given that some individuals will not understand how the indexation works which will result in them exceeding their cap. It's our challenge to educate as many of those individuals as possible before that point to save them the angst.