The SMSF Academy Podcast - Transcript

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Aaron Dunn: Hi there! You're listening to the SMSF Academy Podcast, and this is episode 20.

Speaker 2: Welcome to the SMSF Academy Podcast, the show designed to help professionals stay ahead of the curve. Now, here is your host, the man that's in the know, and shows you how SMSF is done right, Aaron Dunn.

Aaron Dunn: Hi there! Aaron Dunn here, and welcome to the SMSF Academy Podcast. Great that you are joining me, and to see the level of interest in this weekly podcast. Again, it's taken a bit of momentum and time and energy to get things up and running, but certainly buoyed by all the fantastic feedback that I've been getting by email, by social media, and much, much more. So thank you again for the support. I encourage you to follow our SMSF Academy Podcast where ultimately the purpose of this is to help you stay ahead of the curve when it comes to self-managed super funds.

Today's topic is around downsizer contributions. This is an announcement that was in the 2017-18 Federal budget that is currently before Parliament, which is going to provide an individual an additional $300,000 of superannuation contributions. We will be seeing an additional term when we come to contributions being made into super, because this is a not a non-concessional contribution, but is rather an additional after-tax contribution that can be made; that will also sit alongside structured settlement contributions, and also those contributions where an individual is eligible for the CGT small business concessions. This concept of a downsizer contribution is something that we'll be adding into our vocabulary as well.

Importantly, this legislation starts from the 1st July 2018, so we are looking at proceeds of contracts that have been entered into after that date. What this is going to enable that individual to do and their spouse, in certain circumstances, is to be able to make that $300,000 contribution where it has arisen from that individual's principal residence, and whether they were either in full or in part have qualified for the main resident CGT exemption. We'll talk a little bit about that in today's podcast.

Now, one of the other requirements here when we look at the features of the downsizer contributions is that the individual must be 65 years of age or older at the time that that contribution is being made. So therefore, we're going to have to contemplate the way in which the rules of their fund that will enable that contribution to be accepted into superannuation, because we have to ignore any requirements around the work test. Under these rules, an individual where they have to be 65 to make this downsizer contribution, they don't actually need to satisfy a work test. Neither do we have to worry about any timeframe for them to be able to make that contribution from the disposal of that qualifying residence, which means we could, in essence, have an individual at 83 years of age be able to make a downsizer contribution.

The other area that is also excluded from the purposes of making these contribution is the total superannuation balance definition. Something, which has taken effect from the 1st July 2017, which limits an individual's ability to be able to make non-concessional contributions into a superannuation fund. In addition to an individual who may be 83 years of age being able to make the contribution, where that individual has a total superannuation balance that is above the $1.6 million transfer balance cap, they will actually be eligible to make that contribution as well. It is therefore important that when we are thinking about the timing of the contributions being made, and especially when we have a 90-day period in which to make that contribution after the settlement of the proceeds from that disposal, if that actually goes across different years, the timing is going to be critically important here that the downsizer contribution is locked down first, because it may actually tip the individual over the total superannuation balance, which may preclude them from making the non-concessional contributions.

It is going to be critically important, in my view, that you get the timing of those contributions right because the non-concessional contribution can go in first, which would allow for that to occur where the individual satisfies the total superannuation balance definition. Then, they can make that downsizer contribution without fear or failure of their total superannuation balance.

The other requirements here are around that the contribution must be made in respect to the sale of a qualifying dwelling that is in Australia that either the individual or their spouse owned for at least 10 years up to the disposal. We'll go through that 10-year qualifying period a little later on in the podcast. As I've already discussed, the disposal of the dwelling must have qualified or would have qualified for that main residence, CGT exemption in whole or in part. That CGT residence exemption, we need to look at the definition around a dwelling, and we also need to contemplate the issues of what is a qualifying dwelling, and then also the definitions of ownership interest. We're looking specifically there at Sections 118-115 of the Income Tax Assessment Act, and 118-130 of the Income Tax Assessment Act that looks at those definitions of what is a dwelling and ownership interest.

Importantly there, whilst the definition of dwelling would incorporate things like houseboats, caravans, other mobile homes, they are of course specifically excluded here, because when we go back to the purpose of why this legislation is being introduced, we are looking at encouraging older Australians to try and downsize their homes, where potentially it's a four-bedroom house that there are maybe one or two people now living, and the family has long gone from that residence; the policy is to encourage them to dispose of that family home, and try to get some of the proceeds into superannuation.

Some of the other features here, I already touched on before. The requirement of that contribution must be made within 90 days of the disposal of the dwelling, unless the Commissioner allows for some other extended period of time. This is going to be a choice to be able to treat that contribution as a downsizer contribution, so there is going to be notification that needs to be made by the individual that is making that downsizer contribution through an approved form by the ATO. And it needs to be done prior to the time at which that contribution is made. Of course, we currently have ordinarily acceptance rules around contributions, requirements with our total super balance definition, the age of the individual for work test purposes and so forth… as a result, we need to know that that amount is a downsizer contribution, and therefore, the acceptance of that contribution, subject to the rules of the fund allowing for that to occur, would be able to accept that downsizer contribution as such.

Finally, the individual cannot have made a downsizer contribution in respect to an earlier disposal of a main residence. They are the key conditions that must be satisfied around downsizer contribution.

I touched on earlier around the requirements of proceeds from a qualifying dwelling. It is important to note that the contribution can only be made from the sale of a single dwelling. So that would mean that the maximum amount of a contribution that an individual can make in respect of that sale is the lesser of either $300,000 or the proceeds of the disposal of that dwelling. So when we look at proceeds here, we're looking at the gross proceeds that may arise in respect to that property. If there is a debt that is against that asset, you may ordinarily repay that debt, but there is also an opportunity to make a contribution under the downsizer contribution rules. So there is going to need to be some planning around that because in many instances, whilst we see individuals downsizing their actual properties, they're not necessarily downsizing in terms of the money that is being spent.

In many respects, they're most likely upgrading the type of asset that they might be purchasing. Speaking to professionals regularly, what we typically see is that there is not

necessarily, in today's day and age, a lot of change in respect to that transition from one dwelling to another. It will be a function of the $300,000, like I said, and all the maximum proceeds of that dwelling. So in a husband and wife situation, there is a capacity to be able to make $600,000 worth of downsizer contribution.

Now there isn't any specific requirement here about who actually must make that contribution for the individual. But the individual must be the one who makes the choice here to treat that contribution as a downsizer contribution. Ultimately, what this means is that the downsizer contribution that is made or can be made for an individual irrespective of their ownership with the spouse, because there may be circumstances where it's jointly held, there may be circumstances where it's held as tenants in common, or there could be other circumstances from an asset protection point of view where that asset has been held solely in one person's name rather than the other. In all of those circumstances, not only will be the individual who is the title holder of that asset be able to make that contribution, but it will also enable the spouse of that individual to be eligible to make the contribution as well.

Now one of the interesting things here when we look at this ownership test is we are looking at the calculation of the 10 or more years being linked to the property settlement dates. When we look at the calculation for 10 years of ownership, we are looking at the day of ownership that the dwelling commenced being owned by that individual or individuals, so we're looking at the settlement of that purchase contract right through to the day of ownership where that dwelling was sold, again, being the settlement of the sale contract. Now there will of course be circumstances where over that period of time they may have been a change of ownership between the spouses. This may have been through the death of a member. It may have been through marriage breakdown.

Most importantly here though, provided that either of spouses here held an ownership interest in the dwelling at all times, then the downsizer contributions here can be made by the person who had the ownership interest just before disposal, and by the spouse at that particular point in time. I encourage you to go and look at some of the examples that are in the Explanatory Memorandum that talk through how it works in respect to say the death of a member, and also where someone may have remarried throughout that period, and who the ownership period may qualify for.

We then, as I spoke about earlier, looked at this concept of it applying to only one dwelling. However, whilst we only have the one dwelling, it does allow for an individual to make as many downsizer contributions as they wish within the prescribed 90-day time. Again, subject to the contributions being related to the sale of proceeds from that one dwelling. This is going to allow individuals to be able to make contributions to different super funds if they believe it being worthwhile to do. However, it is important to note here that it doesn't extend to the contributions from proceeds of other properties; or if the ownership interest here in the same dwelling that is disposed of ultimately delayed time. We may be have a part sale or through what was a sale and then late purchase of the same dwelling.

Finally here, I guess we need to also ensure that the owner and the spouse here must both be related to the same contract of sales for the residence to be ought to qualify in respect to that dwelling.

So there are some really important pieces to the downsizer contribution, not only in terms of what may qualify ordinarily. In particular, where we look at our main resident CGT exemption, we're looking at our definition of dwelling. And we also need to contemplate here this 10-year ownership period that we spoke about as well. Our principal residence exemption is really important because we're not looking at the asset in whole, we may also be looking at an asset that was eligible for the main resident CGT exemption in part;

because we may be contemplating in certain cases, situations where we have proceeds from the sale of a business where the owner also lived on the site, and is the owner's main residence.

There's a really good example within example 2.2 of the EM that talks about the sale of farmland where the owner was obviously living on the farm, and they had their main residence, which is part of the farmland, and up to two hectares, which was not used to produce any income. On that basis, the individuals qualified for partial main residence on that sale of the property, then they would be eligible to be ought to make $300,000 each of these proceeds as downsizer contribution. So looking at those requirements is going to be critically important, in addition to this 10-year ownership condition and much, much more.

A key requirement here in choosing to treat this contribution as a downsizer contribution, is the fact that we need to make a choice through an approved form. This is a key requirement given that it will enable the fund to be able to accept that contribution at the time the contribution is made. This again, is going to be critically important, subject to the terms and conditions of the trust deed, so we may need to recontemplate amendments to the deed for an individual that wishes to make downsizer contribution, because we have to consider the requirements of that individual's age, and the work test, and the total superannuation balance around what could be an authorised contribution.

Importantly here, this approved form needs to be put in place that enables the Commissioner to be satisfied that it is a downsizer contribution, and enables them where appropriate to specify any further information that must be provided to determine that that contribution has met the downsizer contribution requirements. Because, ultimately, if the contribution is found to not be a downsizer contribution, then we need to look at what the requirements are under SIS Regulation 7.04. This is where we have our acceptance of contribution rules where in the first instance, if it doesn't qualify as a downsizer contribution, the trustees could contemplate whether the funds may be eligible to accept that contribution in respect to the member anyway; based upon their age; based upon their working status; also giving consideration to their total superannuation balance at the preceding financial year.

If it is the case, will then may be able to keep part or all of the proceeds in respect to that downsizer contribution, re-report that as a non-concessional contribution, and therefore, it would be any excess amount that would need to be refunded as an amount that the fund was ineligible to be accepted in respect to SIS regulation 7.04(4). In that respect, we would need to refund either all of the contribution if they were ineligible in any way, shape or form to have it treated as a non-concessional; or if it was able to be treated as a non-concessional, we would need to re-report the accepted amount, and return any excess amount.

Like I said, this is a measure that starts on the 1st July 2018, and applies to dwellings where the exchange of contracts for the sale occurs on or after that date. The proceeds from properties here where the exchange of contracts have occurred prior to the 1st July 2018 will not be allowed to be made as a downsizer contribution. This is despite the fact that the settlement in respect to that sale may not occur until after the 1st July 2018. If you have clients that are wanting to qualify for this downsizer, ensure that the disposal, so the contract that they enter into does not occur prior to the 1st July 2018.

A couple of things that are really important here in the context of these downsizer rules. One of the things that the government has been criticised on here is the incentive for downsizer contributions is somewhat lost because of that fact that we are moving assets that were exempt as a principal residence. For someone that is age pension eligible, they

would have the amount that is contributed as a result of the downsizer contribution being counted towards their total assets for the purposes of Centrelink. However, as their principal residence, as a homeowner, that amount is excluded.

This is really an interesting development going forward. We only have to go back a couple of years, and look at the Productivity Commission's report into housing in older Australians. I guess there are some challenges that are presented for this group of Australians, generally speaking, that are asset-rich and cash flow-poor (when we think of those reliant upon the age pension). It does raise the question at some time in the future whether the government will take a stick approach, and whether this initially is part of the carrot to encourage individuals to start to contemplate and give them the opportunity to get that additional money into superannuation.

We don't know what will happen into the future, but if you take a look at the Productivity Commission's report that I spoke about into older Australians and the challenges of housing, you can see at some point in the future the fact that the government may need to pull the trigger on maybe building in some form of threshold around the principal residence exemption of an individual to incorporate an amount above whatever that particular cap that may be. This may end up forcing individuals to have to dispose of their homes for living costs. It would of course be a courageous Government in this environment to do so, but this is part of the carrot and stick that the Government must be contemplating because it won't be a manageable solution in the long term.

Again, what I should note here is there's no specific exception as well where an individual contributes an amount as a downsizer contribution for it to be ought to move to retirement phase, if they have already reached the $1.6 million transfer balance cap. In that respect, it is going to be, if someone has $2 million in superannuation, they may be eligible to make that downsizer contribution, but the $300,000 would need to be retained in the accumulation phase. Whilst there are some, I guess, downsides to the downsizer contributions here, one of the things that does open up, I think strategically, is if we take away the Centrelink issue it does provide an opportunity to look at situations where we have the disposal of the principal residence to contemplate a re-contribution strategy here. We may not be necessarily having the ability to make that downsizer contribution because they may be using the entire proceeds of capital to upgrade their existing home, because as I spoke about earlier, where they're may be downsizing in terms of the size of the house, but they're upgrading in terms of the quality they own.

It does provide us with an opportunity here to do a re-contribution strategy from an estate planning point of view, because you may have an individual that is say 100% taxable component in their existing superannuation benefits that may be being paid to them as a pension at the moment. Ordinarily, they're going to be ineligible to any further re-contributions either because of their age or because of their total superannuation balance or both. But importantly, what we could do here is we could be withdrawing a $300,000 amount out of their pension balance, creating potentially a commutation in respect to that amount that's coming out, so we get the debit coming off their transfer balance account. Then, when the proceeds come in, we make the $300,000 downsizer contribution, which comes in to the fund as an after-tax amount, which will be treated as tax-free component. Again, this goes to the longer-term estate planning opportunities that we always speak about around the re-contribution strategies that I think has certainly some advantages when we talk to our clients about the benefits of re-contributions. That is certainly something that should be contemplated as part of the downsizer contribution process.

Like I said, we are in a process of this legislation coming into effect from the 1st July 2018. It is currently before Parliament, so we need to await and see where it lands in respect to receiving Royal Assent. So just having a look here on the Parliamentary website, it is

currently still with the House of Reps at the moment. So it does form part of the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 1) Bill 2017. Included in this is the first home saver requirements as well. So if you do want to follow it, I encourage you to look at it on the aph.gov.au. We'll also be keeping you up to date through our regular training as well.

If you do have any other questions in respect to the downsizer contributions, you can reach out to us at info@thesmsfacademy.com.au or get in contact with us through our various social media outlets as well. Other than that, thanks for joining me today in our SMSF Academy Podcast. I look forward to you joining us for our next one. Take care and bye for now!

Speaker 2: Thanks for listening to the SMSF Academy Podcast. Please note that the podcast provides general advice only, and is based upon our understanding of the law at the time of the recording. If you have any comments or questions from this podcast, or wish to subscribe to the series, you can find us at thesmsfacademy.com.au. Tweet us @thesmsfacademy. Like us on Facebook or connect with us on LinkedIn.