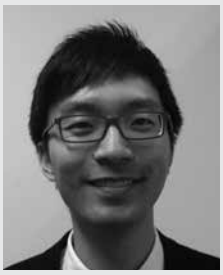

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STRATEGIES TO REDUCE YOUR TOTAL SUPERANNUATION BALANCE

Joseph Cheung and William Fettes

An individual's total superannuation balance (TSB) determines many of their superannuation rights and entitlements, such as eligibility to contribute after-tax amounts into superannuation without an excess arising. Due to the importance of total superannuation balance TSB testing under the major superannuation reforms, there is a strong incentive for individuals to carefully monitor their TSB over time, particularly towards the end of a financial year (FY) when most TSB thresholds are tested. In many cases, actions taken to reduce an individual's TSB through appropriate planning in a prior FY will provide an individual with greater flexibility in relation to their superannuation.

For more detail about the various TSB thresholds, please refer to the DBA Lawyers article *'Total superannuation balance milestones'*.

Background: Components of TSB

Before considering strategies to reduce an individual's TSB, it is useful to consider the key elements of the TSB definition.

An individual's TSB at a particular time is comprised of the following components:

1. The accumulation phase values of their superannuation interests that are not in retirement phase,
2. The amount of their transfer balance or modified transfer balance account — this generally captures the net realisable value of most types of pensions in retirement phase,
3. Any roll over superannuation benefit that has not already been included under steps one and two, and
4. Reductions for any structured settlement contributions.

The above is a broad summary only. A detailed examination of the TSB methodology that is set out in s 307 230 of the *Income Tax Assessment Act 1997* (Cth) is beyond the purpose and scope of this article.

Strategy #1: Make pension payments and/or lump sum payments to an individual

Payments of pensions and lump sum amounts are both outgoings that can reduce an individual's TSB. Generally, an individual must meet a relevant condition of release before they can receive a payment from their superannuation fund. For example, an individual must attain preservation age (which ranges from 55–60 years old depending on their date of birth) before they are eligible to commence a transition to retirement income stream (TRIS).

The quote

For individuals who satisfy a relevant condition of release, making pension payments and/or lump sum payments is a readily accessible strategy to reduce their TSB.

Furthermore, once an individual has met a relevant condition of release with a 'Nil' cashing restriction, e.g. reaching preservation age and retiring or attaining age 65, they can:

- Commence an account-based pension (ABP) and start receiving pension payments,
- Partially or fully commute any ABP they are receiving and cash the commuted amount outside of the superannuation system, and
- Pay a lump sum from their accumulation entitlements to the extent that their benefits comprise unrestricted non-preserved benefits.

Each of the above types of superannuation payments can help to moderate an individual's TSB, though naturally there are limitations on the potential impact of TRIS payments due to the 10% maximum payment limitation (and commutation restriction) where a full condition of release has not been met.

Additionally, it should be borne in mind that there may be non-TSB considerations that will factor into choosing one type of payment over another. For example, making pension payments above the required pension minimums is not generally advisable due to there being no debit for pension payments under the transfer balance account. Consider the following example:

Key take-outs from strategy #1 and Part IVA

For individuals who satisfy a relevant condition of release, making pension payments and/or lump sum payments is a readily accessible strategy to reduce their TSB. This strategy can be used in isolation or in various permutations with other strategies (subject to the below commentary about Part IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936)).

While it is very difficult to rule out the application of the general anti-avoidance provisions in Part IVA of the ITAA 1936 to the strategy of using benefit payments (i.e. making pension payments and/or lump sum payments) to moderate an individual's TSB, we are not aware of the ATO publicly expressing a view that such a strategy constitutes a 'tax benefit' and circumvention of the new rules. Additionally, we consider that paying benefits where a relevant condition of release has been met is, by itself, so common that it would be difficult to see the ATO applying enforcement scrutiny to this strategy in relation to Part IVA of the ITAA 1936 apart from blatant or contrived cases.

However, it is worth highlighting the following example from the Superannuation Taxation Integrity Measures consultation paper released by Treasury in relation to proposed laws to capture outstanding loan balances for limited recourse borrowing arrangements (LRBAs) in an individual's TSB.

The above example illustrates that Treasury regards using benefit payments together with related party loans to moderate an individual's TSB (and as a result of that enable additional non-concessional contributions) is a potential threat to the integrity of the new superannuation reforms.

Naturally, it should be borne in mind that Treasury does not necessarily represent the ATO's view as the regulator of SMSFs, and not everything that is (arguably) a threat to the integrity of the new laws will strictly fall foul of the general anti-avoidance provisions in Part IVA of the ITAA 1936.

However, conservatively, taxpayers should be mindful that where they are contemplating using a benefit payment strategy to moderate their TSB, the risk of Part IVA being enlivened might conceivably be magnified if this strategy is used together with other actions, such a entering into an LRBA with a related party loan, or paying a small benefit and making a large contribution in a tight timeframe.

Example one

Benjamin is the sole member of a self-managed superannuation fund (SMSF) which is 100% in pension phase. Benjamin is not a member of any other superannuation fund.

Benjamin's TSB is $1,540,000 just before 1 July 2017 and is broadly based on the net market value of the assets that support his ABP. However, the fund's assets are performing very well during FY2018 in such a way that there will be overall growth in the fund taking into account all applicable outgoings. Indeed, Benjamin estimates on 10 June 2018 that his TSB will be $1,620,000 just before 1 July 2018

Mindful of this anticipated outcome, Benjamin requests for his ABP to be partially commuted on 15 June 2018 and the commuted amount paid outside the superannuation system as a lump sum. Accordingly, the trustee of Benjamin's SMSF complies with his request and $50,000 is commuted on 16 June 2018. (For completeness, it should be noted that Benjamin has separately ensured that his minimum pension payment requirements were met with cash transfers as he is aware that the partial commuted lump sum will not count towards his minimums.)

On 15 July 2018, Benjamin's accountant confirms that Benjamin's TSB just before 1 July 2018 was $1,580,000. If Benjamin had not partially commuted $50,000, his TSB would have been $1,630,000 just before 1 July 2018 because the performance of the assets exceeded Benjamin's estimate on 10 June 2018. Fortunately, Benjamin took action to moderate his TSB and included a 'buffer' amount in his request for his ABP to be partially commuted and paid outside the superannuation system.

The above example demonstrates how the payment of a lump sum amount can reduce an individual's TSB.

Example (provided by Treasury)

Laura is the sole member of her SMSF, which holds $2 million in accumulation phase.

- Laura takes a lump sum of $500,000 from the SMSF, on 1 June 2019 which reduces her TSB as at 30 June 2019 to $1.5 million,
- On 30 June 2019, Laura lends the $500,000 on commercial terms back to her SMSF under an LRBA,
- The SMSF uses $1 million of its existing assets and the borrowed $500,000 to acquire a $1.5 million investment property.

Current law

Laura's TSB as at 30 June 2019 is $1.5 million, comprising the net value of the property of $1 million ($1.5 million purchase price less the $500,000 LRBA) as well as the other assets valued at $500,000. As her TSB is below $1.6 million, Laura can make further non-concessional contributions of up to $100,000 in the year ending 30 June 2020.

As the SMSF repays the LRBA, the net value of the fund will increase and Laura's TSB will approach the $1.6 million threshold. However just prior to reaching the $1.6 million threshold, she could withdraw another lump sum and enter into a new LRBA to acquire another income-producing asset. This would reduce her TSB again, allowing more contributions to be made to the SMSF.

Strategy #2: Pay arm's length expenses

Naturally, paying fund expenses using fund resources can reduce an individual's TSB. Some common and accepted expenses incurred by SMSFs include, but are not limited to the following:

- The SMSF supervisory levy,
- Investment-related expenses, such as brokerage and bank fees,
- Accounting fees to prepare and lodge the annual return for the SMSF,
- Audit fees,
- Actuarial services,
- Operating expenses such as management and administration fees, and
- Annual review fees for a corporate trustee.

However, it should be borne in mind that inappropriate outgoings or expenses could be problematic for superannuation law purposes, including under:

- The sole purpose test
- The payment standards,
- The prohibition on providing financial assistance to members and relatives, and
- The arm's length rule in s 109 of the *Superannuation Industry (Supervision) Act 1993* (Cth).

Additionally, payment of an expense which is less than an arm's length amount could enliven the non-arm's length income (NALI) provisions in the *Income Tax Assessment Act 1997* (Cth) under the Australian Taxation Office's (ATO's) current administrative practice to NALI. Moreover, it should be noted that the proposed rewording of the NALI provisions in the Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2018 will make the application of NALI to an expense which is less than an arm's length amount much clearer, even where the amount of ordinary income or statutory income derived by the trustee of the SMSF is the same as might be expected in terms of arm's length dealings.

Another relevant rule that must be considered is reg 5.02(3) of the *Superannuation Industry (Supervision) Regulations 1994* (Cth). Regulation 5.02(3) requires the trustee of a regulated superannuation fund to ensure that fund costs are distributed in a 'fair and reasonable manner' as between all members of the superannuation fund and the various kinds of benefits held by each fund member. This is illustrated in the following example:

Example two

Rico and Joel are brothers and members of an SMSF known as RJ SMSF which is 100% in accumulation phase. They are also the directors of R&J Pty Ltd, which acts solely as the trustee of the RJ SMSF.

Rico and Joel are not members of any other superannuation fund.

Based on their working papers, the brothers anticipate that just before 1 July 2018, Rico's TSB will be $1,604,000 and Joel's TSB is $802,000.

However, in the weeks leading up to 30 June 2018, R&J Pty Ltd obtains extensive professional advice for the fund from a reputable financial planner and tax agent. On 25 June 2018, R&J Pty Ltd receives an invoice in relation to the advice for $12,000 which is payable within 14 days. For completeness, all dealings between the relevant parties were at arm's length and the amount charged was consistent with commercial rates for such professional advice. Accordingly, the directors of R&J Pty Ltd have a choice to either:

- Pay the invoice either in FY2018 (i.e. on or before 30 June 2018), or
- Pay the invoice in FY2019 subject to the payment terms.

The directors of R&J Pty Ltd ultimately elect to pay the invoice before 30 June 2018.

As Rico and Joel are the only two members of the RJ SMSF, the directors of R&J Pty Ltd resolve to charge the cost of the invoice in a 'fair and reasonable manner' by apportioning the fee proportionately based on their respective entitlements in the fund. Accordingly, the total amount of the expenses ($12,000) is apportioned as follows: $8,000 is charged against Rico's benefits and $4,000 is charged against Joel's benefits.

The quote

Paying arm's length and appropriate fund expenses can be used as a strategy to reduce an individual's TSB, subject to the super and tax rules.

As a result of this course of action, immediately before 1 July 2018 Rico's TSB is $1,598,000 (it would have been increased to $1,606,000 if not for the $8,000 expense charged against Rico's benefits). Similarly, immediately before 1 July 2018, Joel's TSB is $799,000 (it would have increased to $803,000 if not for the $4,000 expense charged against Joel's benefits).

Key take-outs from strategy #2

As can be seen from the above, paying arm's length and appropriate fund expenses can be used as a strategy to reduce an individual's TSB, subject to the super and tax rules. This strategy can be used in isolation or in various permutations with other strategies.

Before implementing any strategies, consideration must be given to determine whether the implementation of a certain strategy to a particular set of background facts might trigger the anti-avoidance provisions. We have not covered any anti-avoidance provisions such as Part IVA of the *Income Tax Assessment Act 1936* (Cth) in this article. However, if the ATO considers that a tax benefit arose from a scheme that was tax driven, there is the prospect of the ATO raising a Part IVA assessment. Where in doubt, expert advice should be obtained.

Strategy #3: Apply tax effect accounting

Tax effect accounting (TEA) is a prudent accounting methodology that can be adopted by SMSFs to recognise future tax liabilities as part of the SMSF's financial position. In particular, TEA can be relevant for managing TSB compliance by helping to ensure that an individual's TSB is correctly reflected having regard to taxation.

The starting point is that member account balances in an SMSF broadly reflect the financial position of the SMSF (i.e. the value of the SMSF's net assets). Naturally, this means that member account balances are based on the market value of the relevant SMSF's assets (refer to reg 8.02B of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR)).

In practice, many advisers and SMSF trustees treat a member's account balance as equivalent to the member's TSB except where the member has multiple superannuation funds. Moreover, the ATO's default position is to use the member account balance information disclosed in an SMSF's annual return to calculate an individual's TSB (assuming the member is not a member of another SMSF and that no structured settlement amounts have been contributed to the SMSF).

However, it should be noted that a member's TSB is not identical to their account balance. Broadly, a member's TSB represents the amount of their accumulation phase interests and retirement phase interests that would become payable if the individual voluntarily caused the relevant interests to cease at a particular time. This 'withdrawal benefit amount' can broadly be equated to the net realisable value of the relevant interests, and could take into account tax payable and perhaps also future costs associated with realising the assets that support the relevant accumulation and/or retirement interests.

While the transfer balance account report (TBAR) system informs the ATO of an individual's TSB (refer to question 15 of the TBAR form) and essentially overrides the ATO's account balance derived TSB value, this requires ongoing intervention and may not be attractive for many advisers.

As an alternative to using TBAR to manually change the ATO's TSB records periodically, SMSFs have the option to apply TEA so that the SMSF's financial position, and therefore member account balances, better reflects the elements of the TSB definition. For instance, TEA facilitates the recognition of deferred tax liabilities where there is reasonable certainty that a future tax liability will arise for the SMSF. The tax payable on a 'deferred notional gain' in relation to capital gains tax (CGT) relief is one example of a future tax liability that could be reasonably certain. Naturally, this is subject to there being no anticipated (current or carried forward) capital losses which could eliminate the deferred notional gain in the financial year that the asset (i.e. the asset that received proportionate CGT relief) is realised.

The application of TEA can potentially reduce the value of an SMSF's 'net assets' if there is a deferred tax liability and the amount of the deferred tax liability is greater than any applicable deferred tax asset (generally, it is rare for an SMSF to have deferred tax assets). Naturally, such a reduction in an SMSF's net assets will result in a corresponding reduction in member account balances (since the balances are net of tax) which could lead to a more accurate calculation of a member's TSB. We illustrate this in the following example.

Example three

Frank and Jessica are the members of the FJ SMSF. The FJ SMSF does not use TEA and the FJ SMSF's 'net assets' sum to $2,000,000 as at 30 June 2019. Frank and Jessica have equal member account balances of $1,000,000 each which is disclosed in the FJ SMSF's annual return.

The FJ SMSF trustee used the proportionate CGT relief to reset the cost base of a rental property to its market value as at 30 June 2017 of $1,000,000. The property was acquired ten years ago and had an original cost base of $250,000. Assume 50% of the crystallised notional gain is non-exempt, i.e. ECPI equals 50%. The notional gain is broadly the following amount:

- $750,000 (the gross gain arising from the election to apply CGT relief) x 2/3 (reflecting the 1/3 CGT discount) x 50% (non-exempt portion) = $250,000.

The FJ SMSF elected to defer the notional gain on 30 June 2017. As at 30 June 2019, FJ SMSF still retains ownership of the property. If FJ SMSF had applied TEA, the income tax payable in relation to the FJ SMSF's 'deferred notional gain' of $250,000 could be recognised in the FJ SMSF's financial position. In broad terms this tax is likely to be approximately $37,500 (15% x $250,000). Accordingly, all else being equal, if the FJ SMSF used TEA, the FJ SMSF's 'net assets' would sum to $1,962,500 as at 30 June 2019. This would mean that Frank and Jessica would each have a member account balance of $981,250 instead of $1,000,000. Without TEA, each member's account balance would have been overstated by $18,750, which could result in an overstated TSB. If Frank and Jessica were commencing account-based pensions on 1 July 2019, this approach could mean the difference between the FJ SMSF being required to report annually, rather than within 28 days of the end of each quarter of when a relevant event occurs. The annual or quarterly TBAR timing cycles depend on the TSB of an SMSF's members when the SMSF trustee has to first report an event under the TBAR regime.

Strategy #4: Spouse contributions-splitting amounts

Contributions splitting is another available strategy to reduce an individual's TSB. Details on the eligibility criteria and the process can be found in div 6.7 of the SISR.

Generally, the maximum splittable amount, in relation to a financial year (FY), means the lesser of:

- 85% of the concessional contributions (CCs) for that financial year, and
- The CCs cap for that financial year.

We illustrate the effect of contributions splitting in the following example:

Example four

Vincent and Natalie are married. They are both members of the same superannuation fund. During FY2018, Vincent's employer made superannuation guarantee contributions of $10,000 and a further $10,000 CC pursuant to an existing salary sacrifice arrangement. For completeness, assume the salary sacrifice arrangement ends in FY2018 and does not apply for future FYs. The total CCs made in respect of Vincent for FY2018 sum to $20,000. Vincent's TSB as at 30 June 2018 is $1,605,000.

Assume Vincent and Natalie satisfies all the criteria to pursue contributions splitting. On 10 July 2018, Vincent completes the Superannuation contributions splitting application and lodges it with his superannuation fund. He enters the figure of $16,000 at question 20 of the form labelled 'taxed splittable contributions' to split his employer contributions.

Vincent's superannuation fund accepts his application and determines that it is valid because $16,000 is:

a) less than 85% of the $20,000 contributed by his employer, and
b) less than his CC cap for FY2019 (i.e. it is less than $25,000).

Accordingly, Vincent's superannuation fund processes his application and transfers $16,000 to Natalie's member account balance. This results in Vincent's TSB being reduced by $16,000 — i.e. it is now $1,589,000, which is a more advantageous position under the superannuation rules.

Moreover, if Vincent carefully plans and monitors his TSB for the remainder of FY2019, he could keep his TSB under $1,600,000 as at 30 June 2019.

For completeness, we note that the contributions splitting strategy can be applied by members of large superannuation funds, as well as members of SMSFs provided the trustee and trust deed authorises contributions splitting.

Anti-avoidance provisions

Before implementing any of the strategies listed above, consideration should be given to determine whether the implementation of a certain strategy to a particular set of background facts might trigger the application of the general anti-avoidance provisions. We have not covered any anti-avoidance provisions such as Part IVA of the *Income Tax Assessment Act 1936* (Cth) in this article. However, if the ATO considers that a tax benefit arose from a scheme that was tax driven, there is the prospect of the ATO raising Part IVA. Where in doubt, expert advice should be obtained.

Conclusion

Four strategies to more effectively manage an individual's TSB have been covered and these strategies can be used in isolation or in various permutations. Naturally, there may be other strategies that can be used to reduce an individual's TSB.

The law in relation to TSB is a complex area of law and where in doubt, expert advice should be obtained. Naturally, for advisers, the Australian Financial Services Licence under the *Corporations Act 2001* (Cth) and tax advice obligations under the *Tax Agent Services Act 2009* (Cth) need to be appropriately managed to ensure advice is legally provided. **FS**