Navigating the transfer balance cap

Stephen Blake

The transfer balance cap imposes a limit on the amount of capital that can be held in retirement phase in order to support a retirement phase superannuation income stream—also commonly referred to as a superannuation pension. The general transfer balance cap is $1.9 million for the 2023/24 income year. The cap is subject to indexation increases in accordance with increases to the Consumer Price Index (CPI).

The major benefit of having capital in the retirement phase is that any earnings on that capital are taxed at 0%. Similarly, any capital gains tax (CGT) on the happening of a CGT event to the capital is disregarded. However, earnings on investments from accumulation phase assets are taxed at 15%.

The introduction of the transfer balance cap was seen as necessary to prevent wealthy members from using superannuation funds, at least excessively, as a tax haven by transferring significant amounts into retirement phase accounts to benefit from the nil tax rate on earnings and the CGT exemption on eligible capital.

What is a retirement phase account?

When a fund member satisfies certain conditions of eligibility to commence a retirement phase super income stream, they may elect for funds—up to the individual's transfer balance cap—to be transferred from accumulation phase to retirement phase.

The capital held in retirement phase is used to fund the pension payments made to the member. The capital is invested and any earnings may be used to fund future income stream payments.

What is an individual's transfer balance limit?

Keep in mind that the member's personal transfer balance cap may be different from the general transfer balance cap. This is important because it is the individual's transfer balance cap that sets out the limit on the amount that can be transferred to a retirement phase account, not the general transfer balance cap. It is best to view the general transfer balance cap as the starting point for calculating an individual's transfer balance cap.

To calculate a personal transfer balance cap, take the general transfer balance cap in the income year the member commences the retirement phase super income stream and then increase the personal cap according to future income year increases to the general transfer balance cap, but only in respect of any unused cap space. Put another way, an individual's transfer balance cap will only increase in line with indexation of the general transfer balance cap in respect of the percentage of the cap that has been unused. This concept is explained in Example 1.

Example 1: Calculating a personal transfer balance cap

On 15 July 2023, 68-year-old Ciana retires and begins an account-based pension related to her retirement. The value of capital allocated to support her retirement phase income stream is

$950,000. In the 2023/24 income year, the applicable transfer balance cap is $1.9 million. In 2023/24, Ciana's personal transfer balance cap is $1.9 million in accordance with the general transfer balance cap. Assume that because of an increase to CPI, the general transfer balance cap increases to $2.3 million in the 2024/25 income year (hypothetical indexation only).

Because Ciana commenced her account-based pension in the 2023/24 income year, her individual transfer balance cap will not increase to equate with the general transfer balance cap for the 2024/25 income year. Instead, her personal transfer balance cap will only increase in proportion to the amount of her unused cap space. In this instance, Ciana's cap in 2023/24 was $1.9 million and the value of capital held in retirement phase was $950,000.

Therefore, 50% of Ciana's total cap space ($950,000/$1.9 million) was unused. Ciana's personal transfer balance cap therefore increases to $2.1 million, that is, 50% x ($2.3 million - $1.9 million).

As you can see from Example 1, once a proportion of the cap space is used up, that part of the expended cap space is not subject to indexation.

What is a transfer balance account and what role does it play?

When a member starts a retirement phase super income stream as a retirement phase recipient, a transfer balance account will commence. The transfer balance account is used to record the amount an individual has in retirement phase. The balance of the account is the sum of transfer balance credits (increases) less the sum of transfer balance debits (decreases).

A transfer balance credit amount reduces the available cap space. Conversely, a transfer balance debit amount reduces the value of the individual's retirement phase interests and therefore effectively frees up cap space. The recording of the transfer balance enables the fund member and authorities to ensure the amount of capital in retirement phase does not exceed the individual's transfer balance cap.

Keep in mind that where a member commences a retirement phase income stream and the transfer balance account is credited to reflect the amount of capital transferred to retirement phase, any future change to the value of that capital—that is, investment gains or losses—will not impact the transfer balance. Put another way, the growth or decrease in the value of the super interests supporting the income stream is not reflected in the transfer balance account. Instead, there is a point-in-time snapshot of the value of capital held in retirement phase at the time that occurs. Similarly, income stream payments will not reduce the amount recorded in the transfer balance account—despite those payments obviously decreasing the value of the member's super interests. This concept is illustrated in Example 2.

Example 2. Investment gains or losses will not impact the transfer balance

On 15 July 2023, 68-year-old Brooke begins an account-based pension with capital of $1 million held in retirement phase. Brooke's transfer balance account will start at this time and the account will be credited by $1 million, which is the value of the super interests that will be used to support her retirement phase income stream. There are no other credits or debits to the transfer balance account.

The market value of the super interests supporting the retirement phase income stream increases to $2 million on 15 July 2024 due to a significant increase in the value of one of the underlying fund investments. Here, the change in value of the capital held in retirement phase does not result in a debit or credit to the transfer balance account. The transfer balance remains $1 million under Brooke's personal transfer balance cap.

There are special transfer balance account rules that apply to capped defined benefit income streams. These are not addressed in this article.

Transfer balance credits

Transfer balance credits—which decrease available cap space under the individual's transfer balance cap—include:

- Most commonly, the value of super interests allocated to support the income stream of a retirement phase recipient. The credit generally arises at the time the income stream commences.
- The notional value of any excess transfer balance earnings for each day there is an excess.
- The amount specified in section 294-55 of the Income Tax Assessment Act 1997 (ITAA 1997) where there is repayment of a loan under a limited recourse borrowing arrangement.
- An amount specified in the regulations for a reason specified in the regulations.

Transfer balance debits

Transfer balance debits—which increase available cap space under the individual's transfer balance cap—include:

- The value of any lump sum payment to a member which is commuted from the super income stream being received by the retirement phase recipient.
- The amount of any structured settlement contribution made in respect of a member.

The quote

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Stephen Blake, Bristax

The founder and director of Bristax, Stephen is not only a Chartered Tax Adviser and a Certified Practising Accountant. He is also admitted as a lawyer in the state of Queensland. Stephen offers clients a range of practical business experience and high-level technical expertise. When you work with Stephen, you'll be working with an expert professional who is methodical, trustworthy, and whose attention is on the important details of your finances.

- The amount specified in section 294-85 of the ITAA 1997 due to a particular event that results in reduced super, for example, certain types of fraud.
- The amount specified in section 294-90 of the ITAA 1997 due to a payment split because of a spousal separation under the Family Law Act.
- The value of super interests supporting an income stream that stops being in the retirement phase. For example, where there is a failure to uphold the minimum standards for an income stream.
- The amount of any excess transfer balance in relation to a non-commutable excess transfer balance.
- An amount specified in the regulations for a reason specified in the regulations.

Excess transfer balance tax

If the balance of a member's transfer balance account exceeds their transfer balance cap, the member (not the fund) will be liable for excess transfer balance tax. The excess and notional earnings on that excess will need to be commuted by rolling these back to accumulation phase or by making a lump sum withdrawal.

The excess transfer balance tax neutralises the benefit a member obtains from having capital in the retirement phase more than the allowable limit. The tax is calculated as 15% of the notional earnings on the amount of capital moved into retirement phase that exceeds the transfer balance cap for the period of time that there is an excess. There are special rates applied to work out the expected earnings for a day, as set out in sections 294-230 and 294-235 of the ITAA 1997.

Obviously, one would expect lower notional earnings to be achieved if the breach only subsisted for a week compared with an entire year. That is why tax liability outcomes will vary according to the length of time there is an excess.

Example 3. Exceeding the transfer balance cap

Take an example: David moved $2 million of his super interests into retirement phase to support an income stream he receives as a retirement phase recipient. The value of super interests in retirement phase exceeded David's personal balance cap of $1.8 million by $200,000. To determine the excess transfer balance tax liability, you will need to determine the period of time that an excess subsists and then determine the notional earnings (expected earnings) on the $200,000 excess over that period. This aligns the tax treatment of the earnings on the excess retirement phase capital (although notional), with the tax treatment of earnings on accumulation phase capital (where earnings are taxed at 15%). Remember that the excess transfer balance tax will apply to any period of time there is an excess—even if that period is as short as one day.

The rate of tax will increase to 30% if there is a subsequent breach of the transfer balance cap. This is to penalise and deter further breaches of the allowable cap. The tax is generally due for payment by the member within 21 days after the Commissioner gives the individual a notice of assessment outlining the amount of excess transfer balance tax payable.

Impact of death benefit payments

The value of a death benefit income stream paid to a dependant beneficiary is generally added to the transfer balance of the recipient. Care will need to be taken to ensure the receipt of the death benefit income stream does not inadvertently cause the recipient to exceed their personal transfer balance cap.

If the dependant beneficiary would prefer not to cash out the death benefit payment as a lump sum, they may need to commute an amount of their super income stream by rolling it back to accumulation phase to free up cap space for the value of the death benefit income stream. The value of the death benefit is not permitted to be rolled back to accumulation phase.

Example 4. Death benefit income stream

For example, assume Stephen and Georgia both started a super income stream as retirement phase recipients. They used up the entirety of their personal transfer balance caps. Years later, Stephen passes away electing to leave a death benefit income stream to Georgia valued at $500,000. Georgia could either take the $500,000 as a cashed-out death benefit lump sum or could accept the death benefit income stream. Because the value of the death benefit income stream counts towards her transfer balance cap—which has already been exhausted—she could commute $500,000 of her super income stream into accumulation phase. This would result in a $500,000 debit to her transfer balance account, freeing up $500,000 cap space.

At the date Georgia becomes entitled to the income stream, the value of the death benefit income stream would be added to the capital supporting her retirement phase income stream. This would result in a $500,000 credit to Georgia's transfer balance account and cause her to (once again) max out the transfer balance cap.

In Example 4, why would Georgia opt to take a death benefit income stream? The major benefit is that she can retain the capital supporting the income stream in super (in retirement mode) where investment earnings are taxed at 0%.

If a child receives a super death benefit income stream, that child will have a modified transfer balance cap which is broadly based on the transfer balance cap of their deceased parent. **FS**

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