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Super changes broaden the options for windfall contributions

Ashley Davidson

The superannuation system is based on the notion that you can build up your nest egg steadily over the course of your working life, but that is not always the case.

Breaks from the workforce, a lack of disposable funds to top-up compulsory contributions, or just a lack of retirement planning can all lead to retirees finding themselves with a superannuation balance unable to sustain up to four decades of life after work.

This year's Federal Budget offers two key changes to superannuation that reflect an understanding of this challenge, with the partial removal of the work test for those aged 67–74 and a lowering of the age threshold for those seeking to make a downsizer contribution with the proceeds from the sale of the family home.

Together, they make it easier for people to direct larger sums into superannuation immediately before and after retirement, including windfalls from inheritance, property, or the sale of a business.

Removing the work test

The more important of the two changes is the removal of the work test for those aged 67–74 making non-concessional contributions and allowing this group access to the three-year bring forward rule.

Under the present rules, people in this age group are unable to make member contributions to superannuation unless they meet the work test, which requires them to show they are gainfully employed for at least 40 hours during a consecutive 30-day period in the financial year in which the contributions are made.

This restriction has tended to make it harder for people to direct any windfalls they might receive later in life, into their superannuation. Such windfalls could come from realising equity in the family home or the sale of a business in combination with other small business capital gains tax concessions. It could equally be an inheritance, with The Grattan Institute's *Ensuring a fair go for younger Australians* report of 2019 showing that about a third of inheritances flow to people aged 60 or older, and 63% to those older than 55.

By removing the work test, it becomes possible for the proceeds of a windfall or asset sale to be used to top up superannuation balances, while recognising these contributions are still subject to the transfer balance cap of $1.6 million, increasing to $1.7 million on 1 July 2021.

The removal of the work test for this cohort is a good start, although it will likely add to the overall complexity of the system by creating another exception within the system for one age group.

It would have been our preference to see the work test removed in its entirety to reduce the complexity in the system. An aged-based exemption is unnecessary, given the contribution cap effectively limits the balance.

Lowering the age threshold for downsizers

The second change expands access to what is known as the 'downsizer contribution' by lowering the eligible age threshold. The contribution, first introduced in 2018, allows eligible individuals who sell

their main residence to contribute up to $300,000 each to their superannuation.

Previously, the option was only open to people aged 65 and older but under the 2021/22 Federal Budget proposal, the age threshold would drop to age 60, making it an option for many more to consider in the current property market. Importantly, the downsizer contribution is *not* counted as a non-concessional contribution and therefore does not count towards contributions caps. It can be made even if your total superannuation balance is greater than the $1.6 million transfer balance cap.

The nature of the downsizer contribution highlights some interesting anomalies. For a start, there is no strict requirement to downsize your home to be eligible. If you sell the family home for $600,000, you and your spouse can each contribute up to $300,000 to superannuation (if all other eligibility criteria are met). What you do next is not part of the eligibility criteria, so you could then buy a bigger or more expensive home with other funds available outside superannuation.

This may be particularly relevant for people who are near or at the $1.6 million transfer balance cap and who cannot direct other funds into superannuation. Using alternative funds to purchase their next home and making the downsizer contribution with proceeds from selling the family home, could be a more attractive strategy.

Main residence requirement

A second element of the rule is that the property must have been held for at least 10 years and be the main residence of the person claiming the contribution. But here again, there are some important qualifications.

On its 'Continuing main residence status after dwelling ceases to be your main residence' webpage, the ATO gives the example of 'Ian', a 70-year-old who bought his first house in 2005, lived in it until 2013, then bought a second home, renting out the first.

Although Ian no longer lives in the first house, the ATO still considers him eligible to make a downsizer contribution on what is now his rental property, noting that even though Ian is no longer treating his first home as his main residence, he is effectively exempted from some of the capital gain from the sale of the first home because the property had been treated as his main residence prior to renting it out. He therefore meets the main residence requirement for making a downsizer contribution.

This example opens up the possibility of former occupiers being able to remain in their current property while selling and contributing proceeds of a rental property that was their former home.

A third issue to be aware of is the 90-day rule, which requires, for the most part, that the downsizer contribution is made within 90 days of receiving the proceeds of sale, which is usually at the date of settlement.

The ATO, in its Guidance Note GN 2018/2 *Downsizer Contribution*, acknowledges that sometimes this is not reasonable, particularly in the case of ill health, a death in the family or the need to move house, but there are limits to its preparedness to extend this time. If the delay is caused by factors outside the contributor's control, and an application was made within the 90-day period, it is possible that a time extension would be granted.

As an example, the ATO suggests an extension would be granted for someone selling their family home and moving into a new retirement village where completion of the new property is delayed. In this case, it takes into consideration that the contributor might be reluctant to commit the sale proceeds to superannuation before knowing the final price of the new property.

However, the ATO also outlines a case in which someone too young to qualify for the downsizer contribution seeks an extension of time to allow them to meet the age requirements. In that case, no extension would be granted.

Why do these proposed changes matter?

Despite 30 years of the superannuation guarantee, the balances of most retiring Australians remain low—a key reason half of retirees remain reliant on federal government (government) pensions.

In its March 2021 report—based on an analysis of ATO data—*Superannuation balances prior to death: Superannuation balances of older Australians*, ASFA looked at balances for over-70s in 2018/19, and found that nearly 1.7 million older Australians had no superannuation balance at all, while another 350,000 in this cohort held balances under $50,000.

The changes reflect a growing awareness by government that the system is still not adequate for many retirees, and more attention is needed to help people appropriately build their balance during the accumulation phase.

Being able to make additional contributions immediately pre-retirement, or in early retirement, helps to boost the superannuation nest egg and prolong the period in which the retiree can be fully or partially self-funded.

However, it is also a reminder to people well before retirement age to be thinking about where larger sums of money might come from to top up their retirement income. For those five or 10 years out from retirement and thinking of moving house, any discussion with a financial adviser should include whether they can take advantage of the downsizer contribution.

Finally, despite the apparent softening of the government line on these later-life contributions, it is important that financial advisers and self-managed superannuation fund (SMSF) trustees are across the rules for compliance.

It was only in April that the ATO issued a warning—via its 'Sufficient and appropriate audit evidence to support the acceptance of downsizer contributions' webpage—to SMSF auditors over the downsizer contribution, outlining a number of areas where scrutiny was needed to ensure compliance. Seeking good timely advice on this front *before* embarking on the sale of a property or making a contribution, can avoid a costly compliance mistake. FS

The quote

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