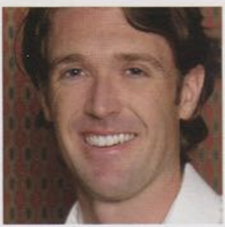
STRATEGY

Upsizing with the downsizer contribution

The ability to make superannuation contributions for those over 65 selling their principal abode was one of two budget measures the federal government announced in 2017. Rob Lavery explains how the legislation works and highlights some lesser-known aspects that can be very useful.



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In the 2017/18 federal budget, the government announced policies connecting superannuation with property ownership for both first homebuyers and downsizing retirees. The latter of these now-legislated announcements, the downsizer contribution, provides a new opportunity for those over 65.

How best to invest funds freed up by downsizing has become an increasingly important question in the past decade, particularly in Australia's booming metropolitan property markets. The downsizer contribution rules provide a new avenue through which funds can be moved into the concessionally taxed super environment. That said, it is crucial fund members and their advisers understand the limitations and impacts of implementing a downsizer contribution strategy.

How it works

Under the downsizer contribution rules, members aged 65 and older will be able to contribute proceeds from the sale of their home to super. Each member will be able to contribute up to $300,000, regardless of their age, work status or total superannuation balance. It will not be considered a concessional or non-concessional contribution, rather it will be its own class of contribution.

Downsizer contributions will be able to be made where the contract for sale for the dwelling is entered into on or after 1 July 2018.

Who can make a downsizer contribution?

To make a downsizer contribution:

- the member must be aged 65 or older,
- the contributor must qualify for a full or partial capital gains tax (CGT) main residence exemption on the sale of the property,
- the 10-year ownership rule must be met,

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- the contribution must be equal to all, or part, of the capital proceeds from the sale of an interest in a dwelling held by the member or their spouse, and
- the contribution cannot exceed the downsizer contribution cap.

Assets owned before 20 September 1985 may be exempt from CGT without needing to meet the requirements of the main residence exemption. A downsizer contribution may still be made if the owner would have qualified for a full or partial main residence exemption but for the pre-20 September 1985 acquisition date.

No downsizer contribution can be made in relation to the disposal of a caravan, houseboat or other mobile home. Downsizer contributions cannot be claimed as a tax deduction.

The spouse's property

A downsizer contribution can still be made where the disposed-of dwelling was owned by the member's spouse, but not by the member. If this is the case, the member must have been able to qualify for a full or partial CGT main residence exemption on the property had they owned part of the property.

The 10-year ownership rule

At all times in the 10 years immediately before the disposal of the dwelling, the member, their spouse or ex-spouse must have held an interest in the dwelling or the land on which the dwelling was located.

If the spouse's estate disposed of their interest in a dwelling, it is treated as though the spouse owned it up until the disposal. This applies where the member was the deceased's spouse at the time the spouse died.

Downsizer cap and limit

Downsizer contributions for an individual cannot exceed $300,000. That said, each member of a couple, if eligible, can make downsizer contributions from the proceeds of the same property up to the $300,000 limit. This may allow up to $600,000 in downsizer contributions to be made by a couple when their home is sold.

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Example

Berwick, 67, and Helena, 70, are retirees who decide to downsize. They sell their family home, originally purchased in 1997, for $1.4 million and purchase a unit nearer the city for $900,000. After costs, Berwick and Helena have $450,000 to invest.

Helena and Berwick decide to contribute to their SMSF. Helena contributes $300,000 and Berwick $150,000 as downsizer contributions.

The limit

As well as the cap, the downsizer contributions for a member and their spouse in relation to a single dwelling are limited to the sum received by both the member and their spouse from that one contract of sale.

In practice, this means multiple downsizer contributions can be made in relation to one contract of sale, however, they cannot total more than the proceeds received for that sale.

Furthermore, once a member has made downsizer contributions in relation to one contract of sale, they can't make any future downsizer contributions in relation to any future contracts of sale. This applies even if their previous downsizer contributions didn't use the full cap and even if the new contract applies to the same home.

Making the contribution

The downsizer contribution must be made within 90 days of the change in ownership occurring, subject to the ATO commissioner's discretion to extend this time period.

The explanatory memorandum to the bill creating the downsizer contribution rules, as well as the ATO's website, identifies that the date the change of ownership occurs is commonly the settlement date. This is different to the usual date of disposal used for CGT purposes, which is the date the contract for sale is entered.

If the member chooses to make the contribution a downsizer contribution, the contribution must be identified as a downsizer contribution by the member in the approved form. This notification must be provided to the member's fund at or before the time the contribution is made.

Elements to consider when making a downsizer contribution

In addition to the usual considerations when

contributing to super, downsizer contributions have some unique elements to weigh up.

Impact on the age pension

The member's home is exempt from assessment under the Centrelink and Department of Veterans' Affairs income and assets tests. This is not the case for amounts contributed to super as a downsizer contribution.

Furthermore, assets from a sold home that are held to purchase a new home are exempt from Centrelink assets testing for up to 12 months (or until the new home is purchased). When the member makes a downsizer contribution to super with the proceeds of sale, they may no longer be seen to be holding that amount to purchase a new home. As such, they may lose the benefit of this exemption.

Any increase in the member's means testing may impact on their social security entitlement.

The transfer balance cap

A downsizer contribution still counts under a member's transfer balance cap if it is used to commence an income stream. If the member has a superannuation balance that is already approaching the transfer balance cap limit, they may not be able to transfer their downsizer contribution to pension phase in super. If it is retained in accumulation phase, earnings will be taxed at 15 per cent. This may still compare favourably to the member's personal tax rate, but it will depend on their other income outside of super.

Total superannuation balance

A member's total superannuation balance can impact on their eligibility for a wide range of benefits and opportunities, including:

- making non-concessional contributions,
- making catch-up contributions,
- the government co-contribution, and
- segregating pension assets in an SMSF.

The total superannuation balance of each and every member is particularly important for SMSFs. If any member's total superannuation balance exceeds $1.6 million on 30 June, the SMSF is prevented from segregating its pension assets the following financial year. This can have a detrimental effect on the other members of the fund, even though their situation did not change.

Strategic approaches

The benefits of having funds in super can be significant. Savings in super that support an income stream in retirement phase are subject to no tax on earnings. This compares to the member's marginal tax rate, potentially as high as 39 per cent or 47 per cent, outside of super. As such, strategies that maximise contributions are appealing.

The $600,000 opportunity

There is a brief window when a member can make both a downsizer contribution of $300,000 and, using the bring-forward provisions, a non-concessional contribution of $300,000. This is because the bring-forward provisions are concerned with the member's age at 1 July in the financial year of contribution, whereas the downsizer contribution rules care about the member's age when the contribution is made.

Example

Erin turns 65 on 21 July 2018 and enters the contract to sell her home on 1 September 2018, settling on 1 November 2018. Erin receives $1.2 million from the sale.

Erin is planning on moving into her holiday home in coastal Baai Bay and would like to get as much of the sale proceeds in the tax-effective environment of super as possible. As she is making the contribution after her 65th birthday (and she meets all the other eligibility criteria), she can make a downsizer contribution of $300,000. Furthermore, she was under 65 on 1 July of the 2019 financial year so she can use the bring-forward provisions to make up to $450,000 in non-concessional contributions as well.

Note, Erin will need to meet the work test in order to make non-concessional contributions after her 65th birthday. However, she will not need to meet the work test to make the downsizer contribution. She will also need to have a total super balance of less than $1.4 million on 30 June 2018 in order to use the bring-forward provisions.

The sneaky spouse

The downsizer contribution is still available to a member where they did not own the home themselves, rather it was owned by their spouse. In this case the member or their spouse must meet the 10-year test and the member must have been able to treat the home as their main residence for CGT purposes had they owned it themselves.

The breadth of this spouse downsizer contribution is greater than it first appears. The key thing to understand is that the money contributed to super under the downsizer provisions does not need to be directly connected to the sale of the home. It could be money the member had saved elsewhere, but the sale of their spouse's home offers them an opportunity to get it into super.

Example

Sam, 66, and Alex, 68, have been in a de facto relationship for 12 years. They were both married previously and took various assets from their respective divorce settlements. When they moved in together they decided to keep their finances separate to minimise the chance of going through messy separation processes again.

They live in a home that has been owned by Sam for the past 15 years. They plan to sell the home and move into a smaller property. Sam plans to make a downsizer contribution from the proceeds of the sale.

Alex has $500,000 held in a range of different investments. While Alex is not entitled to any of the proceeds from the sale of Sam's property, she can use the opportunity to contribute part of her own invested assets into super as a downsizer contribution.

Up on the downsize

The downsizer contribution rules open a welcome new path for those over 65 to get funds into superannuation. That said, they are not entirely straightforward and understanding the intricacies of these rules is crucial in order to seize the opportunities they afford. ▼