DBA Lawyers

Level 1, 290 Coventry Street (PO Box 2085)
South Melbourne VIC 3205
Ph: (03) 9092 9400 Fax: (03) 9092 9440
dba@dbalawyers.com.au www.dbalawyers.com.au
DBA Lawyers Pty Ltd ACN 120 513 037

Downsizer contributions — the basics and some key tips and traps

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Downsizer contributions for the right person or couple can be very strategic. Yet not many are aware of the key rules that can unlock the potential that the downsizer strategy offers.

Broadly, downsizer contributions allow those 65 or over to sell or dispose or an ownership interest in their main residence and make up to a $300,000 contribution to superannuation. This results in a contribution of up to $600,000 for a couple provided the relevant criteria is satisfied. Moreover, these contributions can be made even if the member has more than $1.6 million in super and can be made at age limit over 65, even if you were aged 100!

This article examines two key questions:

1. How do downsizer contributions work?
2. What are some of the key tips and traps?

How do downsizer contributions work?

There are three broad steps that need to be followed before you make a downsizer contribution. The downsizer contribution criteria is largely contained in s 292-102 of the *Income Tax Assessment Act 1997* (Cth) ('ITAA 1997').

Step 1: Eligibility

The first step is to confirm that the amount will constitute an eligible downsizer contribution. Broadly, an eligible downsizer contribution is where:

- The contribution is made to a complying super fund including an self managed superannuation fund ('SMSF') by a member aged 65 years or over.

- The amount is equal to all or part of the 'capital proceeds' received from the disposal of an ownership interest in a dwelling that qualifies as a main residence in Australia subject to a maximum amount of $300,000 for each member of a couple.
- The member or the member's spouse had an interest in the main residence during the period of at least 10 years prior to its disposal.
- The member has not previously made downsizer contributions in relation to an earlier disposal of a main residence.

An ownership interest includes a legal or equitable interest and in certain cases a right or licence to occupy a dwelling may qualify provided the interest has been held for at least 10 years prior to being disposed of.

Note that a caravan, houseboat or other mobile home does not qualify as a main residence for these purposes. This may be unfortunate for 'grey nomads' who wish to travel around Australia in their motor homes, caravans, houseboats or yachts. They would need to first dispose of their home after attaining 65 years to make a downsizer contribution.

Special rules apply where a member has separated from their former spouse or where their spouse has died (and an interest in the dwelling is held by the trustee of the deceased spouse's estate). These special rules may allow, for instance, a member who has obtained their interest in their home from their former partner as a result of a family law property settlement to count the ownership period of their former spouse to determine whether they satisfy the 10 year test. For example, a female spouse who has held the home for the past 6 years can add the prior 8 years that her former spouse held the property prior to the property settlement which resulted in the title to the property being transferred to her.

Step 2: Contributions

The contribution rules must be satisfied. These can be summarised as follows:

- A member can make up to a maximum of a $300,000 a downsizer contribution. Note that the mnaximum downsizer contribution however must not exceed the total capital proceeds that the individual, their spouse, or they both, receive from disposing of their ownership interests in the dwelling.
- There is no age limit or gainful employment test that needs to be satisfied (however many SMSF deeds may still preclude such contributions and an SMSF deed update may be required).

- Downsizer contributions are not counted towards:
    - the relevant member's contributions caps (eg, the usual $25,000 p.a. concessional and $100,000 p.a. non-concessional contribution caps);
    - the total superannuation balance ('TSB') at the start of the financial year a downsizer contribution is made; and
    - the $1.6 million (indexed) total superannuation balance limit (that applies to, among other things, determine an individual's eligibility for non-concessional contributions) does not apply in respect of downsizer contributions in the financial year the downsizer contribution is made. Thus, a member could have over $1.6 million in superannuation and still make a downsizer contribution. However, a member is precluded from making non-concessional contributions if their TSB exceeds $1.6 million at the start of that financial year.

Once the member sells their main residence, they are required to make downsizer contributions to their super fund within 90 days after the day the ownership changed (typically 90 days from settlement unless they have been granted an extension from the ATO).

While multiple downsizer contributions in respect of the sale of the same residence can be made, as noted above, you cannot make a downsizer contribution in respect of a second or subsequent dwelling. Some members may, for instance, contribute some of the deposit moneys they receive and then make a subsequent contribution following settlement of their dwelling.

As noted above an eligible couple could contribute up to a maximum of $600,000 (ie, 2 x $300,000) by way of downsizer contribution that:

- is not counted towards their usual contributions caps;
- can still be made even if they both have TSBs over $1.6 million; and
- will not affect their TSBs, which may impact their ability to make non-concessional contributions, etc , until the end of the financial year after the downsizer contributions are made.

For example, Jane and Finn are both 85 years and each have $2m in super –– they can both still make a downsizer contribution of up to $300,000 each.

Step 3: Reporting and Verification

An approved form should be completed by the contributing member(s) and given to the trustee of the super fund detailing the amount that is to be attributed to downsizer contributions. The ATO then run verification checks on the amount and may contact the member for further information.

If the contribution does not qualify, the ATO notifies the superannuation provider. The amount will then either be allocated as a non-concessional contribution — if permitted by superannuation law and may result in the member exceeding their cap — or refunded to the member in due course.

Expert advice should be obtained if the contribution fails to satisfy the downsizer criteria as there are special rules for dealing with excess contributions.

Some key tips and traps

Full or part disposal of an ownership interest

The explanatory memorandum introducing the downsizer provisions (ie, Treasury Laws Amendment (Reducing Pressure On Housing Affordability Measures No. 1) Bill 2017) confirmed that a part disposal was possible (refer para [2.69]). However, until 21 August 2020, there was no express recognition by the ATO that a part disposal in a dwelling would satisfy the downsizer provisions. The ATO updated its web page (refer QC 54086) on 21 August 2020 to state:

*You can only access the downsizer scheme once. This means you can only make downsizing contributions for the sale or disposal of one home, including the **sale of a part interest** in a home.*

[Emphasis added]

Prior to this ATO confirmation it was generally considered that a person had to sell or dispose their entire interest in their home to be eligible to make a downsizer contribution. However, the ATO confirmation on a part disposal now means that SMSF retirees can sell a part interest in their home and make a downsizer contribution therefore also allowing them to stay in their home.

While a residential property cannot be sold to an SMSF, a part interest in a home can be sold to provide cash to the member that can be contributed to an SMSF, retail or industry superannuation fund.

DomaCom Australia Limited, for example, obtained an "Administrative Binding Advice" (ABA) on its Seniors Equity Release product confirming that a person could dispose of a part interest in their home. This Seniors Equity Release allows a person to receive cash to make a downsizer contribution while remaining in their home. Some elderly people fear disposing of their home but may not have enough cash available to test the facilities in retirement villages. For more information on this option, refer to https://domacom.com.au/downsizer-contributions/ There may be other financial products available that provide a similar facility and please note that we do not provide any financial product advice.

Given a part disposal is possible, there may be some couples who may wish to consider transferring a part interest to their spouse or another family member. Expert advice should first be obtained before implementing such a strategy to ensure it satisfies the relevant criteria and does not fall foul of any anti-avoidance rule.

Age Pension

Members should note that disposing of their main residence (which is exempt from Centrelink's asset test) and contributing downsizer contributions to their super fund (which is counts towards Centrelink's asset test) may adversely impact on their Centrelink entitlements. This is because the Commonwealth Government's age pension provided via Centrelink is assessed against, among other things, an assets and incomes test and those who exceed the applicable thresholds will be denied an old age pension in whole or in part.

A person's family home is generally not included in that person's assets test, however superannuation savings are included once a member reaches pension age. This means that if a member disposes of their main residence and makes a downsizer contribution, the member may either have:

- a reduced age pension; or
- no entitlement to any age pension.

This aspect can significantly reduce the attractiveness of the downsizer provisions for those who would be worse off as a result of a loss to their age pension entitlements. Accordingly, an appropriate assessment of any such adverse impact should be undertaken.

The main residence exemption

An understanding of how the capital gains tax ('CGT') main residence exemption operates is fundamental for advisers to provide strategic advice on downsizer contributions. In particular, a dwelling must have been at least the main residence of a person for part of the time during that person's ownership period that satisfied the main residence exemption criteria for that (part) of that period (in subdivision 118B of the ITAA 1997). In this regard, the ATO note in Law Companion Ruling ('LCR') 2018/9 that the capital gain or loss must be wholly or partially disregarded because the property has been treated as their main residence. For example, a dwelling was the person's home for one year and rented for 9+ years.

It should also be noted that s 292-102 also provides that a downsizer contribution can also be made if the dwelling was a pre-CGT asset (ie, it was acquired prior to 7.30pm on 19 September 1985 as confirmed by the ATO in LCR 2018/9) if it would have satisfied at least part of the main residence exemption if it had been acquired after CGT was introduced.

Proceeds and Borrowings

It is important to note that the downsizer contributions cap is the lesser of $300,000 or the sum of the capital proceeds. Any debt outstanding on a mortgage over the relevant property is not considered for the purpose of determining the capital proceeds.

For example, Peter bought his main residence 14 years ago for $1 million. He then sells it for $1.25 million when his outstanding borrowings are $1 million.

Peter received capital proceeds of $1.25 million. Thus, he can make downsizer contributions of up to $300,000.

Members should also be aware that downsizer contributions are not deductible.

SMSF Deed Provisions

As the downsizer contribution is a relatively new type of contribution, SMSF deeds should have express wording that covers these contributions, especially as prior legislation had not contemplated the flexibility these contributions require.

Related articles

For prior articles refer:

- Downsizer contributions –– basics, tips and traps
- How will downsizer contributions work for SMSFs?

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This article is for general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.

Note: DBA Lawyers hold SMSF CPD training at venues all around. For more details or to register, visit www.dbanetwork.com.au or call 03 9092 9400.

For more information regarding how DBA Lawyers can assist in your SMSF practice, visit www.dbalawyers.com.au.

*By **Daniel Butler** (dbutler@dbalawyers.com.au), Director DBA Lawyers*

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