Ten Things you should know about Downsizer contributions

By - Manoj Abichandani

Downsizing home implies that a person is moving to a smaller home. To make a downsizer contribution to super, there's actually no requirement for a person to purchase a smaller home than the one sold, in fact, there's no requirement to even replace their home once sold.

Downsizer contributions are legislated under Section 292-102 of ITAA 1997, access to this new type of personal super contribution is available from 1 July 2018. This legislation was introduced due to pressure on housing affordability in Australia. It gives older Australians an opportunity to transfer money into super after reaching age 65 without an overly complex set of rules.

There are no specific requirements about who must actually make the contribution for that individual, although the individual must be the one who makes the choice to treat a contribution as a downsizer contribution as long as certain conditions are met.

The downsizer contribution is not a non-concessional contribution, however , the downsizer cannot be claimed as a personal income tax deduction. Downsizer contributions were introduced for two main reasons:

> a) Current contribution restrictions (such as work test and age) prevent older Australians from making contributions into superannuation. Superannuation providers can accept only employer contributions and member contributions in respect of a member who are over 65 years provided the member satisfy a work test – they must work at least 40 hours in a consecutive 30 day period. Downsizer contribution has no age restriction or work restrictions.
>
> b) Being unable to invest the proceeds of selling their home into superannuation and earn tax free income, discourages some older people from downsizing homes that no longer meet their needs. This means many larger family homes sit occupied by older singles or couples.

Below are 10 things which you must know about Downsizer contributions:

1. Age of member who is Contributing

You must be 65 years or older at the time of making a downsizer contribution, there is no upper age limit for making downsizer contributions.

2. Timing of Sale of Property

The contribution amount is from the proceeds of selling your home (exchange date) must be entered into on or after 1 July 2018. You can only make downsizing contributions for the sale of one home. You can't access it again for the sale of a second home.

3. Type of Property

Downsizer contributions can be made in respect of an individual if they or their spouse held an ownership interest in the dwelling, whether that ownership interest was held solely, jointly or as tenants in common.

The home sold (including the land it is built upon) must be eligible for principle place of residence exemption and located within Australia and is not a caravan, houseboat or other mobile home and must be owned for at least 10 years.

The member must have an ownership interest in the home. Where a spouse who held an ownership interest dies, the surviving spouse can count the period of ownership of their deceased spouse (including the period the dwelling is held by the trustee of the deceased estate) towards the 10 year ownership test.

There may have been a change in ownership between two spouses over the 10 year period that preceded the sale of dwelling, for example relationship breakdown or death of a spouse. Provided that either of the spouses held an ownership interest in the dwelling at all times during the period, downsizer contributions can be made in respect of the person who held the ownership interest just before disposal and in respect of another person who is their spouse at that time

If there is a period when land is vacant due to a dwelling having been lost or destroyed or knocked down and a dwelling has been rebuilt or is underway, this vacancy does not stop the 10 year ownership condition from being met. Also, a vacant block which someone has bought and then built a dwelling on and lived in as their main residence may meet the 10 year ownership condition

4. Principal Place of Residence CGT exemption

To qualify for the downsizer contribution, the home must qualify under the CGT main residence exemption. The home will also qualify where the CGT main residence exemption only partially applies. This will allow a property that is not currently the family home to qualify for exemption. For example, a property that was the main residence, but is now being rented out or a property that had the family home on it and was also used to conduct a business from.

In determining whether the CGT main residence exemption applies it is the characteristics of the individual in respect of whom the downsizer contribution has been made that are relevant. For capital gains tax (CGT) purposes, broadly, a capital gain or loss made on a dwelling that is an individual's main residence is disregarded as per ITAA 1997 (subsection 118-110(1)) for the whole or part of the 10 year period.

In situations where the title of the property was held in one spouse name, the requirements will be satisfied where the individual satisfies all the requirements to have qualified for a CGT main residence exemption but for the fact that it was their spouse who held the ownership interest in the dwelling (rather than the individual).

The main residence exemption will also apply to adjacent land such as a garden, up to 2 hectares (section 118-120 of ITAA 1997). The rules apply to individuals with an ownership interest, meaning a legal or equitable interest or right or licence to occupy a dwelling (section 118-130 of ITAA 1997).

5. Ownership Requirement - 10 year rule

The home must have been owned for at least 10 years by the contributor, their spouse, or former spouse. This allows the home to be held either solely, jointly, or as tenants in common. The rules also allows for the death of one spouse during the 10-year ownership period.

The home will still qualify even if a dwelling was used as principal place of residence for part of an individual's ownership period, however, the capital gain or loss is only disregarded for the period it was their main residence (section 118-185). There could be absences from the main residence such as working overseas etc. Also it does not matter if the house was earning rental income for a period of absence (6 year rule).

6. 90 Day Rule

Any downsizer contribution must be made within 90 days after the change of ownership (the prescribed period in which to make the downsizer contribution). Change of ownership usually occurs at settlement date. The Commissioner can allow a longer period, if necessary.

There can be multiple contributions but must be all within the 90 day period. These contributions can be to multiple funds and it is not necessary that they should be made to only one fund.

7. Total Superannuation Balance

An individual's ability to make a downsizer contribution is unaffected by the total superannuation balance test, which is relevant in determining an individual's non-concessional contributions cap. However, if a downsizer contribution is made, it will increase an individual's total superannuation balance for the purposes of that test.

Once the downsizer contribution is made to the fund it is included in the calculation of the total super balance and is relevant for any further non-concessional contributions. Consequently, the timing of making a downsizer contribution is important if the goal is to maximise super contributions, that is, downsizer contribution should be made after any non-concessional contribution if it is likely that after the downsizer contribution, the member is going to breach total superannuation balance cap to make any further non-concessional contributions.

8. Trust Deed Requirement

As with all types of contributions, a superannuation provider does not have to accept a downsizer contribution if it does not meet their trust deed rules.

9. Providing a Form by the trustee

A member who is an eligible contributor must make the choice that the contribution is a downsizer contribution and complete the approved form (a form to be issued by the ATO). Further, and importantly, the form must be given to the superannuation fund before or at the time the downsizer contribution is made.

If you make multiple downsizer contributions or downsizer contributions to different super funds, you must provide a form (available from ATO) for each contribution. In submitting the form with your downsizer contribution, you are confirming that you have met all the eligibility requirements.

10. Maximum Amount of Contribution

Whilst a downsizer contribution is not a non-concessional contribution, it is included in the tax-free component of any benefit payment, which can be important for estate planning purposes.

The downsizer must be no more than the maximum allowed – the downsizer contribution cap is the lesser of:

- The proceeds of the sale; and
- $300,000 per person

A downsizer contribution is a once off opportunity, that is, it applies to the sale of one qualifying home only. Even if a person only uses part of the $300,000 cap, from the sale of one qualifying home, a further downsizer contribution is not available when they sell another qualifying home. However, a person can make multiple downsizer contributions for the same property, within the prescribed period of 90 days after settlement.

If your contribution can't be accepted, the contribution amount will be returned to you by your super fund.

Who should make Downsizer Contribution

Advisors should be careful when advising clients on downsizer contributions as they do not suit every 65 year old client with or without a self managed super fund.

Once the downsizer contribution is made in super it will not be exempt from the Centrelink Asset test. That is, any proceeds from the sale of the family home contributed to super, will effectively be transferred from an asset test exempt asset (the family home) to an asset tested asset.

Also note that if the member has commenced a pension with the transfer balance cap of $1.6M, any downsizer contribution will remain in the accumulation account of the member and any income on investment earnings is limited to a maximum of 15% tax. It is important to note here that any income on accumulation account is credited to the taxable component in the fund, although downsizer contribution credits Tax Free component.

If the contributor has not fully used their transfer balance cap of $1.6M, they can commence a new pension with this new downsizer contribution. Care should be taken to not to commute the existing pension and merge the new contribution to commence one new pension, as the existing pension may have a taxable component. Income on investments in pension phase increase the taxable and tax free components in proportion of their percentage at the commencement of pension.

Examples

Example 1

A couple sell their own home of 15 years in Sydney for $1,900,000 to move to Gold Coast and live on rent. Each spouse can make a contribution of up to $300,000.

Example 2
A couple sell their own home of 20 years for $400,000. The maximum contribution both can make cannot exceed $400,000 in total. This means they can choose to contribute half ($200,000) each, or split it – for example, $300,000 for one and $100,000 for the other.

Example 3
An Australian couple over 65 year old migrated to America in 1990 to work, migrate back to Australia to retire in 2019. They sell their American home which they owned for 24 years for US $2.4M. They buy a modest home in Australia and want to invest the remaining $1.4M in tax free superannuation environment.

Since the home sold is not in Australia, they cannot make an downsizer contribution or non-concessional contribution as they are over 65 and not working.

Example 4
Mary is 69 years old and works for three months in the financial year in her own business and then sells her business and her home for $1,500,000. She has $1,585,000 in her self-managed super fund in pension phase which is 78% taxable component.

She decides to:
- contribute the maximum downsizer contribution available of $300,000, and
- contribute $100,000 under her existing non-concessional contributions caps, which she is able to do because of her age and meeting the work test
- contribute $25,000 as personal deductible contribution of $25,000 for the year

The order of contributions should be
1) Non-concessional contribution
2) Downsizer Contributions
3) Concessional contributions

If the contributions are made in any other order e.g. concessional contributions first, then non-concessional contributions will not be allowed. Also as soon as non-concessional contribution & downsizer contributions are made (and before concessional contribution) - commute $385,000 of existing pension 1 to accumulation account (to reduce balance transfer cap to $1.2M) and commence a new pension with $400,000 to commence a 100% tax free component 2nd pension (to increase balance transfer cap to $1.6M).