FUNDAMENTALLY SPEAKING

A simple explanation of the finance terms we all hear about but don't really understand

Why transfer balance cap can cause some confusion

ROWAN JONES

In July this year the transfer balance cap increased from $1.7 million to $1.9m. This is the second increase since the cap was first introduced in 2017.

The reason for the larger-than-normal jump is due to the spike in inflation.

The TBC is the amount you can move into a superannuation pension when you retire. Before this cap was introduced there was no limit on what you could move into tax-free pension phase.

The reason the government introduced this limit was to reinforce that the role of super was to provide people with a retirement income, not a wealth creation vehicle and a way of avoiding tax.

The TBC has the potential to cause some confusion, both for people who are yet to commence a super pension and for those who already have.

For those who haven't commenced a pension, they mistakenly think the cap is the maximum amount you can have inside your super fund. This is not the case. It just means that when you commence a pension, any balance above $1.9m must remain in accumulation phase. So instead of the investment earnings being tax-free, they are taxed at 15 per cent.

If you have already commenced a pension, the increase in the TBC does not mean you could automatically add $200,000 to your pension. The only way you could add to your pension is if you didn't utilise the full TBC that applied when you first established it.

For example, if the TBC was $1.7m when you commenced your pension and you only utilised 50 per cent of the cap by transferring $850,000 into pension phase, you are now able to add another $950,000.

Rowan Jones is an adviser with Entrust Wealth Management

Illustration: Don Lindsay