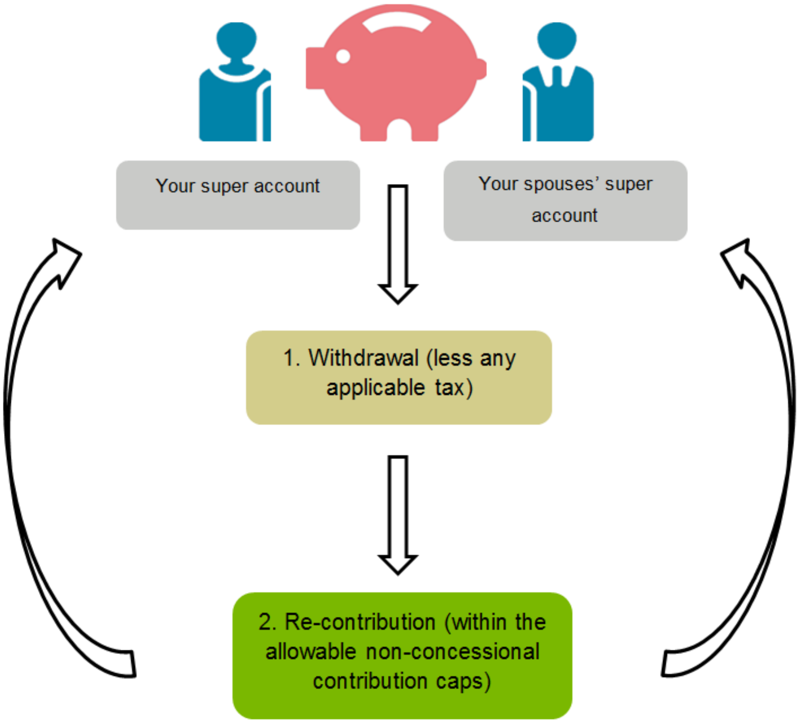
Superannuation

Re-contribution strategy

Aon Hewitt Financial Education Series

What is a re-contribution strategy?

A re-contribution strategy involves withdrawing all or a portion of your super as a lump sum, paying any tax and then re-contributing the balance, subject to contribution rules, back into either your or your spouse's super fund. The reason for undertaking this strategy is to convert the taxable component of your super benefits into the tax free component, or to move your super into your spouse's name.



There are a number of reasons why you might consider undertaking a re-contribution strategy:

- Estate planning
- Tax planning
- To fully utilise both of your transfer balance caps
- To maximise Centrelink benefits
- To access the spouse contribution offset or the Government co-contribution

All of these are discussed further below.

What are the benefits of this type of strategy?

Estate planning

Your super is split between a tax free component and a taxable component. When the taxable component is paid after your death to a non-tax dependant such as your adult children, they may lose up to 30% (plus Medicare) in tax.

By undertaking the re-contribution strategy you are able to convert your taxable component into a tax free component, and this should reduce the tax payable when you die.

For more information on how super is taxed on death, please refer to the 'Withdrawing from Super' fact sheet under the Superannuation Financial Education Series.

Income tax planning

When you use your super to start an income stream, part of the payment may be taxable if you are under age 60. The portion of the pension paid from your taxable component is taxed at your marginal tax rate less a 15% tax offset. The portion paid from the tax free portion is tax free.

By undertaking the re-contribution strategy you are able to convert your taxable component into a tax free component, and this should reduce the tax payable from your pension.

For more information on how income streams are taxed, please refer to the 'Account Based Pension' fact sheet under the Retirement Income Financial Education Series.

Fully utilise your Transfer Balance Caps

You are only able to invest $1.6 million into tax free retirement income streams, but if you are a member of a couple you each get a limit of $1.6m, meaning you can have a total of $3.2m invested in tax free income streams.

By undertaking the re-contribution strategy and contributing the money into your spouse's super, you are able to use both of your transfer balance caps. You will also increase the amount of tax free component for your spouse which means you can take advantage of the two strategies above.

Increase Age Pension benefits

As amounts held in super aren't assessed under the Centrelink Assets and Income tests until you reach Age Pension age, you can use this strategy to move super into your younger spouses name to help the older spouse qualify or increase their Centrelink entitlements. Additionally, you may be able to gain access to a Pensioner Concession Card or Low Income Health Care Card.

Receive a Tax offset and/or Government co contribution

A final benefit of the re-contribution strategy is that the person making the contribution into their spouses super may be eligible for a tax offset of up to $540 (provided all requirements are met). On top of that, the person receiving the contribution may be eligible for the Government co-contribution of up to $500 (again assuming all requirements are met).

Your adviser can help you work out if you qualify for these additional benefits.

How does a re-contribution strategy work?

To use a re-contribution strategy, you must:

- Meet a condition of release to be able to access your super and make the withdrawal, and
- Be eligible to contribute to either your or your spouse's super.

Please refer to the fact sheets on 'Super Contributions' and 'Withdrawing from Super' under the Superannuation Financial Education Series for further information.

The strategy is a two-step process:

1. Make a withdrawal from your super account. You need to be careful when working out how much to withdraw as you want to avoid or reduce the amount of tax that you need to pay. This will vary depending on your age and how much tax free and taxable components you have in your super. You also need to make sure that you are able to contribute the funds back into super, before withdrawing them.
2. The net proceeds of the funds cashed out should then be re-contributed into super as a non-concessional (after-tax) contribution.

You should talk to your adviser to work out how much to withdraw and to confirm you can re-contribute it back into super.

Example 1 – pension under age 60

David has just turned 57 and will be retiring shortly. He has a super balance of $600,000 made up fully of the taxable component.

David plans to use his super fund to commence an account based pension, drawing an income of $60,000 per annum. He will have no other income.

Without the re-contribution strategy

David will receive pension income of $60,000 and will pay tax of $3,147.

Tax payable is $12,147 less a 15% tax offset of $9,000 = tax payable of $3,147.

With the re-contribution strategy

As can be seen in the previous example, David will need to pay some tax on his pension however a proportion of the payment is reduced by the 15% tax offset available for individuals under 60.

However, David can look to undertake a re-contribution strategy to potentially reduce the income tax payable. David's adviser recommends he withdraw an amount up to his low rate cap threshold of $200,000 and re-contribute this money as a non-concessional contribution.

When David re-contributes the $200,000 (using the bring-forward rule) to his super fund, his new components will be:

- Tax free component = $200,000
- Taxable component = $400,000

The tax free percentage of David's super has increased from nil to one third.

David will still draw an income of $60,000 from his account based pension. Of this payment, $20,000 (33%) will be tax free and the remaining $40,000 (67%) will be taxable with a 15% tax offset applying.

As a result, David will receive pension income of $60,000 and will pay no tax, saving him $3,147.

He has also improved his estate planning position in the event that his benefits will be paid to non-dependants following his death (see example 2 below).

Example 2 – estate planning

Simone (age 60) has $300,000 invested in her super fund consisting entirely of taxable components.

Upon her death, the super balance will pass to her husband Jason tax free.

However, if Jason dies before Simone, her super will be passed to her daughter Sandy (age 30). Based on a death benefit of $300,000, Sandy will pay approximately $51,000 in tax, leaving her with $249,000.

Simone has two options:

1. She can leave her super alone, that is, have the account entirely in the taxable component, or
2. She can undertake a re-contribution strategy. This would involve Simone withdrawing the full $300,000 balance tax free (as she is over age 60) and re-contributing it back into her super, making the entire amount tax free.

In the event that Simone undertook the re-contribution strategy and passes away shortly thereafter, the entire death benefit when paid to either Jason or Sandy would be completely tax free. A re-contribution strategy has the potential to save Sandy death benefits tax of $51,000.

Are there any disadvantages in this strategy?

- If you are under 60 years of age, the taxable component withdrawn counts towards your assessable (and therefore taxable) income, but isn't taxed if within the Low Rate Cap. However, this can impact on your ability to receive certain tax offsets and concessions such as the Low Income Earners tax offset, Family Tax Benefit, Spouse Contributions tax offset, Senior Australian tax offset and Government co-contribution.
- The non-concessional contribution cap applies. Any excess contribution can attract penalties. For further information, please refer to the fact sheet 'Super Contributions' under the Superannuation Financial Education Series.

Should I consider using this strategy?

When deciding whether to utilise the re-contribution strategy for estate planning purposes, you need to consider who will receive the death benefit. Generally speaking, a re-contribution strategy for estate planning purposes:

- will be worthwhile if you are sure your death benefits will go to your adult children.
- may not be worthwhile if you have a spouse and adult children.
- will provide little benefit if you have a spouse or young children only.

For more guidance in this area, please speak to your financial adviser.