

From: Grow | Marinis Group
Sent: Monday, 20 March 2017 2:06 PM
To: Grow | Marinis Group
Subject: FW: The 'optional' tax
Attachments: 2017 02 14 - How to avoid a deadly super trap.pdf; Media Release No. 71 - 2017 03 03 - 29.45% death tax is a possibility.pdf

Dear Friends,

I would like to share with you the attached article I wrote recently for the Eureka Report – the investment magazine founded by Allan Kohler.

The article deals with the incongruously named superannuation 'Death Benefits Tax,' which I am also in the habit of describing as the 'optional' tax – optional because liability can be removed (or significantly reduced) by using a 'cash out and re-contribution' strategy currently available to working people over 60.

Ignoring this strategy could result in your estate being liable to pay at least \$17,000 for every \$100,000 of your unused superannuation.

I say 'at least' because there are some very strange quirks in the tax system which are often overlooked (even by those with a reasonable working knowledge of the superannuation system).

In order to make a payment to your estate, your superannuation fund (which may be in pension payment phase at the time of death) will revert to 'accumulation' phase. The complication which arises from this action is the likelihood that your fund will also be liable for the payment of capital gains tax.

The attached media release entitled "29.45% death tax is a possibility" describes the worst case scenario, however it serves to demonstrate that some level of CGT liability in most pension funds is inevitable, with the result that a total death benefit tax has the potential to be higher than 17%!

In the meantime, a cash out and re-contribution strategy can wash away some or all of the liability for the 'optional' (or Death Benefits Tax) component. Bear in mind, however, that this solution (and the solution for minimisation of CGT liability referenced in the attachment) are sophisticated strategies which require the guidance and supervision of a competent financial adviser.

As always, if you would like to discuss any aspect of this edition of eGrow, including whether you may be eligible to benefit from a cash out and re-contribution strategy (or to discuss any other financial planning issue) please don't hesitate to contact any member of our team.

Attachments

1. Eureka Report - 2017 02 14 – How to avoid a deadly super trap
2. Media Release No. 71 – 2017 03 03 – 29.45% death tax is a possibility

Kind Regards

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How to avoid a deadly super trap

With good planning, death tax - payable by non-dependent beneficiaries - can be avoided.

Summary: Sudden death is one of the biggest tax threats for super trustees, but there are ways to get around the looming tax slug that's levied on non-dependents. A withdrawal and re-contribution strategy after age 60 can prevent tax of 17% being sliced from an estate.

Key take-out: The benefit is that the re-contributed amount is converted to a 100% tax-free component within your super fund, allowing it to be transferred to your non-dependents without incurring Death Benefits Tax.

Key beneficiaries: Retirees, superannuants. **Category:** Tax Strategies.

As crazy as it may seem, if you have worked hard, saved diligently and used the government's own superannuation system to maximise your benefits, you may still inadvertently leave a 17 per cent Death Benefits Tax liability for your estate.

This is in addition to the deduction of potentially as much as 15 per cent in capital gains tax by the trustees of your super fund if you die.

This anomaly particularly affects those without financial dependents – and as life expectancy increases, this is a growing sector of the community.

One way around the 'death duty trap' might be to make a full (tax free) withdrawal from super after attaining 60. The success of this strategy, however, relies on knowledge of our date with fate. Fortunately for most of us, this is not generally revealed in advance.

Another 'after age 60' approach, may be to provide an enduring power of attorney including a medical power of attorney (known as an Advance Care Directive or Advance Care Planning) to a close friend or relative. This could provide for superannuation funds to be withdrawn when it becomes clear that life is approaching the final stage. But this strategy too, relies on advance warning. In the event of prior or sudden death, it is

simply too late to act and the tax of \$17,000 per \$100,000 must be paid to the government by the super fund before payment of proceeds to the estate.

The withdrawal and re-contribution strategy

A better alternative to the deathbed switch is the use of a 'withdrawal and re-contribution' strategy after age 60. While still relatively complex, prior to June 30 this year this strategy will allow the tax-free withdrawal of lump sums of up to \$180,000 for re-contribution as a non-concessional contribution. Using the 'three-year bring forward rule', this strategy could potentially allow withdrawal and re-contribution of as much as \$540,000, provided implementation is prior to June 30 this year.

From July this year, provided you are under age 65, a withdrawal and re-contribution strategy will still be possible. However, the maximum annual amount which may be re-contributed will reduce to \$100,000 with the maximum single amount reducing to \$300,000 under the three-year bring forward rule.

The benefit is that the re-contributed amount is converted to a 100 per cent tax-free component within your super fund, allowing it to be transferred to your non-dependent beneficiaries (including adult children) without incurring Death Benefits Tax.

The Australian Tax Office has indicated that it does not view this strategy as a breach of the infamous Part IVA tax avoidance legislation, but care should always be taken to act in conjunction with advice from a competent financial planner.

Persons aged over 65 but under 75 are also able to 'wash out' taxable components in this way, subject to being able to satisfy the government's 'work test' by working at least 40 hours over a 30-day period in each financial year they withdraw and re-contribute.

The withdrawal and re-contribution strategy is now used primarily as an estate planning strategy, and one which I have been recommending and implementing for the benefit of my clients since the introduction of the 'Better Super' regime in May 2006 – when super and pension payments became completely tax-free after age 60.

A strategy that may not last

The secondary reason for washing out these taxable components has been to future-proof the tax effectiveness of super (in the event of a government reversal of the 'over 60' tax-free super withdrawal status).

Given recent super and age pension rule changes (namely the January 1, 2017 Age Pension asset test changes and the '\$1.6 million Super Balance Transfer Cap' from July 1)

as well as the current budget deficit problems, perhaps another rule change can no longer be considered unlikely!

After all, these two most recent changes are just the reversal of the Howard government's easing of certain rules and thresholds during the mining boom, when government revenues were overflowing:

- The Centrelink Asset Test threshold was eased around 1999-2000 and from January 1, 2017, it has really only been returned to about where it was originally.
- The new \$1.6m transfer cap rules are also designed to reinstate a version of the old Reasonable Benefits Limit (RBL) rules that applied prior to the Better Super regime announced in May 2006.

For this reason I now tell my clients *not* to put off their withdrawal and re-contribution strategies, as I expect this too to appear on the radar of Treasury, with the possibility that this strategy opportunity may not be available for very much longer.

I also advise my clients that due to the \$1.6m cap rules, a re-contribution strategy is likely to be more complex than it used to be and, particularly for those with larger balances, care will need to be taken not to exceed that cap.

For those fortunate enough to have more than \$1.6m in super, further non-concessional (tax free) contributions will no longer be possible after July 1. If it is still possible to take this action, however, it should be considered before June 30. The alternative will be to wait until the Balance Transfer Cap is indexed to \$1.7m (this will occur only in amounts of \$100,000 every two to three years) and at that point it will only be possible to make up the increase.

If you are eligible to implement a withdrawal and re-contribution strategy, and have the superannuation assets to be affected, it would be wise to seek and act on advice quickly.

Theo Marinis is a financial strategist and head of Marinis Financial Group.



Theo Marinis

29.45% death tax is a possibility

"In a worst case scenario, adult children could be short changed by almost a third of a parent's estate in taxes – a situation that can be worked around by seeking help from a competent financial adviser" says Adelaide based financial strategist Theo Marinis.

"The complexity of the superannuation, taxation and Centrelink interface has reached a point where most people have very little if any chance of navigating the system. People 'don't know what they don't know'.

The incongruously named 'Death Benefits Tax' is an example of this complexity", Theo said.

"Take for instance, a stereotypical situation where a 'Mum & Dad' couple with a Self-Managed Super Fund are drawing a pension from say, rent on a warehouse. Their adult children are independent. When one predeceases the other, the SMSF pension will continue to be paid to the surviving member.

What many of us may not realise is that in addition to a Death Benefits Tax, there is the potential for Capital Gains Tax to be payable by the pension fund when the last member dies.

On the death of the final SMSF member, the fund will revert from pension to accumulation phase in anticipation of paying a death benefit, as the fund no longer has any members who are eligible to receive a pension.

In order to then pay the Death Benefit Tax, the trustee must then sell down the assets (in this case the warehouse) in the accumulation phase – which in turn, triggers a potential Capital Gains Tax liability. Assuming a capital gain is incurred, CGT payable by the super fund will be at a rate of 10% (if the assets have been held by the fund for over 12 months) or 15% (if held for less than 12 months).

What is left of the proceeds of Mum and Dad's SMSF (net of CGT) when paid to beneficiaries, will then attract Death Benefits Tax at the rate of 17% on the taxable component of the benefit.

Thus in an extremely unlikely BUT absolute, worst case scenario, total tax paid by the fund on a death benefit could be as much as 29.45% as per the example below:

Asset	Tax	Rate	Net benefit
1) \$100,000 (held for < 12 months)	\$15,000	15% (CGT)	\$85,000
2) \$85,000 (net of CGT)	\$14,450	*17% (DBT)	\$70,550
Final net benefit			\$70,550
Total tax paid			\$29,450
Maximum tax rate			29.45%

*on taxed component of super

NOTE – example based on the following assumptions:

- Capital Gains in the fund of 100% (this is **EXTREMELY** unlikely and therefore a worst-case scenario – although inevitably there will be some CGT liability in most pension funds, therefore total death tax has potential to be > 17%)
- A taxable super component of 100%

To work around the CGT sting, the only solution is to regularly review and rebalance the portfolio periodically as part of a regular pension review (as should occur as prudent matter of course anyway!) and thus reset the CGT cost base.

NOTE this portfolio rebalance strategy may not, however be suitable for all portfolios, particularly those with illiquid direct investments (eg properties in SMSF's!).

Death Benefits Tax Liability can, however, be removed or reduced by a cash out and re-contribution strategy.

Both solutions are complex and require professional, qualified supervision and support.

The unfortunate reality is that most people are not equipped to deal with the level of complexity embedded within our superannuation system, or the time to deal directly with taxation, legal and social security experts. Such complexity forces people to hire financial planners, whether they want to or not.

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