How to keep super in the family

Children can share in the parental cache while learning to manage for their own retirement, writes **Tim Blue**

Age old problem: Catherine Robson says many younger clients are suspicious of superannuation and do not maximise contributions Picture: David Geraghty

ALL parents want to give their children a leg-up in life, whenever the opportunity arises. Most often it is a matter of leaving as much as possible in a will, but better options are emerging under the latest changes to tax on superannuation.

How does this idea sound? You retire, convert your super to a pension stream, keep half for yourselves to live on and over time give the rest to the kids to live on, on condition that they salary sacrifice a big slice of their income into super.

Everyone gets to save tax, and parents or grandparents feel content at having helped the family.

There is a hurdle or two, but nothing that looks insurmountable: you must have retired, be aged over 60 and the Government must keep its budget promises about removing all tax on superannuation pension streams from July 1 next year.

Obviously, you would also want to trust your adult children to keep their side of the bargain and not fritter the money away on stuff you had not agreed to.

Tick the box on these and you can effectively transfer your tax breaks in super to benefit your children, and at the same time sidestep a potential tax burden for them.

The big move in the budget that allows this strategy is the planned abolition of tax on super benefits for the over-60s — taken either as a lump sum or an income stream — from next July. While there is now a cap on how much can be contributed as an undeducted (after-tax) contribution to a super fund, a window has been left open that allows up to $150,000 a year to be contributed, plus the right to bring forward such contributions by those aged between 60 and 65.

That is, $450,000 can be contributed every three years from the one-off sale of an investment property or similar. So, assets sold can be invested in the tax-friendly environment of superannuation from day one. This means 15 per cent tax on investment earnings instead of marginal rates while in the accumulation phase of super, and zero tax on everything from age 60.

Adelaide-based financial strategist Theo Marinis says: "People in later life will be able to withdraw large amounts from super to pass on to the kids tax free while they are alive, rather than have it taxed if paid after they have passed on."

Some judicious juggling may be needed on the sums locked away and cash flows involved. Tax breaks have improved the appeal of super, yet the sacrifice involved in locking away funds until later in life can be a drawback to some.

Catherine Robson, a senior manager in financial planning at NAB, says: "Many of our younger clients are suspicious of superannuation and choose not to maximise their contributions.

"Their most common concern is that they will not have access to superannuation in the event of the unexpected — for example, losing their job or serious illness." Robson acknowledges that investors who are closer to retirement are starting to realise how significant the compounding tax savings within super can be, particularly in light of the most recent announcements.

"If there is a legitimate way for parents to help their children take advantage of the long-term tax benefits of superannuation, while offering the flexibility of cash flow if required, this is good for everyone."

So, how could it work? In short, it's a variation of a recontribution strategy. Recontribution is about transforming your super — from money subject to tax if passed on to adult non-dependent children to money not subject to tax.

Consider the example of Bob and Marion, who both plan to retire aged 60 in the 2007-08 financial year. They have about $2 million in super assets between them, all acquired after 1983.

First, they would cash out $900,000 and recontribute this into another super account (as $450,000 each of undeducted contributions) to give a balance of $900,000. (Note, however, that there may be fees for withdrawals and/or for super contributions back in.) From this they will take a pension income stream that will give them a combined income of at least $80,000 a year, tax free.

When they can — perhaps three years later — they could do the same again to wash out much of the balance of their original $2 million in super.

Once they are well into their retirement and are no longer allowed to withdraw and recontribute to a super fund, Bob and Marion will start to withdraw funds from their pension stream super, over and above their own income needs. This will be given to the kids as a gift.

The key benefit of this recontribution scheme is that it minimises the tax liability that might be faced by children if the parents should pass away. Super funds bequeathed to non-dependent children as a death benefit are subject to a tax take of 16.5 per cent.

Marinis suggests that the sum gifted by the parents be used to replace part of the children's income, which meanwhile has been salary sacrificed into their super account. In gifting money to son James, say a spare $26,750, no tax is payable by him, or the parents.

Marinis says: "The children will be saving more into their super net of the salary sacrifice than the parents have actually given them. Bob and Marion agree that this is a good way of gradually, in their lifetimes, passing on their super to their son James and ensuring he and his family get to keep more of it."

James is in his forties, very successful and paying the top tax rate of 46.5 per cent, so his parents' gift of $26,750 is the same as his earning $50,000 before tax. ($50,000 less 46.5 per cent tax or $23,250 leaves $26,750 in net salary.)

The outcome of all this is that James will be saving $42,500 into his super — his saved $50,000 thanks to his parents' generosity, less the usual 15 per cent contributions tax that applies to salary sacrificed contributions. ($50,000 less 15 per cent or $7500 leaves $42,500 going into super.)

James and his family are no worse off as the net salary he has forgone in salary sacrifice to his super has been replaced by the tax-free gift from Bob and Marion.

The bottom line is that Bob and Marion's $26,750 gift from their super has allowed James to boost his net super by $42,500 and potentially save a further $4414 in lump sum tax he would have to pay if he received this amount as a death benefit from mum and dad's super.

There are some limits on this strategy. NAB's Robson says: "There will be a limit to how much can be salary sacrificed into super from July 1 next year.

"Assuming that the children are all under 50 years of age, then this will be $50,000 a year. This puts a natural upper limit on this strategy."

And of course there is a need to ensure mum and dad don't give away too much too soon and get caught short themselves.

A side issue too might be that of spouse loyalty — and the occasionally delicate state of relations between parents and younger in-laws.

Marriages may look fine at the time of starting such a scheme, but may change, leaving parents locked into funding a former in-law after divorce.

Yet the strategy has much appeal. Theo Marinis says: "Strategies such as this one may be a great help to younger people like James, who may be struggling with children and mortgage payments, and who may not be able to later ramp up their super due to a new cap on contributions.

"And the parents get a buzz from seeing the benefits of their generosity."

Financial Strategies (SA) Pty Ltd trading as Marinis Financial Group
67 Kensington Road, Norwood SA 5067 T 08 8130 5130 F 08 8331 9161 E admin@marinisgroup.com.au
Financial Strategies (SA) Pty Ltd ABN 54 083 005 930, Australian Financial Services Licence No: 326403
Reproduced with the Permission of The Weekend Australian
MARINIS FINANCIAL GROUP