eureka
report

Weighing the Tax Options on Super

Theo Marinis examines how to reduce the tax liability on your super and pensions while you still can.

By Theo Marinis

6 Jun 2023

The recent Federal Budget contained no new changes to superannuation, signalling a pause on super tinkering for now. This is mainly because the significant changes had already been announced.

The lack of outrage over the $3 million cap to be applied to the concessionally taxed rate of 15 per cent on super earnings means that it will come into force as announced on 1 July 2025, after the next election, with the Greens poised to fall over themselves to support Labor as it punishes the wealthier electorate.

On the good news side, the Super Transfer Balance Cap (TBC) will increase to $1.9 million from the start of the new financial year on 1 July 2023.

Unfortunately, the caps for Concessional and Non-Concessional Contribution ($27,500 and $110,000 pa respectively) are not due for indexation increases until 1 July 2024 – although it is worth bearing in mind that these limits are per person. Therefore, for a couple they are still quite generous when you consider that the average wage of a working Australian is around $90,000.

Temptation to Tax

As Australia's super pool grows, it is my view that taxing excess private pensions will be inevitable; the temptation to raise more revenue from this source will prove to be too great for future governments.

Regardless of these considerations, having more money in superannuation remains a far better option than having less. Based on an earnings rate of 5 per cent pa, a super balance of $3

million will return $150,000 pa in perpetuity – all free of tax, if appropriately structured (e.g. split 50/50 with a spouse or life partner).

Then, if there is a liability to pay tax outside of this structure, a couple (over pension age of 67) would each need to be earning a taxable income of $28,974 per annum (excluding tax-free super pensions after age 60) before incurring any personal tax liability. That equates to an annual combined income of about $208,000 for a retired couple over age 60 – if they have structured their financial arrangements tax effectively.

Hidden Tax Traps

There are, however, some tax traps which can lie hidden until such time as paying more tax is the only option. My recent advice to a retired senior public servant client demonstrates the value of taking a pro-active approach to tax effective retirement planning.

A member of South Australia's Super SA Constitutionally Protected Retirement Plan, my client had a significant untaxed component (the component on which no contributions tax has been paid and which is subject to tax of 15 per cent on rollover). When this untaxed amount exceeds the Untaxed Plan Cap Threshold ($1.705 million from 1 July 2023) the amount in excess of the cap will be taxed at 45 per cent (plus 2 per cent Medicare levy if not rolled over to another fund).

Assuming the final untaxed balance grows to $2 million in today's dollars, there would be a 17 per cent liability for death benefits tax on the first $1.705 million ($289,850) plus 47 per cent on the balance of $295,000 ($138,650) – a total tax bill of $428,500 before any money is paid to my client's estate.

Address Immediate Liability

The first part of my advice was to address the immediate tax liability by transferring the retirement balance out of Super SA. The obvious downside of this strategy meant paying 15 per cent tax on an untaxed component of $1,166,667, or approximately $175,000 – now.

My client and partner were far from delighted at the thought of handing over such a large amount to the ATO, however they understood the benefits of "cleaning up" this liability before retirement. Retaining the benefit in the Super SA Untaxed Fund would mean deferring, rather than eliminating, a growing tax liability. It would allow further untaxed lump sum tax to accrue

as their benefit accumulated, with at the very least, 15 per cent tax on the income and capital growth to be paid later – probably by the estate.

Paying around $175,000 in tax now is a bitter pill to swallow, but it is so much better than $428,500 in future tax. They are now fully aware of these hidden tax liabilities (as the tax man patiently waits) and were very concerned about the level of death benefits tax the estate would be required to pay.

Reducing Death Benefits Tax

They were however pleasantly surprised to learn that the payment of death benefits tax can be reduced in certain circumstances.

Once we had mitigated the future Untaxed Component tax liability and commenced two tax-free Account Based Pensions, we recommended to eliminate future death benefits taxes via a series of "cash-out and recontribution" strategies.

This action of cashing out the taxable components and recontributing them between the couple (as outlined in this previous Eureka article) will have the effect of removing future tax liability.

At the end of the process, my clients will have two 'tax free' Account Based pensions, ie, 100 per cent investment and income tax exempt, without future death benefits tax liability.

Future Strategies

My clients are also now aware that should they be concerned about future changes, some of which have been telegraphed but yet to be confirmed by the federal government, they still have the option to transfer excess super to the superannuation accounts of their adult children (subject to the relevant contribution caps) provided they also retain enough within and outside of super for their own retirement income needs. This action could preserve the tax-free status of their retirement funds, as well as helping their children, very tax effectively, to boost their super.

When limits on the amount which can be retained in the superannuation environment are exceeded, "tax-paid" insurance bonds also present another option to grow and protect wealth.

Designed to Dwindle

A point which many people in the drawdown phase of superannuation fail to grasp is that Australia's system is designed to run down our retirement funds.

Starting at a minimum annual drawdown of 4 per cent and increasing progressively to 16 per cent as we approach our 90s, this does not mean that money held in super needs to dissipate completely. A smart strategy, if available, might be to reinvest funds (potentially to age 75 under current rules) through the $110,000 per year NCC limit.

My tip for growing wealth, especially post age 45: Read widely on the topic in the financial press; seek, and follow, good retirement savings advice (including my mantra of "contributing to super, as soon as you can, as much as you can, for as long as you can."

Understanding your options will help to ensure that what the government does in the future will have minimum impact on your retirement plans.

Theo Marinis is Managing Director of Marinis Financial Group.

Disclaimer: Performance data quoted represents past performance and does not guarantee future results. The information in this article is general information only.It is not intended as financial advice and should not be relied upon as such. The information is not, nor is intended to be comprehensive or a substitute for professional advice on specific circumstances. Before making any decision in respect to a financial product, you should seek advice from an appropriately qualified professional on whether the information is appropriate for your particularneeds, financial situation and investment objectives. The information provided is correct at the time of its creation and may not be up to date; please contact Marinis Financial Group for the most up to date information.

Proudly

INVESTSMART

Financial Strategies (SA) Pty Ltd trading as Marinis Financial Group
T 08 8130 5130 | **F** 08 8331 9161 | **A** 49 Beulah Road, NORWOOD SA 5067
E admin@marinisgroup.com.au | **W** marinisgroup.com.au
ABN 54 083 005 930 5067 | **AFSL No:** 326403

Reproduced with the permission of InvestSMART

Disclaimer:

Performance data quoted represents past performance and does not guarantee future results.

The information in this article is general information only. It is not intended as financial advice and should not be relied upon as such. The information is not, nor is intended to be comprehensive or a substitute for professional advice on specific circumstances. Before making any decision in respect to a financial product, you should seek advice from an appropriately qualified professional on whether the information is appropriate for your particular needs, financial situation and investment objectives.

The information provided is correct at the time of its creation and may not be up to date; please contact Marinis Financial Group for the most up to date information.