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 This could provide for superannuation funds to be withdrawn when it becomes clear that life is approaching the final stage.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 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.

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