# Inheritance and inter-generational wealth transfer

## Theo Marinis discusses how parents can contribute to their children's super fund while also saving enough for their own retirement.

My friend Ray recently made the comment that should he receive an inheritance from his mother's future estate, he will probably just “flick it” to his three kids.

A nice idea, but there are a number of considerations.

Firstly, when the inevitable happens, can Ray and his partner Rose fit any of this money (likely to be in the vicinity of $500,000) into their individual $1.6 million superannuation Transfer Balance Caps?

Based on:

a) their current balances;

b) the fact that that their combined Transfer Balance Caps (TBCs) are $3.2 million; and

c) the government's claim that the TBC rules affect only four per cent of the population, it is highly probable that they will have capacity to add to their super.

If so, that consideration should be the first stop.

To explain my thinking, over his working life, Ray has earned above-average wages, but his super started late. At 63, he has accumulated $800,000 and Rose about half that (a combined total of $1.2m) and they own their $2m Sydney home. You would describe them as comfortable, not rich.

In retirement, they plan to draw an income of $60,000 per annum, which at an average stock market return puts them in the ‘magic pudding’ zone – drawing down five per cent per annum and, while under present conditions long term balanced fund performance is around seven per cent per annum, still being able to watch their capital grow annually by two per cent.

Of course, inflation, market corrections, economic and/or military shocks can change this scenario. The bottom line for Ray and Rose (and the rest of us) remains. Running out of money in retirement can be a very real prospect. Hence, my mantra “***you should contribute to super, as much as you can, as soon as you can, for as long as you can***”.

While encouraging my friends to each direct $250,000 to their super funds as a Non-Concessional Contribution (NCC), Ray feels that having $1.7m in super will be too much…“And what about my children?” he argues. I remind him that these are the children that he and Rose made sacrifices for to send to expensive schools, and who all now have high paying jobs.

I remind him too, that the extra $500,000 will give them an additional $25,000 per annum to spend in any way they choose and will still see it holding its own against inflation at the present rate of 1.9 per cent per annum.

It is my observation that giving kids (even ‘kidults’) too much money too soon, is unwise. As ‘Yaya’ (Grandma) used to say “‘money that comes easy, goes easy”. It runs the risk of being consumed by that all-important second holiday to Bali this year or the new car for the soon to be ex-son-in-law – to cite a few examples.

A far better approach would be to contribute, a little at a time (if you feel you must) directly to a super fund for your child or children.

As financial adviser and commentator Doug Turek points out, if an employer contributes $15,000 to your kid's super, you could tip in another $10,000 as Personal Concessional Contribution (PCC) for them. If claimed correctly (and there is a process which must be followed in the correct sequence to do so) this strategy could produce a tax benefit of $3,900* when they lodge their annual tax return. Under this scenario, their super will grow $8,500 NET, and over a long career, the compound interest benefits of this will be enormous (particularly if you do this every year)!

You will also have the satisfaction of delayed gratification – knowing the 'kidults' can't (generally) get their hands on the money, until they retire after age 60.

Drip feeding into retirement savings will help supercharge the funding of the last third of their lives but will not make the working phase too easy. Hopefully, the bigger refund cheques might even get them interested in this 'super thing' that's giving them some tax back each year – and we all love getting tax back!

If Ray's children were younger, still at school and working part-time, I would be recommending he makes extra payments of up to $1,000 in NCCs into their super fund. He should then get them to watch the federal government co-contribute $500 per annum. Note that again, there is a process to follow, (including the lodgement of an annual tax return, even they don't have to pay any tax, as the ATO uses this to track eligibility for payment of the Government Co Contribution).

This scenario provides a really teachable lesson in finance, the lodgement of tax returns and how free money from the Government can make life easier – when you have first worked for it. It also acts as a motivation to save.

Another of my friends has an 18-year-old with $1,540 in super after starting his first job last financial year ($1,000 from dad, $500 from the government and a $40 SG payment from his employer). His 25-year-old has $37,500 (despite just commencing their first, permanent, full-time employment in 2019) as a result of this approach, whilst they were studying and working part-time.

As I point out to Ray, he will not live forever. Nevertheless, as long as he and Rose stick to a reasonable lifestyle when they retire, their three children (hopefully by then in their 50s, in stable relationships and careers) will inherit a significant amount of money from their parents – and Ray and Rose will have a ball in their latter years.

Bear in mind too, that in Australia the retirement 'backstop' is the Age Pension. Nobody wants to receive it, but it beats starving. If Ray and Rose accidentally lived into their 90s, inflation has gone up and returns down, they may find themselves needing this backstop – however, if they have given money away to their children, (depending on the money that was gifted) they may not be eligible. Under the present rules 'gifting' greater than $30,000 over three years may impact on social security eligibility for five years after the gift has been made.

So, if Ray's mother decides her son and daughter-in-law should inherit, it is in their best interests of the wider family that the parents first (as we are advised to do in all the flight safety demonstrations) look after themselves.

Next, drip-feed via long term savings, into growing the wealth of the next generation. Then, take the time to teach the 'kidults' some easy financial lessons – which hopefully, will establish life-long saving habits.

**based on a marginal tax rate of 39 per cent for taxable income between $90,000- $180,000 per annum.*

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