Case Study

The Re-contributions Strategy

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The Re-contribution Strategy

As the name suggests a re-contribution strategy involves the withdrawal of your superannuation benefits and the contributing of these benefits back into your super fund. Why would you go about this process you may ask? The objective of the re-contribution strategy is to maximise the tax free component of your super income stream and/or your super death benefit.

When a super benefit is paid from a super fund, be it as a lump sum or income stream, the benefit will include both tax free and taxable components. The benefit will have the same proportion of components as the total value of the super fund. These components will determine how much tax will be paid upon accessing the super benefits.

Whilst an individual is under age 60, superannuation income streams are taxed. The taxable component of the income stream will be taxed at the individual's marginal tax rate less 15%. The re-contribution strategy aims to increase the tax free component of the income stream and hence reduce the amount of tax payable when drawing benefits from super.

Individuals who are aged 60 and over do not pay tax on super income streams regardless of the components. However, the re-contribution strategy can provide significant estate planning benefits for individuals aged 60 to 75. Should an individual pass away the taxable component of the benefit paid on death may incur tax if the beneficiary receiving the benefit is classified as a non-dependant for tax purposes. Again, the re-contribution strategy works by maximising the tax free component of any potential benefit paid on death.

Before commencing a re-contribution strategy it is important to consider the following issues:

- The ability to withdraw super benefits: Have you reached preservation age? Have you satisfied a condition of release?
- The ability to contribute funds back into super: Are you eligible to make personal non-concessional contributions? Should you be aged less than 65, the answer is yes, however if you are between 65 and 75 you must be gainfully employed for at least 40 hours in any 30 consecutive day period within the same financial year. It is also important to remember to remain inside the non-concessional contribution cap of $150,000 p.a., however it is possible to contribute up to $450,000 by 'bringing forward' your contributions for the following two financial years.

Case Study 1 – Income Stream

As at the 1st of July 2013, Michael (age 56) has $500,000 in his superannuation fund, which consists of the following components:

- Tax free components: $175,000 (35%)
- Taxable components: $325,000 (65%)

Michael wishes to undertake a re-contribution strategy and commence an account based pension after applying the strategy. Michael has never received any prior super benefits. In order to withdraw a taxable component of his super benefit up to the low rate cap ($160,000), he would be required to withdraw a total of $276,923 ($180,000 ÷ 65%) from his super fund.

Following the withdrawal, the total amount of $246,154 is re-contributed as a non-concessional contribution by bringing forward his non-concessional contributions for the next two financial years.

By applying the re-contribution strategy, Michael's tax free component has increased from $175,000 to $355,000, which now represents 71% of his super funds from which he can commence an income stream.

Case Study 2 – Death Benefit

Wilfred commences an account based pension with $100,000, consisting entirely of a taxable component.

Two years later Wilfred and his wife pass away. The balance of the account based pension is now $110,000 and will be paid out as a lump sum death benefit to their independent, adult daughter. As their daughter is not classified as a tax dependant, she will be taxed up to 15% (plus the 1.5% Medicare levy) on the death benefit. This equates to a tax bill of $18,150.

Wilfred may have been able to undertake a re-contribution strategy prior to commencing the income stream by going through the process of withdrawing the money from his super and re-contributing it back as a non-concessional contribution. This would have created a tax free component of $100,000 and the components of the death benefit would be received 100% tax free by the daughter, thus avoiding $18,150 in tax.

As can be seen from the examples above, the benefits of a re-contribution strategy are a reduction in tax on super income streams and/or death benefits paid to non-dependants, something that is certainly worthwhile considering. Should you require further information on the strategy and how it applies to you, please contact your adviser.

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