REVISITING CASH OUT RE-CONTRIBUTION STRATEGIES

by Anna Mirzoyan, Lifespan Compliance and Technical Officer

The recent changes introduced to superannuation contribution rules provide increased opportunities for cash out recontribution strategies. While the strategy aims to increase the tax-free portion of superannuation interest, there are important issues for financial advisers to consider. This article provides a summary of:

- the cash out re-contribution strategy;
- potential benefits;
- important points to consider before recommending the strategy.

What are the recent changes to superannuation contribution rules?

In February 2022, The Treasury Laws Amendment (Enhancing Superannuation Outcomes for Australians and Helping Australian Businesses Invest) Bill 2021 **(Bill)** passed both houses of Parliament and received Royal Assent. The key superannuation measures in this Bill for individuals aged between 67 and 75 include:

- Changing the work test requirement and extending the non-concessional contribution bring-forward rules effective 1 July 2022.

This means from 1 July 2022, individuals aged between 67 and 75[1] will be able to make non-concessional contributions to superannuation without having to meet the work test. These individuals will also be able to take advantage of the bring-forward arrangements and contribute up to $330,000 to superannuation in a single financial year (subject to their Total Superannuation Balance being below $1.48m on prior 30 June).

This change may open planning opportunities for older Australians including being able to cash out and re-contribute to super and ability to make non-concessional contributions post-age 67 without having to meet the work test.

Cash out re-contribution strategy

The cash out re-contribution strategy involves withdrawing some or all of the superannuation interest and re-contributing the amount as a non-concessional contribution. The amount withdrawn from superannuation is paid to the individual in accordance with proportioning rules, which is in proportion to existing taxable and tax-free components. When re-contributed to superannuation, the amount is allocated to the tax-free component of superannuation interest.

[1] Amounts contributed must be received no later than 28 days after the end of month in which they turned 75.

As such, the strategy may potentially convert some or all of the taxable component into a tax-free component. Ultimately, this may result in reduced tax payable if superannuation death benefits are paid to non-tax dependent beneficiaries (eg adult non-dependent children).

Potential benefits of cash out re-contribution strategy

Benefits of the strategy include:

- Increase in the tax-free component of superannuation interest.
- Reduction in tax paid by non-dependent beneficiaries in the event of death.
- If aged between preservation age and age 60, increase in tax-free component resulting in paying less tax on pension payments made prior to age 60.
- Depending on income and other eligibility requirements, once the contribution is made the individual may qualify for Government co-contribution of up to $500.
- Equalising superannuation balances for couples where the amount is withdrawn from one person’s superannuation and contributed into the other person’s superannuation account. By doing so, each person may be able to better manage their individual Transfer Balance Caps or Total Superannuation Balances. This may provide an opportunity to transfer more amount to pension or to make additional superannuation contributions.
- Similarly, where one spouse is younger than the other, by withdrawing an amount from the older person’s superannuation and contributing to the younger person’s superannuation account, the couple may be able to access additional social security benefits while the younger person is below age pension age.

Case study

Stephen (aged 74, turning age 75 in August 2022) has $500,000 in superannuation. The amount consists of 70% taxable ($350,000) and 30% tax-free ($150,000) components. Stephen retired 5 years ago and hasn’t been able to make personal superannuation contributions since, due to not being able to meet the work test. He is single, with no financial dependents.

Stephen has made a superannuation death benefit nomination to his non-dependent son, Matthew. If Stephen was to pass away, Matthew would receive the superannuation death benefit payment as a lump sum. When the lump sum is paid, the tax-free component of $150,000 would be paid to Matthew free of tax. However, he would pay 17% ($59,500) in tax and Medicare levy combined on the amount of $350,000 paid from the taxable component.

If Stephen implements a cash out re-contribution strategy of $330,000, he could potentially reduce Matthew’s tax liability from $59,500 to $20,230.

The strategy must be implemented between 1 July 2022 and 28 September 2022. This is because Stephen is turning age 75 in August 2022 and as such, he is able to make the contribution within 28 days after the end of the month in which he turned 75. This makes the deadline for Stephen’s contribution the 28th of September 2022.

When the lump sum of $330,000 is withdrawn from Stephen's superannuation, the amount will be paid in the same proportion as current components, that being 70% from the taxable component and 30% from the tax-free component.

When the same amount is contributed back to Stephen's superannuation, it will be added to the tax-free component. By implementing the strategy before turning age 75, Stephen will be able to reduce the taxable component and increase the tax-free component of his superannuation interest as follows:

Stephen	Taxable component	Tax-free component	Tax payable upon Stephen's death (incl. Medicare levy)
Superannuation balance	$350,000 (70%)	$150,000 (30%)	*$59,500* ($350,000@ 17%)
Super balance	$500,000		
Lump sum withdrawal of $330,000 paid in 70/30 proportion (July 2022)	$231,000 (70% of $330,000)	$99,000 (30% of $330,000)	
Total withdrawn	$330,000		
Tax components after the withdrawal	$119,000 ($350,000 less $231,000)	$51,000 ($150,000 less $99,000)	
Super balance after the withdrawal	$170,000		
Re-contribution of $330,000	$0	$330,000	
Total re-contributed	$330,000		
Super balance after the re-contribution	$119,000 (23.8%)	$381,000 (76.2%)	*$20,230* ($119,000 @ 17%)
Super balance	$500,000		

Important considerations

When recommending the cash out re-contribution strategy to your clients, be aware of the following important points.

<u>When withdrawing lump sum amounts:</u>

- Ensure one of the specified conditions of release is met.
- If the client made personal contributions to super for which they wish to claim a tax deduction, the Notice of Intent form must be submitted and acknowledged by the superannuation trustee before the lump sum is withdrawn. Otherwise, the client may not be able to claim the full deduction.

- If making a full withdrawal, be aware of any existing insurances held within superannuation and potential loss of the 'Retirement bonus'.
- The tax components cannot be separated. The amount withdrawn will be paid in proportion of taxable and tax-free components.
- If below age 60, any amount withdrawn from the taxable component is included in the individual's assessable income. For individuals aged between the preservation age and age 60, the low rate cap[2] will be applied. No tax will be deducted from the amount being withdrawn from the taxable component up to the cap. Amounts withdrawn above the low rate cap are taxed at 17% including Medicare levy.
- For individuals between the preservation age and age 60, although no tax will be paid on the amount withdrawn within the low rate cap, the withdrawal may impact other payments and benefits including child support liabilities, certain Government benefits, and concessions[3] .
- For SMSF members a journal entry is not sufficient. The amount must be withdrawn from the SMSF and paid to the member's personal bank account. If multiple superannuation interests exist, it may be more tax effective to withdraw the amount from the interest with the higher taxable component.
- Transaction costs such as buy/sell spreads may apply.
- Time out of the market during the implementation process.

<u>When re-contributing the amount to superannuation:</u>

- For individuals turning age 75, amounts contributed must be received no later than 28 days after the end of the month in which they turned 75.
- The amount withdrawn can be contributed to the same superannuation account or another superannuation account for the same individual.
- The amount withdrawn can also be contributed to the spouse's superannuation instead.
- Amount contributed will be preserved until one of the conditions of release is met.
- If amounts contributed are retained in the accumulation account, future earnings will be added to the taxable component. Before fully utilising the bring forward amount, consider future contributions. If the bring-forward is fully used in a single year, the individual will not be able to make additional non-concessional contributions in year 2 or year 3.
- If the bring-forward rule was triggered in previous years but not fully utilised, the non-concessional cap available to the individual may be less than the full cap of $330,000.
- Amount contributed in excess of the available cap will be assessed as an excess contribution.

---

[2] The low rate cap is the lifetime limit set on the amount of taxable component of superannuation lump sum that can be paid free of tax. The cap applies to individuals aged between the preservation age and age 60 and is $225,000 for the 2021/22 income year. The cap is indexed in line with AWOTE, in increments of $5,000.

[3] Including Carer Allowance, Family Tax Benefits, Parental leave pay, HELP repayments, certain tax offsets.

- Check the Total Superannuation Balance[4] (TSB) on prior 30 June. If the TSB on prior 30 June exceeded $1.7 million, the individual is not eligible to make non-concessional contributions in that income year. As such, there will be no benefit in cashing out the amount from super.

- To be able to utilise the bring-forward cap in full (that being $330,000), the TSB on prior 30 June must be below $1.48 million. When the TSB on prior 30 June was between $1.48 and $1.7 million, the available cap will reduce as follows:

TSB on prior 30 June	Non-concessional cap amount
< $1.48 million	$330,000
$1.48 million to < $1.59 million	$220,000
$1.59 million to < $1.7 million	$110,000
$1.7 million and above	$0

Conclusion

These recent changes to superannuation contribution rules have been welcomed by the industry. Although the new arrangements will be effective from 1 July 2022, advisers may start planning now and exploring new opportunities for clients going forward.

ADVISER USE ONLY - Please contact the Lifespan Compliance and Technical team if you have any questions about cash out re-contribution strategies or if you wish to discuss a particular scenario for your client.

[4] Total Superannuation Balance includes accumulation accounts, transition to retirement pensions, retirement income streams, rollovers in transit between superannuation funds on 30 June and certain Limited Recourse Borrowing Arrangement amounts. It does not include personal injury or structured settlement contributions made in the past.

Lifespan Financial Planning Pty Ltd ABN 23 065 921 735 Australian Financial Services Licence Number 229892
Head Office Level 23, 25 Bligh Street, Sydney • PO Box R686 Royal Exchange Sydney NSW 1225 • Tel: 02 9252 2000 • Fax: 02 9252 2330 • www.lifespanfp.com.au