Recontribution strategy to reduce tax

SMSF members over 60 should work out whether they can benefit from a recontribution strategy. Advisers often use it as an estate-planning tool to reduce "death duties" for non-dependent children by increasing the tax-free portion of your super. The strategy converts the taxable component into a tax-free component, reducing beneficiaries' tax liability.

It involves drawing down a lump sum or pension income and recontributing it to your SMSF as a non-concessional contribution. To be eligible you need to be 60 or more and, if you draw down a lump sum, have ceased a work arrangement but not necessarily have permanently retired.

"The recontribution strategy occurs when you are eligible to take money out of super and put money back in. So you are in pension mode and accumulation mode at the same time," says Claire Mackay, SMSF adviser with Quantum Financial.

"Under the current rules, income and earnings are tax free in pension mode as opposed to being taxed at the 15% rate in the accumulation phase. You have to take money out [the minimum drawdown] but, if you don't need it, you can recontribute it back into super if you are under 65 or are over 65 and meet the work test.

“When you recontribute, it goes in as a non-concessional contribution. Your pension might be a mix of concessional and non-concessional components and putting it back in as a non-concessional contribution changes the treatment of the money that goes to your estate.”

However, there are rules and limits, warns Laura Menschik, SMSF adviser at WLM Financial. “If you are retired and over 60 you can take out as much as you like via a lump sum or a pension. But there are restrictions on getting it back into super, depending on your age.

“If you are under 65, you can still contribute to super at any time. But if you are over 65 and take a lot out, you don’t have the opportunity to put it back in unless you meet the work test. You have work at least 40 hours in 30 consecutive days in that financial year.”

Currently, the non-concessional contribution cap is $180,000 a year. Under the pull-forward rule, those under 65 can bring forward up to two future years’ entitlements, or $540,000. Those over 65 cannot use the pull-forward rule.

“Some clients are lucky enough and do take out a large pension and don’t need all of it because they have other assets outside super. They might have rental properties or still be working and don’t need the money and can recontribute it knowing they can take it out quite easily whenever they need it,” says Menschik.

She recommends good record-keeping. “Members have to notify the trustees – themselves – that they’ve made a contribution and whether it’s concessional or non-concessional. If you’re paying an accountant or administrator and they keep coming back with queries, it will cost more.”

The strategy can be easier in an SMSF. “Instead of dealing with lots of forms and a large organisation, with an SMSF you are dealing with yourself and paperwork you can control,” says Mackay.

Finally, to avoid falling foul of the rules it’s best to seek expert advice and check whether the benefits stack up.

Vita Palelstrant was editor of the Money section of The Sydney Morning Herald and The Age.