Just what is a re-contribution strategy?

You may have heard about a ‘re-contribution strategy’, but do you really know what it is and how it works? Often when an adviser or accountant provides an idea that will reduce a tax liability, you accept it without really knowing how it is achieved. That’s what you pay them for – right!

Let me explain what a re-contribution strategy is.

Who is eligible?

A re-contribution strategy is where you withdraw money from your SMSF and re-contribute the money back into your SMSF. Before you can do this, you need to be able to access your money by satisfying one of the following conditions of release:

- reached your preservation age (55 to 60 years) and retired from your employment
- reached age 65 (working or not)
- ceased work temporarily as a result of physical and/or mental illness
- ceased work as a result of permanent incapacity
- experienced a terminal medical condition
- accessed money under severe financial hardship grounds
- accessed money under compassionate grounds via the Department of Human Services
- accessed money under the transition to retirement arrangements.

Of course it is unlikely that a person accessing their money under financial hardship or compassionate grounds would be considering a re-contribution strategy.

If you access money in your SMSF without satisfying at least one of the conditions of release, then you will be in trouble with the Australian Taxation Office which regulates SMSFs.

Why bother?

The two main reasons why advisers may suggest a re-contribution strategy is to:

1. Reduce the tax payable on your superannuation pension, especially if you are under the age of 60
2. Lower the tax payable on benefits paid to your beneficiaries in the event of your death.

Money in your SMSF is comprised of two components. One component is the tax-free component which is made up of non-concessional contributions received by your SMSF. The other component is the taxable component which is made up of concessional contributions received by your SMSF and earnings from SMSF investments. Under the superannuation and income tax laws, superannuation benefits (pension and lump sum) paid to you are subject to a proportion rule which requires your benefit to be paid in the same proportion as the tax-free and taxable components of your superannuation interest in your SMSF.

For example, if your SMSF is comprised of a 60% taxable component and a 40% tax-free component, then your superannuation benefit, when paid out, must retain the 60% taxable component and the 40% tax-free component.

A withdrawal and re-contribution strategy involves withdrawing or accessing your superannuation entitlements that consist of the taxable and tax-fee components and re-contributing some or all of the money back into your SMSF as a non-concessional contribution (i.e. all tax-free). This increases the amount of tax-free money in your superannuation account which provides tax savings if you are accessing a pension while under the age of 60. It may also mean large tax savings when you pass on your superannuation savings to your non-dependant beneficiaries after your death.

This is because the taxable component of a pension benefit received by a person under the age of 60 is taxed at the person's marginal tax rate less a 15% tax offset. Converting the taxable component to a tax-free component increases your tax-free pension income.

When you pass away, your beneficiaries who are over the age of 18 or are non-dependant will also receive a greater portion of your death benefit without having to pay tax.

Watch that you don't exceed your non-concessional contributions cap. In addition, if you are aged 65 to 74 you will need to be at least working 40 hours in a period of 30 consecutive days to be able to make non-concessional contributions into your superannuation fund.

It pays to understand how things work so you can better discuss with your adviser.

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