

TechNews - Recontribution Strategy vs. Anti-Detriment Payments

With the advent of the Simple Super legislation amendments on 1st of July, 2007, the need to implement a recontribution strategy to reduce income tax in retirement has been nullified by tax-free income and benefits for those aged 60 and over. From an income tax perspective, the recontribution strategy still provides benefits to those aged between preservation age and age 60. However, this is not to say that the recontribution strategy is not beneficial for those aged 60 and over. Advisers still need to consider the implications of this strategy from an estate planning perspective.

Superannuation death benefits paid to dependants are tax-free, however, with spouses predeceasing each other and children growing up, the actual beneficiary may well be a non-dependant. Using a recontribution strategy to maximise the untaxed component may prevent this potential outcome. On the flip side, such a strategy may actually reduce the potential net benefit paid to a dependant beneficiary.

Unfortunately, little in life is easy, especially when it comes to estate planning. This Tech News compares the effect of implementing a Recontribution Strategy, looking at the benefits and pitfalls of enhancing the untaxed component for estate planning purposes.

Recontribution and Anti-detriment – An inverse relationship

The recontribution strategy effectively replaces the taxable component of your superannuation balance with untaxed component. It involves withdrawing a lump sum, paying any benefits tax, and recontributing back into superannuation. Of course, by withdrawing super from the fund below age 60, you will be able to receive only the first \$145,000 of the taxable component at a concessional tax rate (as per the 2008/9 Low Rate Cap).

The other major consideration is the ability to recontribute. The contribution caps restrict the amount of contributions you can make back into superannuation. The non-concessional contribution is \$150,000 per year, with an averaging provision of \$450,000 over any three years for those under the age of 65. For those aged 65 to 74 on 1 July of the financial year, the non-concessional cap of \$150,000 only applies.

Withdrawing a lump sum must also be done in proportion to your available components, which means that with every subsequent withdrawal, you will inevitably be withdrawing a portion of the tax free component you have already re-contributed into super, unless you are contributing the lump sum into a new account.

Another very important but commonly overlooked consideration when undertaking a recontribution strategy for your client is any potential anti-detriment payments your client may be entitled to.

An anti-detriment payment is effectively a refund of contributions tax paid by the deceased during the accumulation phase. It is an additional payment that may be available if the benefit is paid as a lump sum to an eligible dependant (as defined by Section 295(485) of the Income Tax Assessment Act 1997 (ITAA97)).

Section 295-485 provides a test for determining the anti-detriment amount payable. The ATO has approved a number of alternative means for calculating the tax saving amount. A fund may calculate the tax saving amount by working out the actual total contributions tax paid by the deceased member via an auditor, or it may use one of two approved formulas under section 279D,

and subsequent ATO Interpretative Decision ATO ID 2007/219. In their simplest form, both formulas essentially provide a 17.65% uplift to the death benefit where the deceased's eligible service period is post June 1988.

As you may have determined already, the anti-detriment amount is calculated using the total taxable component of the benefit. Therefore, a reduction in the taxable component by employing the retribution strategy will effectively reduce the maximum anti-detriment payment.

What defines an eligible dependant?

Section 295(485) of the Income Tax Assessment Act 1997 defines an eligible beneficiary for the purposes of the anti-detriment payment as:

- An individual who is a spouse, former spouse or child (of any age) of the member; or
- The deceased member’s estate if it pays the death benefit to a spouse, former spouse or child (of any age) of the member.

This differs from the definition of a death benefits dependant for tax purposes in that a child does not need to be a dependant or a minor in order to be eligible for the anti-detriment benefit. The main differences are summarised below:

Table 1: Tax and Anti-detriment dependant definitions differ

Results	Death benefits dependant	Anti-detriment dependant
Spouse, de facto, or partner from previous marriage	Yes	Yes
Child under 18 (including step children and ex nuptial)	Yes	Yes
Child (as per above) over 18	No	Yes
Dependant	Yes	No
Interdependency relationship	Yes	No

What is immediately apparent is that adult children (children over 18) are not able to receive a death benefit tax free, but are still considered dependants for anti-detriment payments. This means that further investigation needs to take place in order to determine whether any tax savings obtained by undertaking the retribution strategy outweighs any potential anti-detriment payments that your client may be forfeiting.

Case Study – Effect of implementing a retribution strategy on death benefits paid to dependants and non-dependants

Joe is retired and has \$400,000 in super. He is 60 years old and his total super balance consists entirely of taxable component. We have not considered any potential insurance payouts for the purposes of this example.

Joe has stated that upon death, he wishes his total benefit to be paid to his financially independent adult daughter, Jane. If Joe had undertaken the retribution strategy, he would be able to save Jane 16.5% tax (including Medicare levy) on benefits paid to a non dependant. Assuming Joe’s fund does pay the anti detriment payment, there would be an anti-detriment payment of \$70,600.

Table 2: Effect of implementing a retribution strategy on death benefits paid to Non-dependants

	Retribution Strategy NOT Implemented	Retribution Strategy Implemented
Taxable component	\$400,000	Nil
Tax free component	Nil	\$400,000
Anti-detriment payment	\$70,600	Nil
Tax paid by Jane	\$77,649	Nil
Total benefit	\$392,951	\$400,000

As highlighted in Table 2 above, by implementing the Reconstitution Strategy, Jane does not receive any anti-detriment payment, but the income tax savings means that the total benefit paid is \$7,049 greater than if the Reconstitution Strategy had not been implemented.

However, in contrast, if Joe’s wife Martha was to receive the total benefit, the reconstitution strategy would actually have a detrimental effect on the final paid benefit, as death benefits are paid to a spouse tax free regardless of components. This is can be seen in Table 3 where the total benefit is \$70,600 more where a Reconstitution Strategy is NOT implemented.

Table 2: Effect of implementing a retribution strategy on death benefits paid to Dependants

Results	No Reconstitution Strategy Applied	After Applying Reconstitution Strategy
Taxable component	\$400,000	Nil
Tax free component	Nil	\$400,000
Anti-detriment payment	\$70,600	Nil
Tax paid by Martha	Nil	Nil
Total benefit	\$470,600	\$400,000

Generally, the reconstitution strategy is worth considering if the benefit is likely to be paid to a non-dependent for tax purposes, such as an adult child. This is because the tax savings generally outweigh any potential anti-detriment payment they would otherwise receive. If the death benefit is being paid to dependants, it would be wise to consider any potential anti-detriment payments before implementing a Reconstitution Strategy.