The tax effective retirement trifecta

By Ryan Taylor, Super Fund Expert, VBD Chartered Accountants

Since 1 July 2007 we have had a large proportion of our self managed superannuation fund (SMSF) clients taking advantage of the change in rules that came under the Government's SimplerSuper regime. We like to refer to this as the 'tax effective retirement trifecta'. The three legs of the 'tax effective retirement trifecta' are as follows:1. If you are over age 60, the pension payments you receive from your SMSF will be tax free if they are paid from a taxed super source. This has been beneficial for all of our clients over the age of 60, especially as the tax free status of this pension applies regardless of how much income is derived from other sources, e.g. employment income, interest, dividends, etc. This has been a fantastic setup for our clients at the height of their income earning capability, as it enables them to access monies from superannuation without losing any of it to the ATO.2. The tax rate on the earnings of the investments used to fund the pension becomes 0%. This includes any interest, dividends, capital gains or any other income the assets may earn. This allows your SMSF to accumulate wealth, on the assets used to fund a pension, at 15% faster than it otherwise would have. 3. You do not have to change your SMSF investments when you start a pension. Depending on the investment strategy and the earnings capability of the fund, the act of rolling a fund into pension phase can potentially have no impact on the actual assets held in the fund. This can come about via the ability of the fund to have cash earnings greater than the pension amount to be taken out. Thus no assets need to be liquidated to fund the required pension.A great example of how the 'tax effective retirement trifecta' is working for one of our clients is as follows:FactsFred and Cheryl are both 60 years of age.They own a successful business in the Newcastle area.Currently they each contribute $9,000 into their SMSF, from their wage of $100,000 each. VBD have previously discussed the benefits of maximising their superannuation contributions as they approach retirement with Fred and Cheryl, however the business has always needed all of its cashflow to operate successfully. Fred and Cheryl's SMSF has currently has $800,000 in it. This is made up of various assets including property and shares. Its components are all from a taxed source.Fred and Cheryl came to VBD for suggestions to minimise their overall taxation obligation to allow them to free up some additional cash flow in their business.StrategyTo begin pensions for both from their SMSF. In their case, as they both still work full time, a transition to retirement pension would be appropriate as this would allow them to satisfy a condition of release.Their combined pension amount can be, in the 09/10 tax year, between $16,000 and $80,000 jointly. The pension amount drawn from the SMSF can be deposited into their business. This can then be withdrawn from the business and contributed back into the SMSF as a concessional contribution (tax deductible) for Fred and Cheryl. Net result If the maximum pension of $80,000 was taken from the SMSF and then re-contributed back into the it, the tax consequence would be as follows:The SMSF would pay an additional $12,000 tax on the contributions in the 09/10 tax year.The business would save $24,000 tax in the 09/10 year.Based on the fund earning approximately 5% per annum earnings on its pension assets, the fund would save $6,000 in income tax in the 09/10 tax year.The total net tax saving for Fred and Cheryl in the 09/10 tax year would be $18,000.The only cashflow short fall would be $6,000 in the SMSF.No tax would be payable on the pension drawn from the SMSF.For more information, contact VBD Chartered Accountants on 1300 VBD 123

Contacts

Katrina Lees
0249438112
mailto: katrinal@vbd.com.au