Grow @ Marinis Group

From: Grow | Marinis Group
Sent: Friday, 4 May 2018 10:39 AM
To: Alex Wiedenmann | Marinis Group
Subject: You don't know what you don't know
Attachments: Strategy details _ eGrow.pdf

Dear Friends,

<u>We don't know what we don't know</u> – with a nod to Donald (Rumsfeld)

There are times when I reflect on how things might be if there wasn't the need for my job.

In a perfect world there would be overarching government systems in place to simplify retirement, without the need for financial 'sherpas'. But that's not going to happen.

Just how clunky our current system has become was reinforced when a much-loved client shared the news that she needed a heart transplant. In my role I am often privileged to have an insight into people's lives, but this revelation came as a shock.

As a long-term client, I knew her financial affairs well. Planning on living on her pension as a retired public servant, with the benefit of a few external assets, she had come to see me for a regular financial check-up.

At around age 53, she had taken a public service redundancy benefit. My advice at the time was to live on this benefit in the intervening period, and take the genuine '54/11' option when she turned 55.

Then came the devastating news; aged 55, she was seriously ill. Fortunately, due to some considerable experience in the area of public sector superannuation, I was able to advise her that she was still eligible, under the CSS "54/11" rules, to change her retirement categorisation to an 'invalidity' claim. After exhaustive paperwork and even more doctors' visits, her invalidity claim was finally approved.

This approval opened the door to a significant change in the tax treatment of her retirement benefit. Her "54/11" Defined Benefit pension was now substantially higher even than the normally generous "54/11" pension.

Based on retirement due to invalidity, my client's CSS defined benefit lump sum commutation was also much more favourably assessed, with the Tax-Free Component now approximating 50%.

Similarly, the 'invalidity' account based pension we implemented on her behalf with part of her CSS lump sum commutation was also more favourably assessed for tax purposes, despite the fact that she has not yet attained her 'Preservation Age'.

If you would like to view the specific strategy details, please see attached document.

This outcome will fundamentally change her retirement.

Of course, my client didn't know she was entitled to these benefits. She didn't even know to ask the questions.

I hope and pray she receives the transplant and that all goes well. I can't do the surgery, but I can help her to access her financial rights so that her recovery and future life is without money worries.

We are now working together to also make sure her estate is placed in the best possible position. There are complexities, as a previous relationship has ended and there are children involved, but together we believe we have come up with a fair and responsible approach which avoids most of the normal estate planning pitfalls.

Most people don't realise, for example, that 'Death Benefits Tax' is essentially optional. A simple administrative change can save almost 20% of unused super being paid to the government.

Similarly, most people are unaware of the benefits of saving for a first home via super, putting as much as they can (subject to annual limits set by the government) for as long as they can, into their retirement kitty... or that sometimes buying a better home can make them eligible for an aged pension.

So, I 'sort of' get what Donald Rumsfeld (former US Secretary of Defence) meant when he said:

"There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns — the ones we don't know we don't know. And if one looks throughout the history .... it is the latter category that tend to be the difficult ones."

My role as a financial 'sherpa' is to help carry the burden of the 'known unknowns'. I am the one who should be lying awake worrying about the markets, the legislation, and the constant changes to superannuation and taxation laws.

That's why I'm here.

And one more thing:

I'm beginning to see signs of the possible reawakening of the 'inflation dragon,' which is a little scary, particularly for those of us invested in bonds – usually the defensive part of any well-constructed portfolio.

The Reserve Bank of Australia aims to keep inflation 'caged' between 2 and 3 per cent, but once every generation or so it tends to break out....and once out....the inflation dragon is not easily restrained!

The only real way to slay inflation is to increase interest rates... and the net effect of this is a short term burn on the entire economy. Now that is scary!

Those of us old enough to remember 1994 will recognise that periodically, both the bond market and the share market can experience negative returns at the same time.

Will the inflation dragon get to 1994's levels? I think not. Could inflation rise more than expected by most? Very possibly. If it does, there will be short term trauma in the Australian economy.

Having said that, 1994 was a tough year, but the decade of the 1990s saw robust returns for medium to long term investors. Whilst BOTH bond and share markets took a hit in 1994, they soon rebounded.

As I always say, stick to your strategy – and don't panic!

Of course, if you would like to speak with me or any of the staff about your personal situation, please don't hesitate to call us on (08) 8130 5130.

(And for those who are interested, you can see my latest media commentary **here**.)

Kind Regards,

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STRATEGY WORKING PAPER

Strategy 1		
Standard (NON INVALIDITY) CSS "54/11" basic pension & lump sum @ 55		
CSS basic retirement pension (before tax)		**$72,041**
Lump sum benefit (including tax & preservation rules):		
CSS lump sum commutation	$430,000	
Lump sum taxable component	73.0%	
Preserved component (until age 58)	67.5%	
Tax rate on withdrawal of unpreserved component	20.0%	
Personal concessional super contributions	$0	
Tax on Super Fund earnings	$3,870	
Annual after tax income (CSS basic pension after personal tax)		**$55,641**

Alternative (recommended) Strategy		
INVALIDITY CSS "54/11" basic pension and lump sum		
CSS basic invalidity pension (before tax)		**$84,099**
Lump sum benefit (including tax & preservation rules):		
CSS lump sum commutation (includes ABP $200,000)	$430,000	
Lump sum taxable component	50.0%	
Preserved component (100% non-preserved)	0.0%	
Tax rate on withdrawals prior to preservation age	10.0%	
Personal concessional super contributions	$25,000	
Tax on Super Fund earnings (less ABP tax saving $1,800)	$2,070	
Total annual after tax income (including min ABP income):		**$63,407**

Strategy 1

— Retirement on the standard (NON INVALIDITY) CSS "54/11" basic pension and lump sum at 55 equates to eligibility for a gross defined benefit pension of $72,041 pa. (Net pension after Tax and Medicare levy of approximately $16,400 pa = $55,641 pa).
Not a bad outcome, and one which would have provided in excess of the client's required net income of $50,000 pa in retirement.

— The $430,000 CSS lump sum CSS commutation produces a taxable component of approximately 73% and a 'Preserved' component of approximately 67.5% as at age 55, this client is still three years from her preservation age of 58.

— Any lump sum withdrawal of her non-preserved funds would be taxed at 20% on the taxable portion till age 58, resulting in funds being FULLY rolled over in super till age 58 to defer any excess personal lump sum tax.

— This $430,000 super benefit is taxed at the rate of 15% on earnings within the fund (ie $430,000 x 6% pa x 15% = $3,870). Total tax under this strategy is $20,270 pa ($16,400 personal tax + super fund earnings tax $3,870).

Alternative (recommended) strategy

— By applying and qualifying for the INVALIDITY CSS "54/11" basic pension and lump sum, the annual GROSS CSS pension is now $84,099 (producing additional gross annual income of $12,058).

— The CSS lump sum commutation of $430,000 is 'triggered' on the grounds of the invalidity, and is NOW 100% Non-preserved, thus FULLY accessible. (This accessibility affords additional flexibility to diversify the retirement income strategy, as outlined below).

- The invalidity component changes the tax-free component from 27% to 50%. Any lump sum withdrawals (if required) now will only be 50% taxable at 20% tax (prior to preservation age) thus reducing lump sum tax to approximately 10%.
- This ability to access the CSS lump sum benefit in full allows flexibility to roll over $200,000 of the available Lump Sum to a VERY tax effective Account Based Pension (this amount calculated to ensure that the $1.6 Mill Transfer Balance Cap rules are not exceeded after taking into account the current CSS Basic Pension).
- Taxable income is able to be further offset by Personal Concessional Contributions to super.

Benefits of the recommended strategy:

- After allowing for concessional superannuation contributions of $25,000, NET annual income is now $63,407 – equating to 11.3% or $7,766 pa higher NET income than in the normal (NON INVALIDITY) CSS "54/11" retirement scenario. (NOTE: this is inclusive of NET personal $6,870 tax savings)
- There are now savings on ABP/super earnings tax due to the ability to commence a <u>tax-free</u> account based pension ($200,000 x 6% pa x 15%) = $1,800.
- Estimated total super and ABP fees saved v CSS total fees ($430,000 x 0.5% pa) $2,150 pa (Based on the fees on a Balanced CSS account versus the fees on the final recommended super and pension accounts).
- TOTAL annual strategy benefits are $11,717 (approximately $9,567 pa being personal and super fund tax savings)
- Based on 'retirement due to invalidity' the tax-free component on 'rolled over' super benefit is now is 50% NOT 27% as in normal retirement. Thus an extra $98,900 of the $430,000 lump sum is NOW a Tax Free Component – representing a potential lump sum tax saving of $16,813 (based on the lower post preservation age lump sum tax rate of 17%).