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Revisit your Strategy

There is no such thing as a 'set-and-forget' financial strategy which will keep you winning on all fronts. Subscribers to this philosophy risk are missing considerable opportunities.

Life changing events such as children, a new partner, the loss of a partner (through death or divorce) and downsizing a home, all present different considerations, and opportunities. Unfortunately, the 'spaghetti junction' of Superannuation, Retirement Income and Social Security legislation does not lend itself to making strategic decisions which are informed, or timely.

As a case in point, self-managed superannuation funds which were established at a time when legislative conditions were more favourable, have in many cases, become expensive and complex vehicles for managing retirement investments, particularly as their members age.

Many people also believe, based on former Treasurer Costello's 2006/07 comments, that all superannuation is tax free after age 60. Whilst withdrawals from super are tax-free, superannuation accumulation accounts and their earnings are not.

They continue to pay tax at 15% on fund earnings, plus tax on realised capital gains (10% if the fund held the asset for more than twelve months, 15% if the asset was held for less). This tax is offset by imputation credits, usually at the 30% company tax rate. As a result, super funds often receive part of the fund imputation credits as a refund, but only after the ATO keeps part of the imputation credits available to the fund.

Only when superannuation is converted from accumulation to pension phase does the fund pay no tax on earnings – and no CGT – with 100% of all imputation credits refunded.

The following examples highlight the importance of choosing the next (and best) strategy when it is time to change.

The first of these began with the process (at the client's request) of winding up a single member SMSF with an approximate balance of $1.577 million, the objective being to achieve lower costs, and a less time-consuming alternative.

My well-informed client, who retired from full time work in September 2022 at age 68, recognised that a change from her SMSF strategy was required, but she was alarmed by the suggestion that she transfer the SMSF wind-up proceeds to an account-based pension (ABP) to save super fund tax. She plans to return to work, and given her skills and experience, will do so soon. She did not want to deplete her super balance by drawing income.

She was delighted to learn that she can still add funds to super, both as Concessional Contributions of up to $27,500 annually (provided her taxable income warrants this strategy) as well as Non-Concessional Contributions until she reaches the $1.7 million Total Super Balance (TSB) threshold. In addition, should she later decide to sell her home, she may also be eligible to make a 'Downsizer' contribution of up to $300,000 regardless of her TSB. She was, however, unaware that there were more cost-effective alternatives (with all the functionality of her SMSF – including imputation credit refunds back to her own account) than the industry fund she was considering.

Based on the latest Financial Statements, the annual cost of running her SMSF (including accounting and ATO costs but excluding her own management time costs) was $21,769, or approximately 1.37% pa. The alternative, a retail investment platform using professionally managed investment options, could be achieved at a total cost of $16,290 or 1.03% pa, a fee saving of $5,479 pa.

In addition, by transferring from accumulation to pension phase, the estimated tax saving within her retail ABP on income of $55,195 pa x 15% (the actual fund income in 2022, ignoring any CGT) would be $8,279 pa.

Combined with fee savings of $5,479 pa and tax savings of $8,279 pa, this strategy has produced total savings of $13,758 pa, as well as freedom from the administrative burden and trustee responsibilities involved with running an SMSF. As a result of being able to contribute excess employment income back to super, she is also able to draw tax-free ABP income, without significantly impacting on her retirement savings at this point.

Changing her SMSF strategy and taking the next (best) step has proved highly beneficial for this client.

The second example relates to a couple in their early 80s with $320,000 in their SMSF, invested predominantly in direct Australian shares, and an SMSF running cost of 1.43% pa. Their superannuation pensions were 'grandfathered' under Centrelink's income test rules; they also had a reverse mortgage debt of $30,000. They were referred by their friend and long-standing client, whose SMSF was wound up a few years ago. They were also seeking to wind up their SMSF due to the administrative burden, as they too, are getting older.

When this couple established their financial affairs, an SMSF was a cost-effective superannuation investment structure for many high-net-worth Australians. Unfortunately, as readers of Eureka would know better than most, politicians and public servants are inveterate meddlers – they appear to the layperson to be psychologically driven to tinker with superannuation laws.

In the past, there were Centrelink asset test exemptions, now there are none, the thresholds for Centrelink benefits have increased, the cost of investing in retail superannuation funds has plummeted, while the costs of running an SMSF have increased. For younger and more energetic retirees, keeping up with legislative change is manageable, but in most cases, this gets more difficult (and less interesting) as we age.

I recommended that this couple wind up their SMSF as requested, and with the proceeds, establish two retail ABPs fully invested, fully diversified, and fully managed, at a product cost of 0.77% pa. That change immediately dropped their outgoings by approximately $2,960 pa.

Transferring to two new ABPs meant that they would lose the grandfathered Centrelink income test assessment provided by their previous superannuation pensions, a step many Centrelink benefit recipients are often reluctant to take. Based on the amount of pension income they draw, however, under Centrelink's income deeming rules their combined Centrelink Age Pension entitlements increased by $6,622 pa.

That is a benefit of $9,582 pa achieved thus far.

Next, I recommended they pay off their reverse mortgage debt via a tax-free lump sum withdrawal from their existing ABP accounts, freeing up around $2,100 pa in costs.

Their strategy review resulted in $11,682 pa in benefits and savings, and a lot less worry. No debt and no SMSF!

Each year I do assist with the process of winding up SMSFs for clients for many of the reasons outlined above.

It is not only retirees, however, who should regularly revisit and review their financial strategy. An annual strategy review makes a lot of sense for us all.

Remember to seek expert advice from an independent source.

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