FUNDAMENTALLY SPEAKING

A simple explanation of the finance terms we all hear about but don't really understand

Put super out of taxman's reach when it's passed on

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Last week we looked at why it's critically important to understand the breakdown between the tax-free and taxable components of your superannuation.

Each component is taxed differently when inherited by the next generation.

It's your taxable component that has the inbuilt tax liability, with your adult children having to pay up to 17 per cent tax when they inherit it.

There are a number of strategies available to potentially reduce this liability. The most popular one is a re-contribution strategy.

The main purpose of the strategy is to convert some of your super fund's taxable component to tax-free. For every dollar that you can reduce your taxable component, you will potentially save your adult children 17¢ in tax.

There are a number of eligibility criteria that need to be met to be able to implement the strategy, including being able to access your super tax free and having a balance of less than $1.9 million.

The first step sees you withdraw a pension payment (or lump sum) from your super fund. If you are in pension phase this withdrawal will be tax free.

The second step is the "re-contribution" bit. You contribute the money that you just withdrew back into your fund. Technically speaking this is known as a non-concessional contribution.

Because it's non-concessional, it will now form part of your tax-free component. This means that when your adult children inherit it, they will do so tax free.

Although the strategy itself sounds fairly straightforward, it is an easy trip up, which is why it's really important that you seek out expert advice before proceeding.

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Illustration: Don Lindsay