Reducing Death Benefits Tax in Superannuation

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Superannuation law sets out who a death benefit is payable to, whilst taxation law sets out how a death benefit is taxed. Death benefit tax can apply if superannuation is paid to a non-tax dependant. This means that when adult children inherit your superannuation, they will likely have tax to pay. To reduce this potential liability, many consider the use of a re-contribution strategy.

The main purpose of this strategy is to increase the tax effectiveness of your super when it is inherited, resulting in more of your superannuation benefits passing to nominated beneficiaries. A tax rate of up to 17 per cent can be incurred as indicated below.

Components	Tax Rate if Passed to Tax Dependent	Tax Rate if Passed to Non-Tax Dependent
Taxable Component	**Nil**	**15%**
Tax-Free Component	**Nil**	**Nil**

**Plus 2% Medicare levy if applicable. Note that the Medicare Levy is payable where the lump sum death benefit is paid directly to a beneficiary, but isn't payable via a deceased estate.*

The tax liability depends on the underlying components of the super fund balance. Generally speaking, most funds are made up of 'taxable' and 'tax-free' components. The taxable component arises due to tax-effective contributions (such as employer and personal concessional contributions). The tax-free component arises due to personal after-tax contributions (including downsizer contributions). The taxable component is the portion that will attract the 17 per cent tax rate (15 per cent plus 2 per cent Medicare levy). The tax-free component is inherited tax free.

To undertake this strategy, an individual withdraws part of the super benefit and re-contributes that money back into the fund. When you put the funds back they go in as a non-concessional contribution (NCC) which forms part of the tax-free component. This means your adult children will pay no tax on the amount you re-contribute.

Importantly, when withdrawals are made from superannuation the amount is proportionally weighted with respect to their taxable and tax-free components.

Legislation changes that commenced back in July 2022 increase the flexibility around re-contribution strategies. People aged between 67 and 75 are able to make non-concessional concessional contributions to super without meeting the work test. This includes the three-year NCC bring-forward arrangement of up to $330,000 in a single financial year (subject to the Total Super Balance on June 30 of the previous financial year).

The work test presently only applies for 67-74-year olds who wish to claim a tax deduction relating to their personal super contributions.

Case Study

Ricardo (70) has $1,000,000 in super with a 60% taxable component and 40% tax-free component. As his spouse has previously passed away, his ultimate beneficiaries are now two adult children. Upon death, the children will receive the $400,000 tax-free component with no eventual tax, whilst the taxable component exhibits up to 17% tax payable.

Ricardo withdraws $330,000 from the member benefit and uses the funds to make a non-concessional contribution of $330,000 in the days that follow. This means that upon withdrawal, $198,000 comes out of the taxable component and $132,000 is taken from the tax-free component. The impact of this strategy is shown below as a death benefit tax saving of $33,660 is made.

	Amount Before Strategy	Amount After Strategy
Taxable Component	**$600,000**	**$402,000**
Tax-Free Component	**$400,000**	**$598,000**
Death Benefits Tax Payable	**$102,000**	**$68,340**

If you need to know more or wish to discuss your situation further, please contact your adviser.

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