Rules may change, but plan anyway

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Australians are going through yet another period when there is speculation about possible changes to superannuation. It seems government can't leave the super rules alone.

They are being tweaked on a regular basis. Modifications to the borrowing rules are the most recent example. There is also talk about contribution limits and the tax penalties that come with exceeding these limits.

One area of speculation is how long the $150,000 a year of non-concessional contribution entitlements will last, given the sharp reduction in tax concessional limits already introduced.

Against this backdrop there are plenty of people planning their retirement around the present limits. The only thing they can do is apply the current rules, says Meg Heffron, a principal with super adviser Heffrons.

Take the reader who is looking towards her and her husband retiring in five years when they are in their late 50s.

Her husband is earning a good income and they jointly own their home and have super between them worth $700,000 and another $200,000 in shares.

Their major focus is on an investment property valued at $800,000, bought in the late 1980s for $120,000. There will be a sizeable capital gains tax bill to pay when this property is sold, so the question is when to sell and contribute the proceeds to super.

Heffron says while her view is that tax should not drive major decisions such as when you stop work, if you have a major asset it can be a good idea to sell it after you have finished work.

This will ensure the taxable gain comes when there is little or no employment income to increase the tax bill.

As long as her husband then meets the test where no more than 10 per cent of his income during the year comes from employment, it will give him the opportunity to claim a personal tax deduction of $25,000 against the capital gains from the sale of the investment property.

The deduction will allow him to ever so slightly reduce the capital gains tax paid on the investment property.

Being under the age of 65, he could under the present rules contribute $450,000 of the property proceeds to super.

This amount is allowed under the entitlement those under 65 have – they can make three years' worth of contributions in one lump of $450,000.

Heffron says while there is no certainty that either the $150,000 non-concessional limit or the $450,000 entitlement will be around in five years, you still need to plan your retirement based on current law.

Planning based on the existing rules will allow you to canvass the various options that are available to you. For example, under present rules while her husband could contribute up to $450,000 after the sale of the property, non-concessional contributions could also be made into her super.

To minimise capital gains tax on an investment property, sell after you have finished work. Photo Andrew Quilty

Another idea is to borrow against the investment property the year before it's sold – say in June – and contribute $150,000 in that year. While the interest on this loan would not be tax deductible, it's a way of using the annual $150,000 after-tax contributions limit for the previous year that might not otherwise be available.

Borrow against the investment property the year before it's sold.

Once you make a full three-year bring-forward contribution, you have to wait three years before being entitled to make any further after-tax contributions.

The strategy of borrowing against an asset such as property that you could be selling is also available to anyone who is closer to retirement. It could be a hedge against any possible earlier changes to the non-concessional contribution rules for someone who is retiring earlier than five years from now.

As far as making contributions are concerned, Heffron says their age should give the couple time to make non-concessional contributions even if the limits are reduced. You can keep contributing to super until the age of 65.

Another planning consideration, Heffron says, is making use of entitlements to start super pensions. So long as you are 55, you can start a super pension before you retire and before the property is sold.

Starting a pension with the existing super balance before contributing the large non-concessional contribution amount from the property sale is a possible strategy. If an amount such as $450,000 is contributed after a pension begins, it could be used to start a second pension. And because this pension will come from after-tax contributions, it will be tax free under current rules.

Remember, even if certain changes are foreshadowed from sources such as the coming Henry review, it can often take years before they are implemented.