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Nine rules to guide you to die with zero

INSIDE

BY JAMES GRUBER

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In my broader family, an issue that's come up for recent discussion is about parents gifting their children money before they die instead of leaving it until after they die. As you can imagine, it's a thorny issue. The parents reflexively believe that the money should be given through inheritance after they pass away. The children, or at least some of them, think the money would be of more value if it were given to them before that time. To them, it would be more compassionate, and might also avoid any quarrelling between the children after their parents' deaths.

The issue doesn't make for pleasant dinner table conversation but it's one that's likely to be aired more often as Baby Boomers in Australia get older, die richer and leave behind larger bequests. The Productivity Commission says Boomers – those born between 1946

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and 1964 – are expected to pass on an estimated $224 billion each year in inheritance by 2050, a fourfold increase in bequests.

The question for many parents is whether to make their children wait for their inheritance or not. Today, we'll go through the pros and cons of the issue, as well as the legal and tax implications.

The nine rules

My family discussions on inheritance have coincided with the reading of a book by a former fund manager, Bill Perkins, called Die with Zero. As the title of the book implies, Perkins believes all of us should aim to die with nothing in our bank accounts.

Why? Because for him life is about having experiences rather than accumulating money:

"Those are two very different goals. Money is just a means to an end: Having money helps you to achieve the more important goal of enjoying your life. But trying to maximize money actually gets in the way of achieving the more important goal."

By aiming to die with zero, Perkins thinks you'll forever change your autopilot focus from earning and saving and maximizing your wealth to living the best life you possibly can:

"Why wait until your health and life energy have begun to wane? Rather than just focusing on saving up for a big pot full of money that you will most likely not be able to spend in your lifetime, live your life to the fullest now: Chase memorable life experiences, give money to your kids when they can best use it, donate money to charity while you're still alive. That's the way to live life."

Perkins outlines nine rules for achieving the aim of dying with zero:

Rule 1: Maximise your positive life experiences

Perkins reckons you should start thinking about the life experiences you'd like to have, and the number of times you'd like to have them. This will get you to focus on meaningful and memorable experiences:

"Unlike material possessions, which seem exciting at the beginning but then often depreciate quickly, experiences actually gain in value over time: They pay what I call a memory dividend."

Rule 2: Start investing in life experiences early

If life is the sum of your experiences, then everything that you do in life adds up to who you are. Yes, you'll need money to survive in retirement, but the main thing you'll be retiring on is your memories. Therefore, Perkins thinks you should invest in life experiences, and start as early as you can.

Rule 3: Aim to die with zero

Perkins says that though you may not succeed in dying with zero, that should be your goal:

"People who save tend to save too much for too late in their lives. They are depriving themselves now just to care for a much, much older future self—a future self that may never live long enough to enjoy that money."

Rule 4: Use all available tools to help you die with zero

Perkins addresses the fears of many people that they'll run out of money before they die. He thinks if that's a concern for you, then you need to investigate various tools including annuities – financial products that offer a guaranteed income stream.

He suggests that the other, more important part of the equation is how not to waste your life energy by underspending.

Rule 5: Give money to your children or to charity when it has the most impact

Perkins says the peak utility for money – the time when it can bring optimal usefulness or enjoyment – is around 30 years of age. Yet, the average age for inheriting money is close to age 60 for Americans and 50 in Australia (though most receive it between ages 55 and 59):

"Putting your kids first means you give to them much earlier, and you make a deliberate plan to make sure what you have for your children reaches them when it will make the most impact."

Rule 6: Don't live your life on autopilot

Perkins isn't saying that you shouldn't save for the future. Instead, he's saying that it needs to be balanced with spending on the present.

He makes a good point that many experiences depend on your physical health. If you've been biding your time to go on that hiking trip, it's best to do it now rather than later.

Rule 7: Think of your life as distinct seasons

To get more out of the present, Perkins advocates dividing your life into time buckets. That is, draw a timeline of your life from now to the grave, then divide it into intervals of five or ten years. Think about the key experiences - activities or events - that you definitely want to have during your lifetime.

Rule 8: Know when to stop growing your wealth

Often, your net worth peak - where it's the highest that it will ever be - happens well before retirement. Perkins believes that's the time to start spending down, or de-accumulating.

Rule 9: Take your biggest risks when you have nothing to lose

Perkin's view is that you're better off taking more chances when you're younger. You're less likely then to let irrational fears get in the way of making choices that reflect your priorities.

An older theory

Perkins' book is a modern take on an old theory. In the 1950s, economist Franco Modigliani, who went on to win a Nobel Prize, created the idea of the Life-Cycle Hypothesis. The hypothesis says that people should manage their spending and saving to get the most out of their money across their life span. Put another way, making the most out of your money throughout your life requires that wealth declines towards zero by the time of death.

As for the fear that you might run out of money, Modigliani says that to be safe, you should think about the maximum age that a person can live. He believes a rational person will spread their wealth across all the years up to the oldest age to which they might live.

The Australian dilemma

The issue of inheritance or to 'die with zero' is becoming more relevant in Australia as the population ages.

A 2021 Productivity Commission report found that Australians are currently passing on $120 billion each year - 90% as inheritances and the rest as gifts - with an average inheritance netting the recipient $125,000.

The report projected a fourfold increase in the value of inheritances between 2020 and 2050 "partly driven by rising wealth among older age groups" with housing wealth a significant factor, along with unspent super.

It also estimated that the ageing population will see a doubling in the number of deaths by 2050, with older people making up a larger share, and falling fertility rates meaning fewer children to leave wealth to in the future.

Productivity Commissioner, Lisa Gropp, commented that:

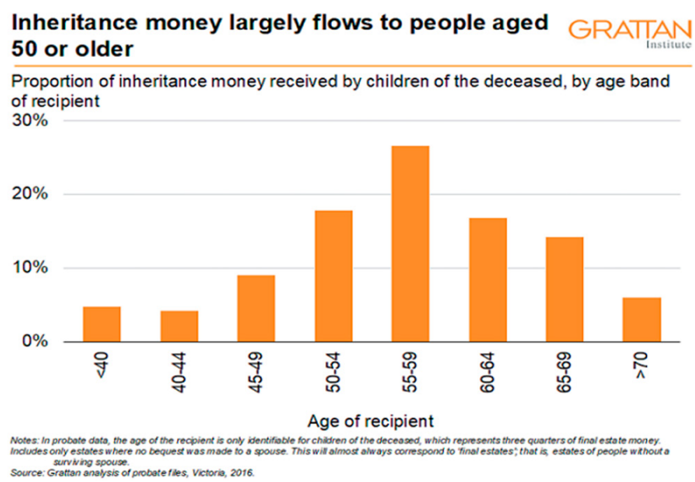
"By the time people receive inheritances, they'll usually be well into middle age – about 50 years old on average. This limits the impact inheritances have on opening up lifetime choices and opportunities about career and family."

And the report concluded that Australia's taxation system is geared towards encouraging intergenerational transfers of housing wealth, as the family home is exempt from the pension assets test.

An earlier report from the Grattan Institute found that in Victoria, the median estate is worth around $500,000. About 20% are worth more than $1 million, and 7% are more than $2 million. Property is the largest component, accounting for half of the average value.

The main beneficiaries of 'final' estates - estates without a surviving spouse - are children, who get about three quarters of all inheritance money. And average inheritances are growing about 2% above the rate of inflation each year, and that's expected to accelerate in future.

More than 80% of money passed down from parents goes to people aged 50 years and over. The most common age bracket in which people get an inheritance from parents is 55-59 years of age.



The pros and cons

The question then goes back to whether parents should consider giving their money to their children before they die. Perkins' book over-simplifies the choices that people must make. There are numerous things to examine before making a final decision. Here is a list of pros and cons:

> **Giving money to children before you die may seem like it will reduce the prospects of inflaming family drama, yet that might not be the case. Early giving may cause resentment among loved ones who don't receive the most of your generosity.**

Pros:

1. **You get to see it.** If you give money to your children early, you will get to see the fruits of that. Whether it's a holiday, purchase of a home or the funding of education, helping loved ones like this can't be overstated.
2. **You may be able to give money when your children most need it.** As Perkins mentioned, the peak utility for money is around 30 years of age. Instead of children inheriting it at age 50 or above, when they often don't need it so much, it might be better to give the money to them when they require it most.
3. **Potential tax benefits.** Australia is one of only eight developed countries that don't tax inherited wealth. However, there is a 17% tax on superannuation passed to a non-dependant, which is an important part of estate planning as strategies are required to take the money out of super before death. Given the current government's crackdown on super tax breaks for the wealthy, it wouldn't be surprising if inheritance taxes were looked at in future.

Cons:

1. **You might run out of money.** Despite all the research suggesting that Australians spend little of their retirement money, there's always the fear of running out of money. And it's understandable: you must plan and save for the future, including for unexpected spending events/decisions.
2. **Tax issues.** If you give money to your children, they won't have to pay tax on that gift. But if you sell an investment to fund the gift, there may be tax consequences such as capital gains on any profit that you make on the sale.

   If you decide to finance a future expense such as a grandchild's education, you may need to consider the tax implications, as minors are subject to penalty taxes on investment income.

   An alternative option that may avoid tax complications is to loan rather than gift money to your children. With a written loan agreement, you can set the terms to benefit and protect people according to your wishes.
3. **May lead to more family drama.** Giving money to children before you die may seem like it will reduce the prospects of inflaming family drama, yet that might not be the case. Early giving may cause resentment among loved ones who don't receive the most of your generosity. There can be other complications. Say you gift your child money, and they buy an apartment with the funds. They later break up with their partner, who could ask for half of the money that was put into the property purchase.
4. **It can affect your age pension.** Centrelink has special gifting rules to prevent people from giving money away to qualify for the age pension. It says you can only give away $10,000 in one year, or up to $30,000 spread over five years, without any effect on your pension.

For amounts exceeding this, you will still be treated as though you have held onto the money for five years. The excess over the limit will be included in your assets for the pension assets test, and you will be deemed to have earned income on it for the pension income test.

Can you get around the gifting rules by selling your home or other assets to your children at a reduced price? Centrelink says gifting also includes assets that are sold or transferred for less than their market value. If you own a home worth $600,000, and sell it to your children for $300,000, it says $300,000 will be regarded as a gift and used in calculating your pension entitlement after allowing for the permissible $10,000 gift.

Note that these gifting rules don't apply to those not on an age pension, who can gift as much as they like.

This isn't an exhaustive list of pros and cons, and if you want to receive professional advice on the issue, please consult a financial advisor and an estate/tax lawyer.

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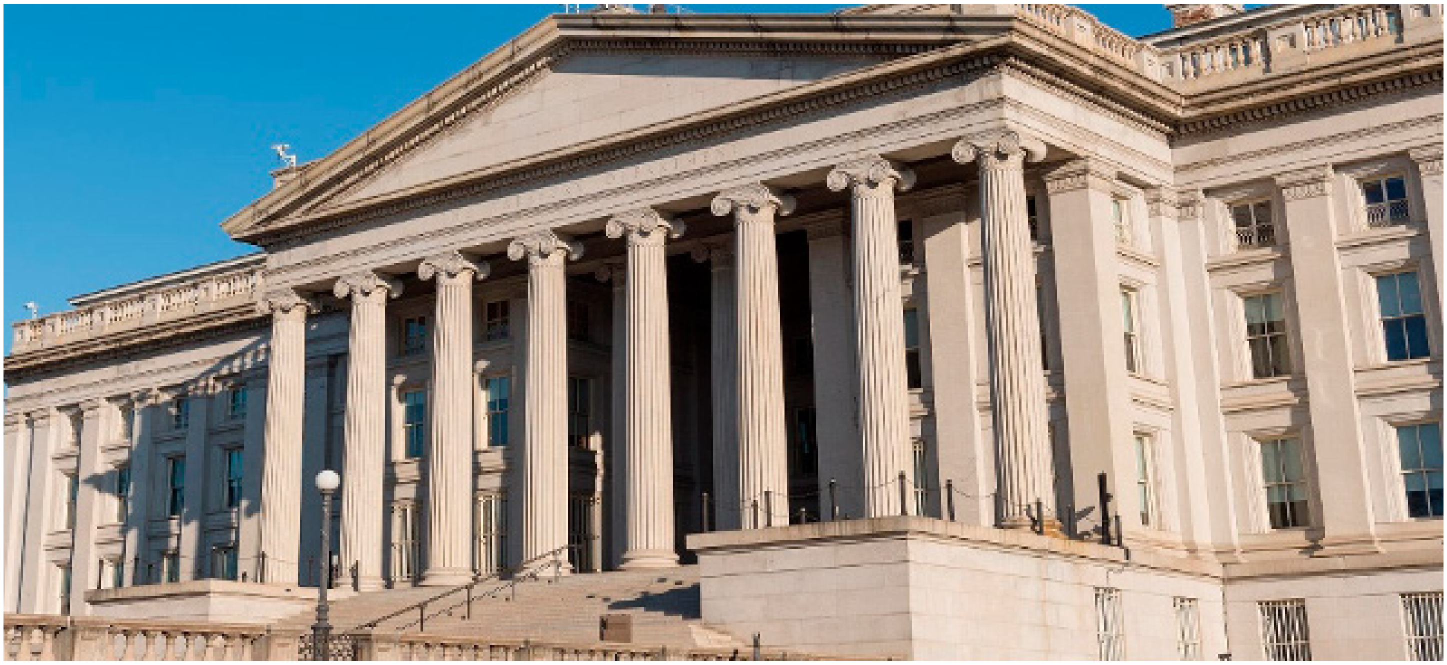

Is the money safe?

Executive summary:
- In the event of any further stresses in banks, the U.S. government is very likely to raise the FDIC coverage limit for banks that fail
- A repeat of the 2008 financial crisis is very unlikely
- Regulators have made the necessary moves to keep issues in the global banking system idiosyncratic, rather than systemic

BY ERIK RISTUBEN

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Are my deposits secure?

This is an understandable question I've fielded from countless concerned investors ever since the sudden demise of Silicon Valley Bank on March 10 and the collapse of Signature Bank two days later. Worries about the health of the overall banking system have led a to drawdown in deposits, with investors yanking nearly $100 billion in deposits from U.S. banks during the week that ended March 15.1 What's more, there are fears that the stresses in the banking sector could be the start of the next financial crisis.

Before I get too far into the weeds, let me address these concerns by emphatically stating that:

1. If you are with an FDIC insured bank and your account balances are below $250,000, your money is safe.
2. If you have deposits in excess of $250,000, it is likely that the U.S. government will guarantee those deposits as well—as it has in the case of the three bank failures.
3. A repeat of the 2008 financial crisis is highly unlikely. Let's dive in to the nitty gritty to understand why.

This is not the GFC on replay

To understand why today's difficulties in the banking system are very unlikely to spark another global financial crisis (GFC), it's helpful to understand what the factors were that caused the GFC in the first place. At the top of the list? Over-leveraged banks. Leading up to the 2008-09 crisis, most banks were highly leveraged—some to the tune of 30:1. Nowadays, balance sheet leverage is much more muted.

In addition, in the run-up to the GFC, highly leveraged balance sheets were invested in highly questionable mortgage-backed securities—some of which defaulted before they matured. Contrast that with today, when most of the assets owned by banks are invested in high-quality Treasuries and guaranteed agency securities that will almost certainly be worth their face value when they mature.

Rising rates always expose the most vulnerable participants

So, what led to the failure of Silicon Valley Bank, Signature Bank and Silvergate Bank, as well as the forced acquisition of Credit Suisse by UBS? One key factor was the aggressive tightening campaign among central banks that's been underway for the past 12 months. In the U.S., for instance, the federal funds rate has risen from near zero in March 2022 to almost 5% in one year. That's a massive increase in borrowing costs in such a short span of time—and tightening cycles of this magnitude almost always expose vulnerable market participants.

Take Silicon Valley Bank, for example. The California-based lender was uniquely vulnerable to rising rates due to its highly concentrated depository base of privately held companies—many in the under-pressure tech sphere—and its large bond portfolio, which was invested before the dramatic rate rises of the past year.

Overall bank failures are actually lower than normal compared to similar periods

Due to the sheer amount of banks around the world—by one estimate, there are over 40,000 banks and credit unions globally2—it's not unusual for a bank to fail. The truth is that bank failures are a routine occurrence in the global banking system—in large part because not all banks are properly run. Case-in-point: Since 2001, 564 banks (mostly small) in the U.S. have failed. It's worth pointing out that the number of bank collapses we've seen this year (three) is actually lower than in similar periods. In 2019, for instance, four U.S. banks failed.3 This year the banks that collapsed have been much larger than average, and with the current risk environment we can expect heightened market awareness of any bank failures. This, in large part, explains the heightened government response.

It's also important to understand that these bank failures have been caused by a lack of liquidity, rather than a lack of solvency. Overall, the assets that the collapsed banks held were generally high quality. The problem was that in order to meet runs by depositors, these banks were forced to sell securities and realize losses. Those losses eroded their capital ratios, which in turn required them to raise capital. The announcement that these banks were going to raise capital caused more depositors to withdraw, leading to a snowball effect that resulted in bank closure.

The importance of the Fed's new lending facility

From my vantage point, the March 12 announcement of the U.S. Federal Reserve (Fed)'s Bank Term Funding Program also goes a long way toward limiting systemic risk in the banking system—and securing investors' assets. Essentially, the new facility allows banks to borrow the money they need to meet depositor withdrawals by putting their U.S. Treasury and agency bonds up at collateral at par value—meaning they avoid realizing the losses that would erode their capital ratios. I believe that this, in combination with raising the guarantee level for the banks that failed, should have the desired effect of slowing depositor withdrawals.

In our view, this is the reason we have not seen broadening pressure on the U.S. banking system similar to what we saw with those three banks. Things have calmed down. Let's hope this remains the case.

One caveat here: U.S. Treasury Secretary Janet Yellen doesn't have the authority to change the $250,000 guarantee level for all banks. This can only be changed by Congress. I believe this is probably why Yellen has not come out and said she will raise the FDIC coverage limit for the industry as a whole. That said, the Treasury Department/FDIC/Fed can very likely raise this limit for any banks in receivership that come under intense market scrutiny, as they've already done for the recent bank failures. In addition, Fed Chair Jerome Powell's remarks at the FOMC (Federal Open Market Committee) press conference, where he stated that "depositors should assume that their deposits are safe," should give strong assurances to investors with deposits in excess of $250,000. Both of these are reasons why I emphatically believe investors can sleep safely at night.

Benefits of a total portfolio approach and knowing what you own

I would be remiss if I didn't mention that times like these underscore the need for investors to have detailed, real-time knowledge of their portfolio holdings. After all, one of the most common (and very understandable) questions we received from clients as the banking crisis took hold was whether or not we had any exposure to any of the failed banks.

Thanks to the near real-time visibility we have in our portfolios, we knew the answer right away. Yet it's critical to understand that this type of clarity is not easily achieved. In order to have such visibility, years of investment in data systems and analysis that inform portfolio managers on where their portfolios are positioned—down to the security-level detail—are required. A total-portfolio view that incorporates multi-dimensional risk exposures is also a must-have. At Russell Investments, we have both.

The bottom line

The current turmoil in the banking sector appears far from a replay of the Global Financial Crisis. That said, the Fed has tightened dramatically and as Milton Friedman famously said, monetary policy has a lagged and variable effect on the economy.

As a result of all of this, it's best to expect more idiosyncratic bank issues. Ultimately, however, we believe that regulators have made the necessary moves to keep issues in the global banking system idiosyncratic, rather than systemic.

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The impact of superannuation on retirement outcomes

BY ROSE CLARE

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Superannuation is substantially improving retirement incomes for nearly two million retired Australians by providing regular income streams. Australian Bureau of Statistics (ABS) data also indicate that in 2019-20 around 580,000 households, encompassing over 1 million Australians, were mainly dependent on payments from superannuation. This is nearly double the number of households mainly dependent on superannuation in 2009-10. For those dependent on superannuation income, around 75% of such households have less than 20% of their income from government pensions. Many more retirees also have benefitted by taking lump sum benefits either at retirement or during retirement.

Putting super income payments into context

By 2021-22, there was a total of $59 billion in superannuation income payments in retirement, (Table 1), which is greater than the annual Age Pension expenditure of around $51 billion in that year [DSS 2021-22 Annual Report].

Table 1: income stream payments from APRA funds and SMSFs (a)

Income year	SMSF income stream payments ($ billion)	Total income stream payments for APRA funds with greater than four members ($ billion)
2021-22	18.4	40.4
2020-21	18.1	38.5
2019-20	19.3	40.9
2018-19	22.7	39.2
2017-18	24.4	36.4
2016-17	36.2	34.5

(a) Figures from APRA Annual Superannuation Bulletin June 2022, Excel version Table 2

Historically the Age Pension has been the main source of income for most retirees in Australia. Government pensions and allowances were the most common main source of income for the 3.9 million retirees in Australia in 2018-19 aged 45 and over (49% for men, 44% for women), followed by superannuation (30% for men, 17% for women).

Yet this is beginning to change with increasing superannuation balances and with more retirees relying mainly on superannuation. As shown by Table 2, in 2021-22 (for funds with more than six members) there were around 1.37 million people who received regular income from account-based income streams. There also were 99,000 people receiving annuity payments (both term and lifetime) along with 159,000 individuals receiving defined benefit pensions, (mostly related to former public service employment). The total amount of pensions paid by funds with more than 6 members increased from $28.4 billion in 2014-15 to $40.4 billion in 2021-22.

A further 81,000 people received transition to retirement pensions in 2021-22. These pensions have become less popular due to changes in their taxation treatment. In 2016-17 there were 162,000 individuals receiving such pensions from funds with more than four members.

Table 2: Superannuation income streams, 2021-22 (a)

	Total account based	Annuity	Defined benefit pensions
Number	1,370,000	99,000	159,000
Average annual payment	$20,353	$47,294	$25,426

(a) Payments from funds with more than 6 members. Source: APRA Annual Superannuation Bulletin

There also are very substantial numbers of people (over 330,000 in 2019-20) receiving income stream benefits from Self-Managed Superannuation Funds (SMSFs). SMSFs have a substantial proportion of their membership in the retirement phase.

The average income stream benefit paid by an SMSF was around $47,900. This is significantly higher than the average for APRA regulated funds, reflecting the higher average account balances in SMSFs. Income stream payments in 2019-20 would also have been affected by the temporary reduction in minimum draw down rates. The minimum annual payment required for account-based pensions and annuities, allocated pensions and annuities and market-linked pensions and annuities was reduced by 50% for the 2019-2023 financial years.

Vast majority draw down almost all super

The evidence available indicates that in most cases individuals draw down entirely on their superannuation during retirement rather than leaving a substantial amount for a spouse or children. The Association of Superannuation Funds of Australia (ASFA) 2021 paper findings are confirmed by more recent ABS data which indicate that in 2019-20 for those aged 75 and over, only 41.7% of males and 29.5% of females had a superannuation account balance or were receiving income from superannuation (which would include receiving a defined benefit pension which cease on death).

Table 3: Percentage of older Australians with superannuation

	2017-18			2019-20		
Age	Males	Females	Total	Males	Females	Total
65-74	62.3	50.6	56.3	62.7	53.8	58.0
75 and over	33.8	25.8	29.5	41.7	29.5	34.9
Total 65 and over	51.3	40.0	45.4	54.1	43.4	48.5
Total	74.4	69.5	71.9	78.0	70.9	74.4

(a) Includes persons with a superannuation account balance above zero and/or receiving regular income from superannuation and/or who received a lump sum superannuation payment in the last two years
(b) The number of persons with superannuation coverage expressed as a percentage of total persons in the corresponding group (age and sex)

ATO sample file data indicate that in 2019-20 for the 2.9 million Australians aged 70 and over, only 540,000 had more than $1,000 in superannuation, around 310,000 had more than $200,000 and only 180,000 had more than $500,000. Most of the higher balances are held by members of SMSFs. In 2019-20 there were around 115,000 members of SMSFs aged 70 and over receiving income streams and with balances over $500,000.

However, overall, 90% or more of those aged 70 and over pass away with little or no superannuation, having drawn down on their balances after their retirement.

That said, some individuals do have significant balances in superannuation. In 2019-20 around 35,000 individuals had more than $3 million in superannuation, with around 90% of them in SMSFs. The number is expected by Treasury to grow to around 80,000 by 2025-26.

Growing super assets ease burden on government

As well, the large and growing pool of superannuation assets is positively influencing both adequacy of retirement incomes and sustainability of government expenditure on the Age Pension.

As a result of increasing superannuation account balances, at Age Pension eligibility age an increasing proportion of retirees have substantial private incomes, which increases retirement incomes, decreases the proportion of retirees who receive a full Age Pension and increases the proportion who receive no Age Pension at all.

Already there has been a fall in the percentage of new Age Pensioners who are on the full Age Pension and an increase in the percentage who at the time of retirement are fully self-funded.

As shown by Table 4, only around 40% of the age group 66 to 69 currently receive the Age Pension.

Take-up rates vary between each State and Territory, largely driven by differences in average superannuation balances. For instance, in the Australian Capital Territory coverage of superannuation and average superannuation balances are higher than the national averages. There also is a relatively high incidence of defined benefit pensions in the Australian Capital Territory.

Table 4: Age Pension recipients by state and territory by age group, December 2021

State	% of age group 66-69 receiving Age Pension	66-69	70-74	75-79	80-84	85-89	90 and over	Total
ACT	25%	3,471	6,490	5,936	4,569	2,800	1,556	24,822
NSW	40%	128,234	212,236	183,079	136,428	84,753	48,810	793,540
NT	36%	2,374	3,442	2,224	1,379	595	281	10,295
QLD	44%	89,115	145,626	120,786	82,250	46,869	25,459	510,105
SA	45%	35,344	57,820	49,693	36,656	23,255	13,980	216,748
TAS	47%	12,605	20,399	16,891	11,888	6,701	3,366	71,850
VIC	38%	93,749	159,547	139,243	105,798	67,158	37,993	603,488
WA	41%	41,107	66,419	54,366	40,299	24,238	13,131	239,560
Total	42%	415,034	694,215	594,107	436,816	266,719	149,172	2,556,063
% of age group receiving Age Pension		42%	63%	77%	83%	84%	71%	65%

Source: Department of Social Services Demographic Data, ABS Population Estimates

In 1997, the take-up rate for the Age Pension and the age-related Veterans Pension for those aged 65 and over was 79%. By 2007, this had fallen to 75%. As shown by Table 4, it is now around 65% for those eligible by age to receive the Age Pension. If the take-up rate for the Age Pension in 1997 applied to the Age Pension in 2021 there would be around 550,000 extra Age Pensioners, increasing the cost of providing the Age Pension by about 20%.

As people age, their receipt of the Age Pension generally increases. This makes sense as older age groups had less or no time in the compulsory superannuation system. Superannuation balances also generally decline with age as balances are drawn down.

However, greater wealth is associated with longer life expectancy so there is a small decline in the relative incidence of accessing the Age Pension after age 90 for the relatively low number of Australians in that age category. As well, most individuals aged over 90 are single and subject to the relatively tighter asset test for singles.

The take-up rates for the Age Pension will decrease further as superannuation balances increase and if the trend for more people to remain in paid work after age 65 continues. The decrease in take-up will be particularly marked for those in their late 60s.

Currently just under 20% of those aged around 67 are still in paid employment with a further 40% or so self-funded (or at least not eligible for the Age Pension).

Currently around 30% of couples and singles reach or exceed the ASFA Comfortable Standard and projections

"As people age, their receipt of the Age Pension generally increases. This makes sense as older age groups had less or no time in the compulsory superannuation system. Superannuation balances also generally decline with age as balances are drawn down."

indicate that the superannuation system as it matures will play a crucial role in improving retirement living standards. By the year 2050 ASFA projections indicate that around 50% of retiree households will be able to afford expenditure at the level of ASFA Comfortable or above.

Australia relies less on the Aged Pension than other countries

Consistent with ASFA projections, projections published by the Retirement Income Review (RIR) indicate that by the year 2060 around 50% of the Age Pension population group will be totally self-funded. Of the 50%, around 40% will be part-rate pensioners. In comparison, currently only around 35% of the total Age Pension population are self-funded with only around 32% Age Pension recipients on a part-rate pension.

As a result, according to the RIR report, Age Pension expenditure as a percentage of GDP is expected to fall moderately over the next 40 years, from 2.5% in 2020 to 2.3% in 2060. This is despite the population over Age Pension eligibility age being expected to grow faster than the working-age population, leading to fewer working-age people for each person of Age Pension eligibility age.

Across the OECD, expenditure on publicly funded pensions averages 8.8% of GDP and is projected to increase to 9.4% by 2050. Some European countries already have four times the level of Australian expenditure, with this projected to rise further. Those countries where expenditure on public pensions is expected to increase (in the absence of reform) include Canada, Germany, New Zealand, the United Kingdom and the United States. In contrast, as noted earlier, Australian expenditure is already relatively low as a percentage of GDP and is expected to decline.

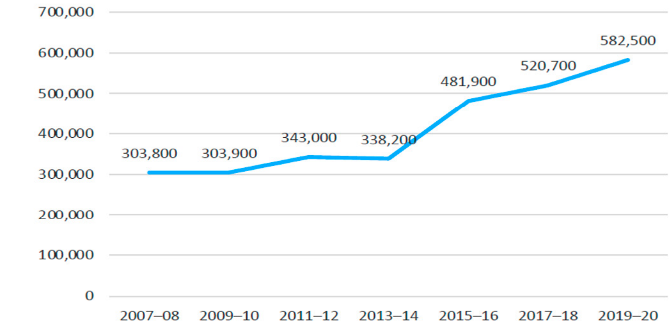
As shown by Chart 1, the growth in the percentage of retirees reaching ASFA Comfortable (largely through the growing maturity of the compulsory superannuation system) is accompanied by a fall in the percentage of retirees who receive a part or full Age Pension.

Chart 1: Projections of reliance on the Age Pension and also for reaching ASFA Comfortable Retirement Standard

Source: Department of Social Services demographic data and ASFA estimates. Note: Per cent of retirees on Age Pension and per cent achieving ASFA Comfortable do not necessarily add up to 100%. Some retirees at ASFA Comfortable or above will receive the Age Pension after drawing down on their superannuation.

Consistent with this, the maturing compulsory superannuation system has led to a substantial increase in households that are mainly dependent on superannuation rather than being mainly dependent on the Age Pension (Chart 2).

Chart 2: Number of households mainly dependent on superannuation income



The impact of additional tax on super balances over $3 million

The tax concession enjoyed in relation to investment earnings for high balance members is substantial for large accounts. Based on ATO data, in 2019-20 there were around 35,000 superannuation fund members with balances within superannuation of over $3 million. Treasury projects the figure will be around 80,000 in 2025-26. Some of these funds have balances of some hundreds of millions of dollars, well in excess of retirement needs. The Treasury estimates suggest that the average additional tax paid by the individuals affected would be $25,000 a year.

While the current caps on superannuation contributions limit the ability for members to build up excessive balances in the future there is a real question regarding the appropriate treatment of high balances that were achieved in the context of more generous contribution caps in the past. Large capital gains on business and/or real property asset holdings are also an issue, particularly for SMSFs. These have not been impacted to a great extent by changes to contribution caps as the increase in account values has been driven by capital gains rather than contributions.

The Transfer Balance Cap regime limits the amount a member may take into pension phase. However, 'excessive' balances may still be present in accumulation accounts and therefore will be subject to a current tax concession of up to 30% of the tax on earnings (that is, 45% personal tax rate less 15% tax on fund earnings).

Treasury has estimated that changing the taxation treatment of investment earnings related to total superannuation balances in excess of $3 million would lead to additional revenue of around $2 billion a year, although the exact amount raised would depend on how excess balances were invested after they were withdrawn from the superannuation system. This figure of $2 billion would reduce the total tax concession applying to superannuation contributions and investment earnings by around 4.5%, and by 9.5% in regard to investment earnings alone. This clearly is a substantial impact.

In regard to who would be affected by such a cap, broad demographic information on holders of large superannuation accounts is available from the ATO sample file for 2019-20 and from SMSF taxation statistics.

These statistics indicate that around 65% of those affected by the proposal are male. Those affected are relatively old, with around 50% aged over 70 and around 90% aged over 60.

Even though the age groups affected are relatively old, only around 50% are retired, with around 30 receiving wage or salary income.

Labourers and unskilled workers are not represented in those affected by the measure. The ATO statistics suggest that of those likely to be affected around 20% currently identify as managers, around 10% as a professional, around 5% clerical or administration, around 2% as consultants. However, as noted above many of those affected are retired with no data available about former occupations.

Those likely to be affected are relatively affluent on a number of measures. Around 25% owned a rental property, around 25% received dividends of over $40,000 a year and around 15% had total income for tax purposes of over $500,000.

The majority of those likely to be affected live in Sydney and Melbourne, but there are significant proportions living in Brisbane, Perth and Adelaide. Only a relatively small proportion of those likely to be affected live in regional areas of Australia.

Ross Clare is Director, Research and Resource Centre at The Association of Superannuation Funds of Australia Limited (ASFA). Read the full report here. This article is general information and does not consider the circumstances of any person.

Q&A: Ask a Question

Question 1

Should I create a SMSF?

Whether or not you should create a self-managed super fund (SMSF) depends on your personal circumstances, financial goals, and level of experience and expertise in managing investments and complying with superannuation rules and regulations.

SMSFs can offer greater control and flexibility over investment choices, tax planning, and estate planning compared to other superannuation options. However, managing an SMSF can also be complex and time-consuming, and there are additional responsibilities and compliance requirements that come with running an SMSF.

Before deciding whether to create an SMSF, it's important to consider the following factors:

1. Investment expertise: Managing an SMSF requires knowledge and experience in managing investments and understanding superannuation rules and regulations. If you're not confident in your ability to manage an SMSF, it may not be the best option for you.
2. Time commitment: Managing an SMSF can be time-consuming, particularly in terms of monitoring investments, meeting compliance requirements, and preparing financial reports. If you don't have the time to dedicate to managing an SMSF, it may not be the best option for you.
3. Size of super balance: SMSFs can be more cost-effective for those with larger superannuation balances. If your super balance is relatively small, the costs of running an SMSF may outweigh the benefits.
4. Risk appetite: SMSFs provide greater investment choice, but also come with greater investment risk. If you're not comfortable with managing higher risk investments, an SMSF may not be the best option for you.

For points 1 & 2, you can pay outsource these to professionals which will increase the costs to running your SMSF, which puts additional emphasis on having sufficient balance and scale in it.

Ultimately, the decision to create an SMSF is dependent on what you're looking to achieve from using one. If you are considering one, it is recommended to seek professional financial advice before making any decisions.

Question 2

What are the advantages to a testamentary trust?

1. Control: A testamentary trust allows the testator (the person making the will) to maintain control over the assets even after death. The trust document can specify how the assets are to be distributed and managed and can even set conditions on how the assets are used by the beneficiaries.
2. Protection: A testamentary trust can provide protection for beneficiaries who are not capable of managing their own affairs, such as minors or individuals with disabilities. The trust can be structured to provide for their ongoing care and support.
3. Taxation: A testamentary trust can be used to minimize taxes payable on the estate and its assets. By distributing assets through a trust, the estate can take advantage of certain tax benefits that may not be available if the assets were distributed directly to the beneficiaries.
4. Privacy: A testamentary trust can provide greater privacy and confidentiality than a will. Since the trust document is not a public record, the details of the trust can be kept confidential.
5. Flexibility: A testamentary trust can be structured to meet the unique needs of the testator and their beneficiaries. The trust document can be customized to provide for specific assets, beneficiaries, and distribution arrangements. This flexibility can be especially important for blended families, where the testator may want to ensure that assets are distributed fairly among all of their children.

Question 3

Does my total super balance count across all accounts?

Yes, the total super balance includes the sum of all superannuation savings across all accounts held by an individual. This includes accumulation accounts, defined benefit accounts, and retirement phase accounts you may have.

The total super balance is used to determine eligibility for certain superannuation measures, such as the ability to make additional after-tax contributions, and may impact the amount of tax you pay in your super.

It's important to note that some superannuation accounts, such as certain defined benefit accounts, may have different rules and calculations for determining their value and how they contribute to the total super balance. It's always a good idea to seek advice from a qualified financial adviser to understand how the total super balance rules may apply to your specific situation.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to **centraladvice@wtfglimited.com**.

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