Investing an inheritance in super

By Perpetual Private Insights
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You may have recently received an inheritance, or maybe you're expecting one soon. Receiving a lump sum gives you opportunities, and choices. You may want to pay off your mortgage, take a holiday or share the money with your children.

You may also consider putting money into your super to boost your retirement savings – or even retire early. While investing an inheritance in super offers many tax benefits, there are contribution rules you need to be aware of.

Your contribution limits

When investing an inheritance in super, there are limits to how much you can contribute, depending on your existing super balance. From 1 July 2021 the total superannuation balance has been capped at $1.7 million. If you've reached this limit, you can't make non-concessional (after-tax) contributions to your super. If you are approaching this limit, only part of your inheritance may be contributed into super, and the remainder of your inheritance will generally need to be invested outside of super.

Your total superannuation balance shouldn't be confused with the general transfer balance cap, which is also $1.7 million. The general transfer balance cap is the limit you can use to commence an income stream from your super when you retire. Any balance in superannuation above this limit, may be retained in accumulation phase where appropriate.

If your total superannuation balance is below $1.7 million, there are two types of contributions you can make from 1 July 2021:

- Concessional (before-tax) contributions up to $27,500 per year, which includes your employer's Super Guarantee. Concessional contributions are taxed at just 15% which may be lower than your marginal tax rate. Note an additional tax of 15% will apply where your taxable income, with some modifications, is more than $250,000.
- Non-concessional contributions up to $110,000 per year. While you don't get a tax deduction for these contributions, you still receive tax benefits on investments inside super.

Depending on your age, there are other important considerations which may affect how much inheritance you can put into super:

1. If you're under age 67, the 'bring forward' rule is useful if you're inheriting a substantial amount. Keeping in mind your $1.7 million limit, the bring forward rule lets you contribute up to $330,000 into super in a single year, effectively putting three years of non-concessional contributions into your fund at once.
2. If you're between age 67 to 74, you can only make a $110,000 non-concessional contribution if you pass the 'work test' – that is, in most cases, you need to be gainfully employed for at least 40 hours a week in any consecutive 30 day period. If you don't pass the work test, unless you gain an exemption, you won't be able to contribute your inheritance to your super.

There's more to consider when contributing an inheritance to your super. Before making any decisions, it's important to speak to your financial adviser or accountant to make sure you're not breaching the contribution cap rules.

Investing inside and outside super

If you’ve reached your contribution caps, it's a balancing act between investing inside and outside super, says Chris Marshall, Partner at Perpetual Private.

“Super is still the most tax-effective investment vehicle in retirement from which to draw an income. But it's important to understand the rules. Use them to your advantage and align the rest of your investment portfolio outside super to make sure tax is minimised and gains are maximised,” Mr Marshall says.

“If you’ve reached the caps, sometimes it can make sense to invest assets held outside super in equities, which generate tax benefits in the form of imputation credits. The part of the portfolio invested in the non-tax paying super system may be in other asset classes, which also helps to achieve diversity and manage risk."

It’s also essential to consider how an inheritance may affect Centrelink benefits so the overall asset base can be structured to take advantage of any government concessions.

“It’s about balancing your overall taxable income and situation,” Marshall concluded.

Inheriting super

Super can be an important part of an inheritance, however unlike other assets such as property or shares, it isn’t automatically included in the assets distributed according to the testator’s Will.

“Super doesn’t necessarily form part of an estate,” says Catherine Chivers, Senior Manager Strategic Advice at Perpetual Private, “so it won't be dealt with according to the Will, unless they make a direction for their super to be paid to their estate.”

Beneficiary Nominations

If super will form part of an inheritance, it’s important a binding or non-binding death nomination has been made to ensure that this passes in the manner intended.

- Binding nominations: a binding nomination is a direction to the fund’s trustees about how super should be handled after the individual’s death.
- Non-binding nomination: a non-binding nomination can merely give the trustees guidance about how super should be handled, they are not bound to follow it.

Unlike other assets, there are also rules around who can receive a super benefit. Super law provides that this person can be the deceased members Legal Personal Representative, or a ‘dependant’.

For the purposes of super law, a ‘dependent’ includes:

- a spouse, including defacto or same-sex
- children of any age, including adopted and step-children
- someone who is financially dependent on the deceased as of their date of death
- someone who has an inter-dependency relationship with the deceased as of their date of death, such as a sibling that lives with them and provides financial and domestic support plus personal care

"If you're a dependent, you can inherit super as an income stream, lump sum or combination of the two, depending on the deed of the fund," Ms Chivers says.

"The exception is for children originally receiving the death benefit as a minor who reach age 25, and have a permanent disability (or one likely to be permanent) which reduces their capacity for communication, learning or mobility to the extent that there is a need for ongoing services."

"The decision on keeping an income stream inside super, or taking a lump sum out of super, will often rest on how much money you have already in super and your age," Ms Chivers added.

If you and the deceased member are younger than 60, it's tax free for you to take the money out of super. Alternatively, you can choose to keep the money in super and receive an income stream from the fund, says Stuart Le Cornu, Partner with advisory business Fordham Group, a specialist part of Perpetual.

"In this case, the taxable component of the pension (income stream) will be taxed until you reach age 60, notwithstanding the 15 per cent rebate on tax payable on the pension, and will be tax free after 60," Mr Le Cornu says.

In recent times, COVID-19 has increased volatility and led to share market volatility. For retirees, or those thinking about retiring soon, this economic turmoil may lead to a very different outcome if recently inherited super is taken as a lump sum, or an income stream.

To find out the best way to support your retirement income during this time, we recommend you speak with your financial adviser.

This article has been updated to reflect the latest super legislation changes which came into effect from 1 July 2021.

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