The best gift you can give your kids

Clients often ask us – how can we help our children with their own wealth? And, as you already know, the answer is generally a combination of hard work, getting the right investment advice and starting early.

However, when your children are embarking on their careers, they have many competing priorities, including building a career, raising a family and studying, and there isn't much time left at the end of the day to focus on managing the finer details of their wealth strategy. Fortunately, your children have you to point them in the right direction.

One area of concern for many investors has been the reforms to superannuation in recent years. And while it's likely you've already considered the impact of the reforms on your own wealth, as parents it's important to encourage your children to look at the implications of the changes on their own super, so they too can make smarter decisions for their future wealth. For this reason, here's something they might appreciate knowing sooner rather than later.

Rethink the timing of super contributions – the sooner your children start, the more they'll be able to contribute

To harness the effects of compounding, it's even important for younger savers who are still accumulating wealth to start contributing to super sooner rather than later – where they can make the most of compounding and give themselves as much time as possible to build a substantial balance over a number of years. Otherwise, postponing significant super contributions closer to retirement, as is often the case, may result in money being stuck in a less favourable tax environment than super (although we note that this favourable tax environment comes with access restrictions to capital and income).

What are the current contribution limits?

- Concessional contributions (before-tax): $27,500 p.a.
- Non-concessional contributions (after-tax): $110,000 p.a. if super balance is less than $1.7 million.

Bring forward provision may allow up to $330,000 in one year (if eligible).

Why invest through super?

- Investment earnings concessionally taxed at a rate of up to 15 per cent in accumulation phase.
- In retirement phase, up to $1.7 million can be held with 0% tax on earnings.

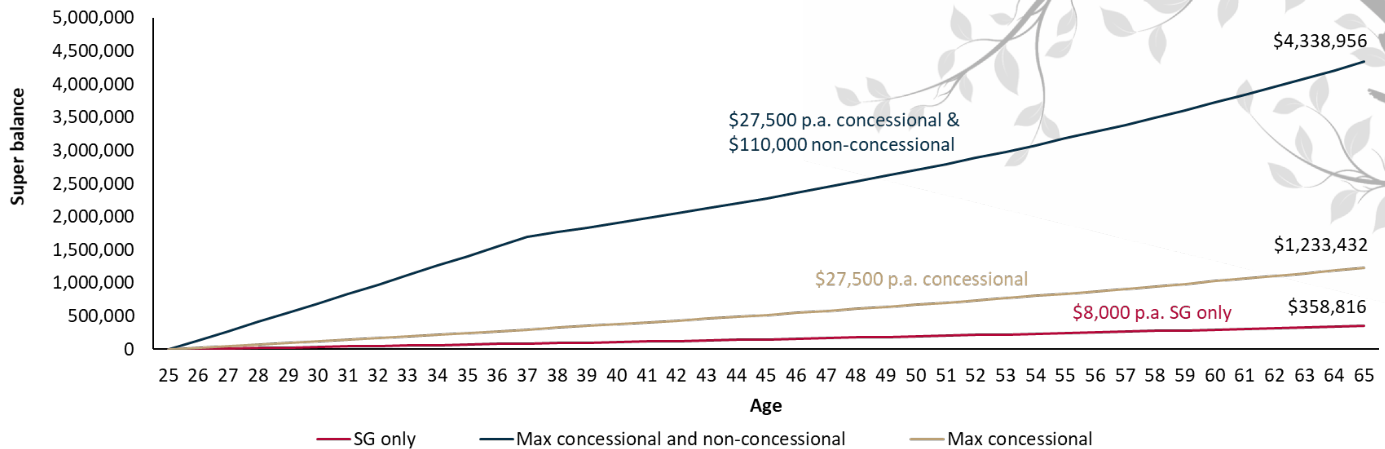
Why it's important to start early – the magic of compounding plus maximising super contributions

The following graph illustrates three possible scenarios:

1. 40 years of savings making only superannuation guarantee (SG) contributions
2. 40 years making maximum $27,500 concessional (before-tax) contributions
3. 40 years making maximum $27,500 concessional and $110,000 non-concessional (after-tax) contributions (made until the superannuation balance reaches $1.7 million).

Where all assumptions are equal, it's easy to see the difference that time and maximising contributions could make to your children's overall super balance at retirement. In fact, the difference in retirement balances in the three scenarios is quite significant.

Super contributions over time – three scenarios



Note: For illustrative purposes only. Assumes earnings 3.09% p.a. income, 2.95% p.a. growth. Results will depend on actual earnings. This is not a predictor of future earnings. All figures are expressed in today's dollar terms. Superannuation guarantee (SG) is based on 10% of $80,000 per annum salary. SG: Superannuation guarantee.

Two things to first consider

Being super savvy isn't just about maximising your super contribution limits, it's also about starting early so you can make the most of compounding. As your children can't make any more after-tax contributions into their super once they've reached the $1.7 million limit, the sooner their balance reaches this limit, the more time it has to grow in a tax-effective environment. Plus, they can still make future concessional contributions after this time.

Assets left outside of super, including future wealth your children accumulate or inherit closer to retirement, may end up being less tax-effectively structured in the long term. Commonly, non-super investments are held in a discretionary trust structure where the tax benefits ultimately depend on the financial situation of beneficiaries in a given year. Where no low tax family beneficiaries are available to receive distributions, as is often the case for families with significant assets using these structures, a company beneficiary may be the next most tax-effective option, where tax at the corporate rate (currently 30%[1]) applies.

What you can do for your children

Have you considered helping your children make super contributions so they can start building their retirement savings sooner? Building their super early can make a big difference to their end balance while making the most of the tax-effective super environment. If you give them a lump sum inheritance when they're close to retirement, there may be limited ability to move this money into super.

There are a range of benefits to helping your children build their super sooner. Not only are you providing them with an upfront tax benefit, but you're also encouraging them to be more invested with their super and investments, while seamlessly and tax-effectively passing on your family wealth to the next generation. At Evans and Partners, we generally prioritise the following to maximise super:

1. **Maximise each child's concessional contribution limit**, after allowing for any employer contributions they already receive – for example, an employee with $8,000 of superannuation guarantee contributions could save almost $3,800 in personal tax via maximising their concessional contribution limit (based on a voluntary concessional contribution of $19,500 and 34.5 per cent marginal tax rate). The example above shows that this strategy could help build a super balance of more than $1.2 million in today's dollars over 40 years.

[1] For a non-trading entity.

2. **Help fund your children's non-concessional contributions** as well if you have the capacity. This will assist in structuring their assets tax-effectively in the long term and in maximising their overall balance.

While earnings on superannuation investments will be taxed concessionally over your children's working lives, before contributing funds to super, it is important to work through with your children their priorities and capital requirements, as they won't be able to access their super until they retire (or reach preservation age).

How we can help

At Evans and Partners, we have dedicated strategic financial advisers who help clients across multiple generations to manage and grow their wealth through a range of effective financial planning strategies.

If you'd like to start the conversation, please contact your adviser or fio@eap.com.au.

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