

## **Optimising your transition to retirement strategy made easy**

### **Summary**

Since 1 July 2005, the transition to retirement condition of release has existed to allow those who have reached age 55 and are still working, access to their superannuation as a non-commutable pension – that is, it cannot be cashed as a lump sum.

The transition to retirement condition of release was initially seen as a means of supplementing a reduced salary or self-employed income for those winding down work hours in the final years to retirement. However, there are significant tax benefits in maintaining full employment, drawing a tax-effective pension from your superannuation and contributing excess taxable income back to superannuation.

There is no work-test needed to be satisfied to access a transition to retirement pension. This means an eligible person could work any number of hours, on any basis, in any week – without affecting their right to access the pension. Furthermore, there is no restriction on the amount of super benefits that can be used to commence the transition to retirement pension.

### **What are the tax benefits of implementing Midwinter's TTR strategy?**

The main tax benefits of implementing Midwinter's TTR strategy using *Resasonable Basis* are as follows:

1. Earnings within super are taxed at up to 15%, but earnings and capital gains in the pension environment are tax-free - The reduction in super attracting earnings has a significant impact on final retirement savings. As an example, a person with \$300,000 in super earning a gross return of 10% could pay up to \$4,500 p.a. in earnings tax ( $\$300,000 \times 10\% \times 15\%$ ). Compounded over ten years this could reduce their final balance by over \$50,000 at retirement at age 65.
2. NCAP income drawn from 55 to 59 is eligible for the 15% pension and annuity tax offset applies to pension income and from age 60 any income drawn from the pension becomes tax-free - This can open up an "arbitrage situation" whereby the NCAP income drawn from the retirement savings is significantly less than the amount contributed back via salary sacrifice or self-employed contributions.
3. Drawing tax-effective NCAP income as opposed to taxable salary or business income means less assessable income is required to meet current net income levels - this could mean the eligible person falls into a lower marginal tax rate. Also, excess salary or business income contributed back to super is taxed at a maximum of 15% (up to contribution deduction limits) – opposed to individual marginal tax rates (of up to 46.5%);  
and

4. Enhanced ability to qualify for additional tax offsets – The strategy reduces the amount of income generated from working as a result of increased deductible contributions (e.g. salary sacrifice or self-employed contributions). This means that eligibility for tax offsets such as the mature age tax offset or low income tax offset increases – because they are based on a person’s level of net income from working (and not other assessable income – such as pension income).

### **What other opportunities exist in implementing a TTR strategy?**

Other opportunities the transition to retirement condition of release offers include:

1. Reducing desired net income level enhances benefits exponentially – If the investor is willing to reduce their current net income level when implementing Midwinter’s transition to retirement strategy they will significantly increase retirement benefits. For example, a person earning \$75,000 (or \$56,025 net income) with \$200,000 in super was willing to reduce their desired net income level to \$52,000 (\$1,000 per week) the increase in superannuation benefits they could expect at age 65 would rise from \$80,275 to \$125,393;
2. Providing the self-employed with a consistent income stream – Drawing pension income allows the self-employed to smooth out fluctuating annual income and provides a certain and pre-determined level of cash-flow. This is especially useful for farmers and other workers in industries whose income levels fluctuate significantly from year to year;
3. Combining the TTR strategy with contribution splitting between spouses - allows the utilisation of the tax-free pension environment sooner, minimisation of combined income tax liability during the accumulation phase, and the sheltering of assets to increase the Age pension benefits;
4. Prolong workforce participation – The ability to reduce work hours in the period leading up to retirement and supplementing that reduced salary or business income with tax-effective pension income allows current lifestyle to be maintained and could potentially prolong working life; and
5. Access to additional cash flow – This may be to renovate the family home, pay for child education expenses, or to make additional personal contributions that qualify for the Government co-contribution.

### **Midwinter’s Reasonable Basis - Transition to Retirement optimisation**

Reasonable Basis – Transitions allows financial advisers to optimise a person’s retirement savings – WITHOUT changing net income levels and WITHOUT changing risk/return of the fund – simply by changing the way the person draws the income that is available to them.

In a matter of seconds, Reasonable Basis – Transitions finds the optimal pension income level to draw to gain the greatest tax benefits and increase in benefits at retirement (Note: pension income can range from 4% to 10% of the account balance at commencement and 1 July under the new rules). Statement of advice documents are automatically generated, providing financial advisers with necessary documentation to justify their strategic recommendation under ASIC’s FSR requirements. The increase in benefits can be demonstrated to the investor in additional income, assets and centrelink benefits in retirement or as a difference in superannuation at age 65.

Table 1 below highlights the increase in retirement benefits achieved by optimising the transition to retirement strategy using Midwinter’s Reasonable Basis software from age 55 to age 65.

**Table 1: Increase in superannuation benefits implementing Midwinter’s transition to retirement optimisation strategy maintaining current net income levels**

	Superannuation Balance at age 65							
Taxable Income - salary or business	\$100,000	\$150,000	\$200,000	\$300,000	\$400,000	\$500,000	\$750,000	\$1,000,000
\$25,000 p.a.	\$24,759	\$33,912	\$42,849	\$60,509	\$73,136	\$91,919	\$136,178	\$166,832
\$50,000 p.a.	\$32,349	\$46,821	\$61,061	\$89,303	\$112,990	\$134,528	\$181,249	\$226,301
\$75,000 p.a.	\$42,746	\$61,692	\$80,275	\$114,160	\$145,539	\$173,363	\$228,026	\$276,387
\$100,000 p.a.	\$43,365	\$65,045	\$86,730	\$129,350	\$166,615	\$191,844	\$243,227	\$293,968
\$150,000 p.a.	\$52,652	\$78,889	\$103,969	\$150,751	\$181,261	\$203,953	\$256,111	\$306,674
\$200,000 p.a.	\$52,653	\$78,985	\$105,306	\$151,671	\$178,825	\$202,466	\$253,210	\$303,278

**Assumptions**

- Earnings rate of 8%, fees of 1.6% giving a net earnings rate of 7.4% before tax
- Superannuation at age 55 comprises all post June 1983 benefits
- The 2006/7 personal tax rates are used in all personal tax calculations
- The minimum and maximum NCAP drawdown use the current PVF tables for 2006/7. After this they revert to a minimum of 4% and maximum of 10% in any one financial year.
- All fees and returns are calculated and applied monthly. All contributions are added month end.
- Superannuation tax is levied at 15% on all earnings (incl. capital gains) whilst no tax is levied on NCAP’s.
- It is assumed the individual retires at the end of the financial year, in the year of their retirement age.
- The Maximum Deductible Contributions will apply to all current and future deductible contributions and is indexed by AWOTE.
- No tax is levied on pension income from age 60 after 1 July 2007.

## **Common transition to retirement misconceptions**

- ***Transition to retirement only applies to high net worth individuals***

Midwinter's transition to retirement optimisation strategy substantially increases superannuation benefits for all Australians – it is not restricted to high income earners. In fact, it could be argued that it is those on the lower levels of superannuation at age 55 who need it most. As an example from Table 1 above, a person at age 55 earning \$25,000 salary and with \$100,000 in superannuation could expect an increase in superannuation benefits of \$24,759 at age 65. This is compared to what they would have had if they had not implemented the strategy and contributed only the required 9% SG over the 10 years.

- ***Draw maximum income from the pension for the best result***

The optimal results generated from a transition to retirement strategy are far from linear. There are far too many tax interactions and opposing forces at work to make this assumption. In fact the minimum pension level is generally the best outcome where superannuation benefits are large relative to income.

- ***Salary sacrificing down to \$25,000 will give you the best outcome***

This is a classic mistake in relation to TTR. It is assumed that salary sacrificing down to this level will mean the investor will fall below the 31.5% tax bracket (beginning at \$25,001). What they are failing to realise is that the income from the pension income is assessable to age 60 – which will push their total income back above the 31.5% level.