

The Magic Pudding gets heavier still...

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. TTRP 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 TTRP 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 TTRP 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 Midwinter’s 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. Pension Refresh – This involves commuting both the TTR Pension and Superannuation balances at the end of each year and rolling them over to commence a new pension. This has the effect of moving all superannuation benefits into the pension phase where any earnings are tax-free (compared to 15% in superannuation phase). It also means the TTR Pension balance is higher enabling a greater level of concessional tax or tax-free pension income (from age 60) to be drawn out of the pension which means there will be less reliance on taxable salary or self-employed income.
3. 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;
4. 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;
5. 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

6. 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.

Case Study – Taking Transition to Retirement to the extreme

David has just turned 55 and plans to retire at age 65. He earns a salary of \$75,000 p.a. (or \$57,375 net income) and has \$300,000 in superannuation. David is married and his wife takes a net income of \$45,000 p.a. The couple have determined they need about \$90,000 p.a. to live off. David wants to implement Midwinter’s transition to retirement strategy.

This case study explores three TTR strategies:

1. Midwinter’s basic TTR strategy – This consists of rolling his current \$300,000 superannuation balance into a Transition to Retirement Pension (also called Transition to Retirement Pension), and using Midwinter’s unique optimisation modeling finding the optimal level of pension income level to draw out and optimal salary sacrifice amount to contribute back to superannuation to maintain David’s current net income level of \$57,375;
2. Reducing Net Income Requirement – Here we take the basic strategy, but instead of maintaining David’s current net income level of \$57,375 we reduce his net income down to his required level of \$45,000 (splitting the combined net income requirement of \$90,000 equally between David and his wife). This means a reduction in net income in the transition to retirement but it has an exponentially positive effect on David’s total superannuation benefits at retirement (refer to “What other opportunities exist...” for explanation); and
3. Pension Refresh – This is taking the Set Lower Net Income strategy and improving the result further by commuting both the Transition to Retirement Pension and accumulated Super Balance each year and rolling them over to commence a new pension – effectively starting the TTR strategy from scratch again each year (refer to “What other opportunities exist...” for explanation).

	Net Income	Superannuation Balance	Transition to Retirement Pension	Total Benefits	Total Benefit Increase (\$/%)
Current Situation	\$57,375	\$580,249	N/A	\$580,249	N/A
Basic TTR Strategy	\$57,375	\$460,748	\$201,786	\$662,534	\$82,285 14.18%
Reducing Net Income Requirement	\$45,000	\$681,543	\$203,948	\$885,491	\$305,243 52.61%
Pension Refresh	\$45,000	\$0 (Rolled into pension phase)	\$920,051	\$920,051	\$339,803 58.56%

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 10% income from the TTR pension provides 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. There have been comments in the media that drawing 10% pension income will provide the best result. This is not true. In fact the minimum pension level is generally the best outcome where

superannuation benefits are large relative to income and will generally always be the case if the transition to retirement pensioner has utilised Pension Refresh strategy each year.

- ***Salary sacrificing down to \$35,000 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. What's more is that there are a number of benefits, such as the low income tax offset which are extremely attractive at income levels lower than the income tax threshold of \$35,000. The low income tax offset can provide up to \$1,200 for 2008/09 as a rebate to total tax payable and this occurs well below \$35,000.