Transition to retirement

what you need to know

A transition to retirement strategy may give you more flexibility and allow you to take advantage of tax concessions to help you achieve the lifestyle and super balance you want.

Beginning the transition to retirement

The years before you retire can be challenging. While you are probably looking forward to having more time to do the things you enjoy, you may not be ready to stop working just yet. Many people are also concerned about whether or not they have saved enough to provide them with a comfortable retirement – especially with retirees living longer than ever before. A transition to retirement (TTR) strategy can help you ease into retirement and boost your super in a tax effective way.

What is a transition to retirement strategy?

Transition to retirement strategies are designed to give you greater flexibility as you move towards retirement. Once you reach what's known as your 'preservation age', you can access your super by drawing down a pre-retirement pension (a regular income stream drawn from your super savings).

What's your preservation age?

By law, super contributions are generally locked away or 'preserved' until you reach your preservation age. Your preservation age is based on your date of birth (as set out in the table below). Once you reach your preservation age, you can begin drawing a pre-retirement pension. You will need to check with your super fund as not all funds offer pre-retirement pensions.

Date of birth	Preservation age
Before 1 July 1960	55
1 July 1960 – 30 June 1961	56
1 July 1961 – 30 June 1962	57
1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
On or after 1 July 1964	60

What is a pre-retirement pension?

A pre-retirement pension allows you to draw a regular income from your super while you're still working, provided you have reached your preservation age. There are restrictions on accessing your super as a lump sum, and limits to the level of payments you can receive each year, during this pre-retirement phase.

Prior to 1 July 2017, pre-retirement pensions are particularly tax-effective because earnings on assets supporting your pension are tax free, rather than taxed at 15% as your accumulation super balance is. However, from 1 July 2017, earnings on assets supporting pre-retirement pensions also become taxed at 15%.

Unlike retirement phase pensions, which are limited to $1.6 million from 1 July 2017, there is no limit to how much you can transfer into a pre-retirement pension from your super savings. So you don't have to worry about excess transfer balances.

Why start a pre-retirement pension?

If you would like to ease your way into retirement, a transition to retirement strategy could enable you to reduce the number of hours you work. While working less will mean a smaller pay packet, if you decide to take out a pre-retirement pension, you could supplement your work income with the pension payments. This would give you more time to do the things you enjoy, while maintaining your income and lifestyle.

If you continue to work without reducing your working hours, a pre-retirement pension also gives you the flexibility to drawdown an income and at the same time make pre-tax super contributions (e.g., through salary sacrifice), in a way that may be more tax effective than just relying on your salary alone. In many cases, you'll pay less tax on your pension income than you would on the same amount of salary or wages.

Depending on your circumstances, it could also be beneficial to use payments from your pre-retirement pension to:

- make after tax contributions to your super account,
- make contributions to your spouse's super account
- pay off debt.

Is a pre-retirement pension right for you?

Transition to retirement strategies don't suit everyone's circumstances. You should discuss the following factors with your financial adviser when deciding if a transition to retirement strategy is right for you:

- your age
- whether you have sufficient super to support drawing a pre‑retirement pension
- whether or not your employer will:
    - allow you to work part-time at a rate that suits you
    - allow you to salary sacrifice
    - agree to continue to pay your super guarantee (SG) contributions at the pre-salary sacrifice level
- your tax position
- your financial objectives and retirement needs
- the costs associated with this strategy.

Financial advice can make all the difference and help ensure you are not disadvantaged from a tax or social security perspective if you decide to implement this type of strategy.

Salary sacrifice

Once you're receiving payments from your pre-retirement pension, the surplus income could allow you to salary sacrifice an equivalent amount to super (take care not to exceed the relevant concessional contributions cap). This could maintain your after-tax income while boosting your super with tax-effective contributions.

Salary sacrifice contributions are taxed at just 15%[1], unlike the salary they replace which would be taxed at your marginal tax rate (which could be up to 45% plus applicable levies). Salary sacrificing may therefore reduce the amount of tax you have to pay.

In addition, investment earnings on contributions made to your super are also taxed at 15% or less, compared to your marginal tax rate (which would generally apply to investment income on your investments outside super).

A word about contributions caps

When considering any super strategy, it's important to assess how much you are contributing to super in any one financial year. The government has set annual limits – known as contributions caps.

The contributions caps for the 2016-17 financial year are:

- Concessional (pre-tax) contributions cap of $30,000 if aged under 49 at 30 June 2016, or $35,000 if older.
- Non-concessional (after tax) contributions cap of $180,000, or $540,000 over a three-year 'bring forward period' if you are under 65 years any time during the financial year you make the contribution.

Contributions caps are changing significantly for the 2017-18 year. The new caps are:

- Concessional (pre-tax) contributions cap of $25,000, regardless of age.
- Non-concessional (after tax) contributions cap of $100,000, or $300,000 over a three-year 'bring forward period' if you are under 65 years any time during the financial year you make the contribution.
- Your non-concessional contributions cap is reduced to Nil if your total superannuation balance (just prior to the start of a financial year) is $1.6 million or more. Your cap available during a bring forward period may also be reduced based on your total superannuation balance.

It's important to keep your financial adviser informed about any contributions you make, or your employer makes on your behalf so they can ensure you don't exceed these caps. Contributions over these caps may be taxed at up to 49% (47% from 1 July 2017).[2]

Pre-retirement pensions at a glance

- You must draw a pension payment of between 4% and 10% of your account balance each financial year.
- Earnings on assets supporting pre-retirement pensions are tax free prior to 1 July 2017, but taxable at up to 15% from that date.
- Pre-retirement pensions can be started with preserved and restricted non-preserved superannuation benefits[3] (as well as unrestricted non-preserved benefits, which can be accessed at any time).
- Lump sum withdrawals can only be made from a pre-retirement pension if:
    - they are from unrestricted non-preserved benefits [3]
    - you have reached preservation age, have ceased a gainful employment arrangement and do not intend to return to work for 10 hours or more per week
    - you are at least age 60 and have ceased gainful employment since turning 60
    - you have reached age 65.

– Once you are aged 60 or over in most cases you will pay no tax on the pension payments you draw from your pre-retirement pension. If you are between your preservation age and age 59, part of each payment you receive may be tax free, with the remaining assessable income in your hands and taxed at your marginal tax rate, but in most cases you will receive a 15% tax offset on the taxable payment.

1 If you have income greater than $300,000 (reduced to $250,000 from 1 July 2017), an additional 15% tax may apply to some or all of your concessional contributions.

2 Contributions made in excess of your concessional contributions cap are effectively taxed at your marginal tax rate, plus an interest charge. You are also able to withdraw up to 85% of any excess concessional contributions. Contributions made in excess of your non-concessional contributions cap are taxed at 49% (changes to 47% on 1 July 2017), however, you will generally instead have the option of withdrawing non-concessional contributions above your cap tax free, plus an associated earnings amount which is taxed at your marginal tax rate less a 15% tax offset.

3 Preserved and restricted non-preserved benefits are accumulated super benefits that are unable to be cashed out because you have not satisfied the appropriate condition of release e.g. being permanently retired after reaching your preservation age. For more information, contact your super fund or seek professional financial advice.

Speak to us for more information

If you have any questions, please speak to your Red Diamond Wealth Pty Ltd Financial Adviser.

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