

Transition to retirement

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What is the strategy?

An individual who wants to reduce working hours while maintaining the same level of income can do so by drawing a pension from superannuation using the transition to retirement condition of release.

Who is suited to this strategy and why?

This strategy is suitable for individuals who are:

- preservation age or older, and
- currently working, but wanting to reduce employment hours while retaining the same level of income.

The benefits of this strategy are:

- cash flow can be maintained during semi-retirement
- the overall return from superannuation investments is increased because earnings within the pension are tax free.

How the strategy works

Transition to retirement is a condition of release, allowing restricted access to superannuation for people who have reached preservation age (currently age 55) but are still working.

It allows a person to reduce their hours at work and still receive the same level of income, by drawing down the salary reduction amount from their pension.

The restrictions imposed under transition to retirement are as follows:

- funds can only be accessed in the form of a non-commutable pension
- lump sum withdrawals are not allowed, and

- pension income is limited to 10% of the account balance each year. The 10% limit is determined at commencement of the pension and every 1 July thereafter.

There is no limit to the amount of superannuation that can be used to commence a transition to retirement pension. Although various types of pension can be used, the most common is an account based pension because it offers the greatest level of flexibility.

For the 2011/12 financial year, the pension drawdown relief will be in the form of a 25% reduction in the minimum pension payment amount for account based, allocated and market linked pensions. This means that the annual minimum pension drawdown for a person under 65 years of age is 3%.

Account based pensions must pay a minimum pension from the account balance each year for people under age 65. The minimum is recalculated every 1 July based on the account balance on that date.

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Pension income is tax free to the individual if received after age 60. Pension income received prior to age 60 may be partially or fully taxable, with the taxable amount attracting a 15% tax offset.

Once the individual meets a full condition of release (such as permanent retirement), all transition to retirement restrictions are lifted and the individual will have full access to their funds.

For further information, refer to the flyers:

- Account based pensions
- Transition to retirement to increase cash flow
- Salary sacrifice.

Example

Dakota is age 57 and working full time earning \$50,000 per annum. Dakota wants to semi-retire so she can spend more time with her family, but she can't afford a reduction in her cash flow.

Dakota starts a transition to retirement pension. Based on a purchase price of \$170,000, she must draw annual income between her minimum of \$5,100 (3%) and maximum of \$17,000 (10%).

Dakota then arranges with her employer for her hours to be reduced resulting in a salary reduction of \$15,000. To replenish this lost income, Dakota only needs to draw pension income of \$12,170 because the pension income attracts a 15% tax offset.

The effect of this strategy is shown in the following table:

Cash flow	Before strategy	After strategy
Gross salary	\$50,000	\$35,000
Account based pension income	\$0	\$12,170
Taxable income	\$50,000	\$47,170
Tax on taxable income*	\$8,550	\$7,701
Less 15% pension tax offset	\$0	\$1,826
Less Mature age worker offset	\$500	\$500
Less Low income offset	\$700	\$813
Plus Medicare	\$750	\$708
Net tax payable	\$8,100	\$5,270
After-tax income	\$41,900	\$41,900

* 2011/12 financial year. Includes relevant tax offsets and the 1.5% Medicare levy.

Risks and implications

- Commencing a pension reduces the amount of superannuation available on retirement.
- Changes in legislation may reduce the flexibility or benefits that superannuation currently enjoys.



Note: Any advice contained in this document is general in nature and does not consider your particular situation or needs. Please do not act on this advice until its appropriateness has been determined by a qualified adviser.

Need more information?

Contact your Genesys wealth adviser to arrange a consultation.

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