Superannuation

Transition to retirement strategy

Aon Hewitt Financial Education Series

A transition to retirement strategy involves the commencement of a transition to retirement pension and salary sacrificing part of your income into super at the same time.

Please refer to the fact sheets on ‘Transition to Retirement Pension’ and ‘Salary Sacrifice’ for more information.

Why should I use this strategy?

Salary sacrifice is a tax-effective way to increase your retirement savings, however most people require their salary to pay for their living expenses. In this case your financial adviser may recommend that you commence a transition to retirement pension, and use that income to meet your living expenses.

This strategy is more beneficial than using your salary because part of your transition to retirement pension income may be tax free, and the rest carries a 15% tax rebate. When you reach age 60 all the income from the transition to retirement pension is tax free, so you are effectively replacing taxable salary with tax free income.

Under this strategy you are however holding two types of accounts: a super fund to accept future contributions and a transition to retirement pension which pays your income payments.

The Australian Tax Office (ATO) would never allow this!

Actually they do. The ATO has expressly stated that they have no problem with you salary sacrificing your salary into super and commencing a pension.

There must be a catch?

The only catch is that the money you are salary sacrificing into super will have contributions tax of 15% deducted from it (or 30% if your adjusted taxable income is above $250,000). This is the same contributions tax which is currently payable on your Superannuation Guarantee Contributions (SGC). You also have to ensure you do not exceed your super contribution limits.

Additionally, you can only receive up to 10% of the balance of your transition to retirement pension as an income each year.

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Will this strategy work for everyone?

The strategy is most effective for those:

- Aged 60 or over as the pension income is tax free.
- Aged between 55 and 59 and part of their pension income is tax free.
- With large super balances as they can receive a larger pension.
- With larger salaries as the tax savings are greater.

It must also be noted that if you choose to commence a transition to retirement pension, you are not required to rollover the full balance of your super into the pension. You are able to rollover any amount up to your account balance from your super fund, but you will need to be mindful of the minimum requirements set by the pension provider.

Your financial adviser will review your situation to determine if you can benefit from undertaking a transition to retirement strategy.

Example 1:

Ben is aged 57 and has $350,000 in his super account (which is 100% in the taxable component). Ben receives a salary of $60,000 each year (with super guarantee contributions of 9.5% or $5,700 a year), pays $12,147 in income tax and Medicare levy, and is currently spending all of his income.

Ben has completed a budget and believes that he can reduce his living expenses to $40,000 a year. Ben is 57 so he can commence a transition to retirement pension. He decides to use $150,000 of his super to start a pension which allows him to receive an income between 4% and 10% of his account balance, or $6,000 to $15,000.

Let's assume that Ben wants to maintain a net income of $40,000. After seeing a financial adviser, he salary sacrifices $1,600 per month (or $19,200 a year) into his super (this is still below his concessional cap of $25,000 after taking into account his super guarantee contributions of $5,550), and also draws a pension of $6,000.

Item	**Amount**
Salary	$60,000
Less Salary Sacrifice	($19,200)
Plus Transition to Retirement Pension Payment	$6,000
Taxable Income ($60,000 - $19,200 + $6,000)	**$46,800**
Income Tax Payable (plus Medicare levy)	$7,395
Less 15% Tax Rebate ($6,000 * 15%)	($900)
Total Income Tax Payable	$6,495
Net Income Received	**$40,305**
Plus Contributions Tax on the Salary Sacrifice	$2,880
Total Tax Payable	**$9,375**

Benefits of the strategy

Ben has saved $2,772 ($12,147 less $9,375) in total tax and his retirement savings have increased by $10,320 in one year, not including any investment earnings within super and the pension, as illustrated below:

Item	Amount
Opening Balance (includes super and transition to retirement pension)	**$350,000**
Plus Salary Sacrifice	$19,200
Less 15% Contributions Tax	($2,880)
Less Pension Payment	($6,000)
Closing Balance	**$360,320**
Increase in Retirement Savings*	**$10,320**

* Net of any fees and investment returns

Example 2

Mary is aged 60 and has $400,000 in her super (which is 100% in the taxable component). Mary receives a salary of $90,000 each year, pays $22,732 in income tax (including the Medicare levy), and wishes to retain close to her existing net income of $67,268 ($90,000 - $22,732). Mary's employer pays $8,550 of super guarantee contributions ($90,000 x 9.5%) and as such, she is limited to salary sacrificing $16,450 into super to stay under the concessional cap of $25,000.

As Mary is 60, she can receive all of her pension tax free. After receiving financial advice, she rolls over $200,000 of her super into a transition to retirement pension and is able to draw an income between 4% and 10% of her account balance, or $8,000 to $20,000. The way in which she can use a transition to retirement strategy to reduce tax and continue to meet her living expenses is shown below:

Item	Amount
Salary	$90,000
Less Salary Sacrifice	($16,000)
Taxable Income	**$74,000**
Less Income Tax	($17,077)
Plus Transition to Retirement Pension	$10,000
Total Income Received	**$66,923**

The tax payable is calculated as follows:

Item	Amount
Income Tax Payable (including Medicare levy)	$17,077
Plus Contributions Tax on the Salary Sacrifice	$2,400
Total Tax Payable	**$19,477**

Benefits of the strategy

Mary has saved $3,255 in total tax ($22,732 - $19,477), not taking into account any other rebates or tax offsets she may be entitled to, and her retirement savings have increased by $3,600 in one year not including investment earnings, as illustrated below:

Item	Amount
Opening Balance (includes super and transition to retirement pension)	**$400,000**
Plus Salary Sacrifice	$16,000
Less 15% Contributions Tax	($2,400)
Less Pension Payment	($10,000)
Closing Balance	**$403,600**
Increase in Retirement Savings*	**$3,600**

* Net of any fees and investment returns

Your financial adviser can assist you in calculating the best outcome for your personal situation.