

# Aspects of Financial Planning

## Transition to retirement

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The transition to retirement rules allow members who have reached a certain age to access their superannuation in the form of a non-commutable income stream without having to retire or leave their job.

### Background

The Treasurer in February 2004 announced a series of policy objectives in a paper titled 'A More Flexible and Adaptable Retirement Income System'. One of the measures discussed was the idea of people 'transitioning to retirement'. Regulations which give effect to this measure were subsequently released and thus the transition to retirement rules commenced from 1 July 2005.

The regulations are designed to dissuade people from deciding to retire or leave their job prematurely in order to access their superannuation benefits. They also cater for more flexible workplace arrangements for people making the transition from work to retirement, allowing people to retain a connection with the workforce for a longer period. The Government has cited a number of other benefits including greater labour force participation by mature age workers, increased retirement incomes amongst this group and the maintenance of economic growth in the context of an ageing population.

The transition to retirement rules allow people over preservation age (see below) to access their superannuation benefits as an income stream to supplement their employment income while still working. They enable people, for example, to move to part time work or reduce their responsibilities and hence the pay packet of their full time employment. There are no restrictions on the proportion of the superannuation benefit that can be converted to an income stream and no work or salary test to qualify. The only restriction is that the benefit must be taken as a non-commutable income stream (see below). It is not compulsory for superannuation funds to offer a transition to retirement product to members.





## Attaining preservation age

Under the transition to retirement rules, after reaching preservation age, currently 55 years and increasing to 60 years for people born after 30 June 1964, you are entitled to a limited condition of release known as 'Attaining Preservation Age'. Reaching preservation age will allow you to convert some or all of your accumulated superannuation benefit to a transition to retirement income stream, prior to retirement.

## Redefining pensions and annuities

Definitions were inserted into existing pension regulations to introduce transition to retirement pensions and annuities. In general terms, these have the same features as the existing income stream products except that transition to retirement pensions and annuities are non-commutable, meaning you are not able to make lump sum withdrawals except in very limited circumstances.

Such pensions cannot be commuted except:

- to give effect to an entitlement of a non-member spouse under a payment split
- to cash an unrestricted non-preserved benefit; or
- when a (full) condition of release has been satisfied.

In most cases people will choose to use an account based pension as their transition to retirement pension.

At any time the money used can be rolled back to the accumulation phase. Being able to do this may be necessary or desirable if the income stream is no longer required due to the member resuming full time employment for example. When choosing this type of product, the regulations contain provisions for flexibility to allow a member to keep their options open in transitioning from work to retirement.

In some cases a complying pension or annuity may have been commenced as a transition to retirement pension. In these products, the withdrawal rules are very restrictive and not even when a full condition of release has been satisfied is commutation available. A commutation within six months of commencement is permitted within certain circumstances however you may rollover to another complying transition to retirement pension or annuity at any time.

The decision to commence a complying non-commutable income stream should not be taken lightly.





## Rules and restrictions

The regulations are simple because in practical terms, these are not new income stream products, but slight variations of the existing ones.

### Non-commutable

As mentioned earlier, the income stream is 'non-commutable', meaning you are unable to make lump sum withdrawals. Depending on the type of income stream you purchase, it will revert to being commutable upon permanent retirement or turning age 65.

### Level of income

The level of income you receive per annum will depend on your requirements but also on the type of income stream you choose. The minimum income that is required to be drawn from an account based pension each year is 4% of the capital value for those under age 65.

For the 2008/09 and 2009/10 financial years, the Government introduced regulations which allowed for a 50% reduction in the minimum payments that are required to be taken in these years. The Government has further extended the reduction in the minimum payment amounts for the 2010/11 financial year.

The maximum income you are able to withdraw from a transition to retirement pension is 10% of the capital value each year.

### Tax on earnings

No tax is payable by the fund on the investment earnings accruing in the fund. Consequently a benefit of converting from the accumulation phase to income stream phase is the difference in tax rates. Investment earnings are taxed at 15% in the accumulation phase, but 0% in pension phase.

### Tax on income received

While no tax is payable on earnings in the fund, the income received in your hand may be assessable income and be taxable. If you are aged 60 and over you will receive your transition to retirement income tax free. If you are under age 60 however your income may constitute a taxable and/or tax free component. The taxable component will be assessable for tax however you will receive a 15% tax offset on this component. If the offset entitlement exceeds the tax payable on the assessable portion of the income, the remaining offset can be used to reduce the tax payable on other income you may receive. There is no tax payable on the tax free component.





## **Death benefit**

On death, any remaining funds can be paid as a lump sum or transferred as an income stream to a nominated dependant; or paid as a lump sum to any non-dependants or your Estate.

## **Opportunities**

A transition to retirement pension can be combined with other strategies to provide a better retirement outcome. Examples of these include contributing excess income into superannuation as a non-concessional contribution and if eligible, claiming a Government co-contribution; making additional personal contributions and claiming a tax deduction, if eligible; and salary sacrificing a portion of your salary income into superannuation. The salary sacrificing strategy has received much media attention – please see our Aspect 'Transition to Retirement – Salary Sacrificing Strategies' for more information.

## **Cautionary notes**

### **Depleting superannuation balance**

It is important to remember there is a price to pay for accessing your superannuation benefits prior to full retirement. Over the period of transition, your superannuation balance is gradually being depleted, and although your employer, or yourself, may still be contributing into your superannuation fund, this may be at a lower rate than previously and consequently you need to consider the impact on your long term savings for retirement.

### **Preservation**

A superannuation benefit may contain portions of unrestricted non-preserved benefits, accessible at any time, restricted non-preserved benefits, limited access, and preserved benefits, not accessible until a full condition of release is satisfied. When you commence a transition to retirement income stream it is likely these benefits will be reduced in the order they are described above (i.e. unrestricted non-preserved first). Even worse, unrestricted non-preserved benefits may be deemed to be preserved by your superannuation fund.

This may have implications if the superannuation benefit is commuted back to accumulation phase, as the unrestricted non-preserved benefit may be lost, possibly rendering your remaining benefit inaccessible.

## **Administration**

The administrative burden of modifying existing products and setting up systems and procedures for this new type of preservation status will, in most part, lie with product providers and administrators.





Self managed superannuation funds (SMSFs), if allowable under the trust deed, will also be able to provide a transition to retirement product alternative for members. Clients administrating their own SMSFs will need to be aware of the legislation and accordingly keep appropriate records. Trustees of SMSFs will need to be mindful of the non-commutable nature of the transition to retirement income streams and not allow members access to superannuation benefits prematurely.

## Conclusion

The transition to retirement regulations have wide ranging implications for many of our clients. In most cases the benefits will allow increased flexibility and opportunities for those people who would prefer to transition into retirement. Taxation benefits exist within the fund due to pension assets having a 0% tax rate and in the ability to access the 15% tax offset or receive transition to retirement income tax free if over 60. You may also be able to take advantage of other financial planning opportunities such as the salary sacrifice strategy previously mentioned.

As outlined above however, accessing your superannuation funds prior to full retirement will have a significant impact on your long term benefits as you will be depleting your superannuation balance. We therefore advise you speak to your financial planner before you 'transition to retirement'.





## Centric Wealth Advisers Ltd may be able to be of assistance

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