Transition to retirement and salary sacrifice strategies
July 2012

An effective strategy for those who are 55 years old and over combines salary sacrificing into superannuation and simultaneously drawing an income from your superannuation benefit. This can provide a number of immediate and long term benefits, however to maximise the outcome the strategy should be determined on a case by case basis.
Background

Transition to retirement laws introduced from 1 July 2005 allow those who are at least 55 years to access their superannuation benefit in the form of an income stream, prior to their retirement. Transition to retirement (TTR) income streams are very popular because they provide certain income and tax benefits as well as work and retirement flexibility.

An effective way to boost retirement savings and reduce your tax bill is to enter into a superannuation salary sacrifice agreement (SSA) with your employer. Salary sacrificing means you forgo receiving income in your hand in return for a contribution into superannuation. This practice has also risen in popularity as people have become aware of the need to accumulate funds for retirement and recognise that superannuation represents a tax effective vehicle for savings.

This Aspect discusses the benefits that can be achieved when the above two strategies are used concurrently. Superannuation retirement benefits can be increased when a TTR income stream is used in conjunction with salary sacrificing into superannuation. However it is important to note that for many of our clients, the effectiveness of this strategy has been greatly reduced with the halving of the concessional contributions cap.

Further details of each of these strategies can be found in our Aspects, ‘Transition to Retirement’ and ‘Salary Sacrifice’.

How it works

The strategy is simple. It firstly requires commencement of a TTR income stream with monies from an existing superannuation benefit. Secondly, enter into an effective SSA with your employer so part of your pre-tax salary is redirected into superannuation.

It seems that the combined strategy could leave a neutral cash flow and superannuation balance position. However by replacing salary income with superannuation income and redirecting salary to superannuation, you are effectively taking advantage of tax concessions offered by superannuation. In most circumstances, this will improve net income, reduce taxation and increase your end retirement benefit. In order to maximise the net result the amounts needed to fund a TTR draw down and salary sacrifice into superannuation must be determined on a case-by-case basis as individual circumstances are different.

The benefits

The combined TTR and salary sacrifice strategy pulls together a number of notable benefits including:

Flexibility of income level

Where most employees receive a fixed income, a TTR income stream offers a certain degree of income flexibility as you will be able to adjust your nominated TTR income within a prescribed minimum and maximum level.

The minimum income is 4% of your account balance at the commencement of the pension, pro-rated for a part year, and at each subsequent 1 July.

Note: The minimum payment amounts were halved for certain pensions and annuities for the 2008/09, 2009/10 and 2010/11 years. The Government has further extended the reduction in the minimum payment amounts for the 2011/12 and 2012/13 financial years to a 25% reduction of the minimum income payment. This means that in this financial year, only 3% of the account balance is required to be taken as pension income for those pensioners aged under 65 (ie. 75% x 4%). The minimum payment amounts will return to normal from 1 July 2013.

The maximum income you are able to withdraw from a TTR pension is 10% of your account balance each year.

A flexible income stream can assist in meeting changes in lifestyle and cash flow requirements however be wary of withdrawing funds beyond cash flow requirements as this will reduce the benefits of the strategy. Some individuals will also be able to periodically adjust their SSA, hence achieve further income flexibility.

If at any stage you no longer want to use this strategy, you are able to stop a TTR income stream and transfer your benefits back into the accumulation phase of superannuation.

Lower income tax

Income tax may be reduced because compared to salary income which is taxed at personal marginal tax rates, superannuation contributions and benefits receive concessional taxation treatment. TTR income streams commenced after 1 July 2007 will either be tax free if paid to a person over age 60 or be subject to a 15% tax offset on the taxable portion if the recipient is under age 60.

Salary sacrifice superannuation contributions are subject to tax inside the superannuation fund at a maximum of 15% which is potentially lower than the tax charged if salary income is received in the hand.

0% tax on earnings

There are tax savings within the fund supporting the TTR income stream because where earnings were being taxed at up to 15%, while accumulating, there is no tax on earnings in pension or income stream phase. This represents a significant tax saving for larger superannuation balances or if funds are held in a self managed superannuation fund (SMSF). Moreover for those running a TTR income stream from their SMSF, if...
assets supporting the pension are segregated (your adviser can explain this), then assets with unrealised capital gains could be realised with a 0% capital gains tax rate. A big advantage in some cases!

Build retirement savings
Depending on your circumstances, this strategy can lead to a number of other benefits including the ability to make additional personal non-concessional and/or concessional superannuation contributions into your superannuation or your spouse’s superannuation fund. In fact although commencing a TTR income stream will draw down on superannuation savings prior to permanent retirement, because of additional contributions via the SSA and the tax concessions of a TTR income stream, in many cases the strategy will result in a higher overall superannuation balance.

Other considerations
Part IVA
As the combined TTR income stream and salary sacrifice into superannuation strategy can produce significant tax savings the industry sought confirmation that the anti-avoidance provisions contained in Part IVA of the Income Tax Assessment Act 1936 would not apply. The Australian Taxation Office (ATO) has announced that “the general anti-avoidance provisions will not apply where taxpayers are simply commencing a transition to retirement pension, and making salary sacrifice contributions to superannuation”. These “straightforward arrangements” are deemed “OK”, however the ATO would be concerned in circumstances where “accessing the pension or undertaking the salary sacrifice may be artificial or contrived”. We recommend individuals seek a private binding ruling from the ATO if they are concerned.

Concessional contributions cap
All employer contributions (including superannuation guarantee (SG) and salary sacrifice contributions) are concessional contributions. The concessional contributions cap for 2012/13 is $25,000 pa for everyone, regardless of age. Any contributions made in excess of the cap are subject to additional tax at the rate of 31.5%.

Law recently passed to temporarily pause the indexation of the concessional contributions cap so that it remains fixed at $25,000 up to and including the 2013/14 financial year. In 2014/15, the general cap is expected to increase to $30,000 through indexation, and the higher cap would then commence at $55,000.

Note: The Government announced in the 2012 Federal Budget that the start date of increasing the concessional contribution cap for individuals over 50 with low superannuation balances will also be deferred by two years, from 1 July 2012 to 1 July 2014.

Under the higher concessional contribution cap measure, individuals aged 50 and over with superannuation balances below $500,000 will be able to make up to $25,000 more in concessional contributions than allowed under the general concessional contribution cap.

The two year deferral means that for 2012/13 and 2013/14, all individuals will be able to make concessional contributions of up to $25,000 per year as permitted under the general concessional contribution cap.

It should be noted that most Budget measures are proposals only, legislation is still required to be passed with possible changes and clarification to be provided.

The TTR and salary sacrifice strategy has become less effective as the ability to make salary sacrifice contributions is effectively limited to under the cap.

Preservation and non-commutability
It is important to understand the disadvantages of a TTR income stream and salary sacrifice strategy. Significantly, until you permanently retire or reach age 65, your TTR income stream is non-commutable. This means you are unable to make lump sum withdrawals from the funds that support the TTR income.

Further, 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. Salary sacrifice superannuation contributions are fully preserved until you meet a condition of release such as permanent retirement.

Will it work for you?
In order to determine whether this strategy will work for you, you will need to assess the potential rewards and risks the strategy entails. In the short to medium term you will not be able to access lump sums from the funds that support your TTR and your salary sacrifice superannuation contributions will be preserved. In the long term you should consider the possibility that changes to super law may have a negative impact on your strategy. Bear in mind that the net result will differ from person to person however given the concessional tax treatment of superannuation the TTR strategy is one with universal appeal.