

Tax breaks on way to retirement

A transition-to-retirement pension strategy can be used by nearly anyone

MICHAEL LAURENCE



SUPERANNUATION specialist Meg Heffron says a superannuation fund member aged 60-plus with a high account balance and a high salary "would be crazy" not to consider a transition-to-retirement pension strategy.

The co-principal of specialist self-managed super fund administrator Heffron, she describes such members as ideal candidates for what is arguably the best tax and retirement savings strategy in superannuation, depending on a member's circumstances.

The most popular version of the strategy involves taking a TTR pension and re-contributing the money (or even more) back into super mainly through salary-sacrificed contributions.

This could potentially cut tax on a portion of a member's salary by as much as two-thirds and eliminate tax on superannuation assets backing the pension.

While Tim Sanderson, a senior technical manager with Colonial First State, says ideal candidates for a TTR pension are high-income, high-balance members in their 60s, as described by Heffron, far more lower-balance, lower-income members could benefit "than initially thought". This is despite the strategy not being as financially rewarding for them. Heffron agrees.

Sanderson believes lower-income, lower-balance individuals are much forgotten when financial planners recommend TTR strategies to their clients.

In broad terms, Sanderson is convinced most fund members aged over 55 (the minimum age for eligibility) would benefit from having a TTR pension.

And almost everyone over 60 would benefit, perhaps apart from a very few who are already contributing to their maximum concessional and non-concessional contribution caps.

But he warns that a minority of members aged 55 to 59 — depending on their circumstances — will find that taking a TTR pension will add to their taxable income. It is crucial for would-be users of TTR pensions to consider their particular circumstances.

TTR pensions were initially introduced six years ago as a means for fund members aged 55-plus to reduce their working hours in their run-up to retirement and to make up for the lost income with a pension.

But most TTR users continue to work full time and re-contribute the amount of their pension back into super.

Tax and savings benefits

THE potential tax and savings benefits from a TTR pension-salary sacrifice strategy are straightforward.

- Income and capital gains of superannuation assets backing the payment of a pension (including a TTR pension) are exempt from tax. (Stuart Jones, editor of the *Australian Superannuation Handbook* published by Thomson Reuters, describes this as the "greatest advantage" of the TTR/salary-sacrifice strategy.)

- Any taxable portion of pension payments receives a 15 per cent tax offset until members reach 60, at which time the pension becomes tax-free.

- Salary-sacrificed and personally deductible contributions are taxed at

Case study: transition-to-retirement strategy

Detail	2011-12# scenario one (\$ (No TTR))	2011-12## scenario two (\$ Year one)	2012-13### (\$ Year two)
Salary package	200,000	200,000	200,000
Super contributions (salary sacrifice/SG)	-18,000	-50,000	-25,000
TTR pension (tax-free because member is over 60)		60,000	60,000
Total income	182,000	210,000	235,000
Gross PAYG payable	55,450	43,450	52,700
Medicare	2730	2250	2625
Flood levy	1070	750	1000
Total tax	59,250	46,450	56,325
After-tax income	122,750	163,550	178,675
Saving by using TTR strategy		40,800 (against scenario one)	55,925
Super fund			
Opening balance		1,500,000	1,500,000
Concessional contribution		-50,000	-25,000
Fund earnings (at 7%)		105,000	105,000
Pension		-60,000	-60,000
Tax on contribution		-7500	-3750
Fund balance after 12 mths		1,587,500	1,566,250

Member profile: Age 60, starting super balance, \$1.5 million backing TTR pension. Fund earnings, 7%

Source: OnePath

15 per cent instead of margin tax rates.

Graeme Colley, national technical manager of financial services group OnePath, says a TTR pension-salary sacrifice strategy enables most fund members over 55 to simultaneously minimise their tax and increase their super savings.

Low-income members

SANDERSON looks at the example of a 60-year-old with \$300,000 in super and an assessable income of just \$25,000 from a part-time job.

This member will benefit from using the entire super balance to begin a TTR pension, taking the minimum annual pension of normally 4 per cent of the balance and re-contributing the money as a non-concessional (after-tax) contribution. The pension payments are tax-free because he is over 60, earnings on the \$300,000 backing the pension are tax-free, and the member becomes eligible for a \$1000 government co-contribution to super.

Given certain assumptions about fund earnings, Sanderson calculates that this

TTR strategy will provide the member with \$26,567 more in super by the time he retires in five years.

Low-balance members

"THERE has been some commentary saying that TTR pensions are not worth taking unless your balance is over \$200,000 or \$300,000," Sanderson says. "I certainly disagree with that."

He gives the case of a 55-year-old member with \$70,000 in super and a 30 per cent marginal tax rate.

This member uses all of their balance to begin a TTR pension, takes a maximum allowable annual pension of 10 per cent of the balance and re-contributes the extra income from the pension as salary-sacrificed contributions.

Again, given assumptions about fund earnings and the taxable component of their pension payments, Sanderson calculates that this TTR strategy will add \$9838 to the member's super by the time they retire in five years.

The extra super is generated because earnings on the super balance are no

longer taxable, and less tax is payable on the member's personal income because of salary-sacrificed contributions. And a tax rebate applies to the pension payments.

Contribution limits

SOME fund members are reluctant to take a TTR retirement pension because they are already contributing up to their concessional contribution caps. This means they cannot adopt the popular TTR pension-salary sacrifice strategy.

But Sanderson emphasises that a TTR pension may still provide a valuable advantage.

He looks at the example of a 60-year-old member with a \$500,000 super balance who is already contributing up to their concessional contributions.

In this case study, the member used the entire balance to back a TTR pension, choosing to receive the usual annual minimum pension of 4 per cent.

As this member cannot make any more salary-sacrificed contributions, they contribute the entire tax-free

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Footnote: # Scenario one concessional contribution \$25,000 from 2012-13. \$ non-concessional contribution

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Super map is key to retiring

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Ian Silk, chief executive of AustralianSuper, describes the benefits for members of TTR pensions as a much overlooked feature of Australia's retirement-income system. "TTRs haven't received the prominence or publicity they should have." In short, he suspects that many super fund members simply do not recognise the potential advantages.

"Every person approaching retirement should be looking carefully at whether a TTR strategy is beneficial for them," Silk says. "A large number of people are finding to their surprise that it is very financially beneficial."

On the face of it, the proportion of AustralianSuper members taking a TTR pension seems low. Of its 1.8 million members, 2800 receive a TTR pension. But Silk explains that given the profile of the fund's membership, including typical balances near retirement, "we have a pretty healthy take-up of TTRs". The number of members taking the pensions with AustralianSuper has doubled in the past year.

"A significant proportion of our retiring members have relatively low account balances, and many choose to cash out their super to pay off debt, buy a vehicle or whatever," Silk says. Such members would not have taken a TTR pension before retirement.

However, Silk emphasises that of the eligible AustralianSuper members' larger account balances, a high proportion will take a TTR pension. The average balance of the fund's members with a TTR pension is \$200,000. Most continue to work full time.

Like Rice, Silk regards a TTR pension as a bridge for super funds to keep members for life. "I think industry funds have woken up to the fact that it is one thing to carefully manage members' superannuation savings in the accumulation phase, but it is only doing half the job if that's where their stewardship of members' savings end."

Nathan McPhee, chief executive of superannuation researcher SuperRatings, expects competition between super funds marketing their TTR pensions will become even hotter because the strategies are so crucial to their businesses. McPhee is confident a fund will "almost certainly keep a member who has executed a TTR strategy for the next decade and beyond", provided it doesn't do anything to upset the member.

Until a few years ago, McPhee says industry funds focused on their younger members and left it largely to the retail funds to snare the older, larger balance members. But this has changed.

More than 42 per cent of the pension members with NGS Super take a TTR pension. Fund chief executive Anthony

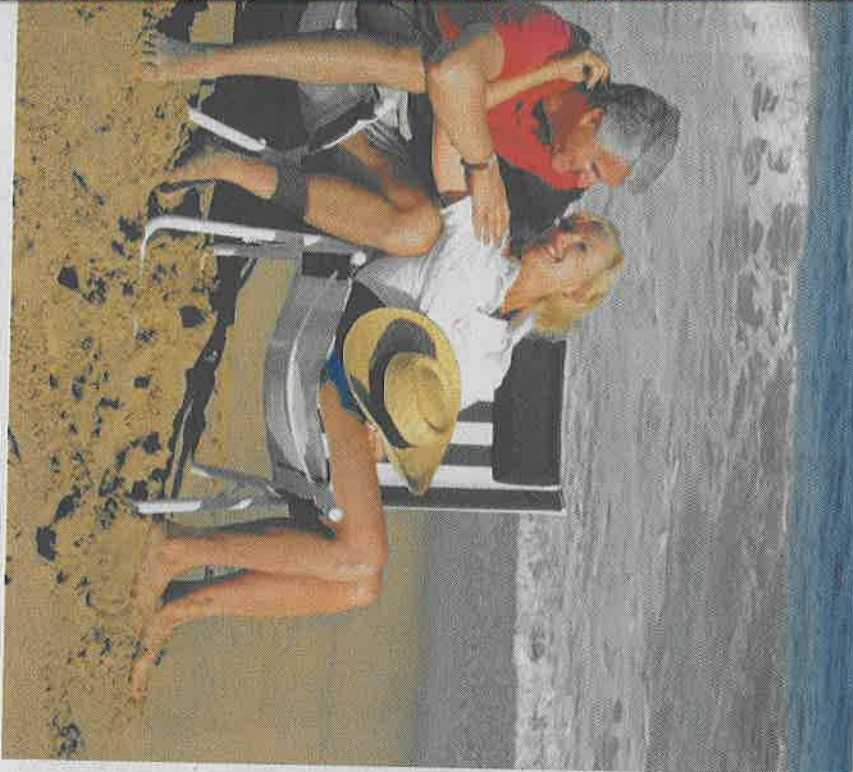
Rodwell-Ball says the high percentage appears to suggest that most members who are still in the workforce and eligible for a TTR pension have taken one.

NGS — which has \$3.9bn in assets and 89,000 members — loses many members with balances under \$100,000 on retirement. Such members tend to withdraw their money from super rather than take a pension. "But we retain 70 to 80 per cent of members at that vulnerable stage of retirement," Rodwell-Ball says.

"And we convert them to pensions (if they are not already in a TTR). We have seen a significant growth in our pension assets over the past few years; our deliberate strategy is paying off."

NGS Super members typically have \$200,000 to \$250,000 in their TTR pension accounts.

Michael Dwyer, chief executive of First State Super, which has \$32bn in assets and 760,000 members, believes the TTR pension-salary sacrifice strategy gives members a "turbo-charged opportunity" to increase their super savings. About half of First State Super's pension members have TTR pensions, which is considered a high percentage. (SuperRatings regards the proportion of a fund's pension members who take a TTR pension as a proxy for its level of engagement with members.) State Super's pension, launched five years ago, has more than \$1bn in assets.



to TTR strategy. SG contributions only. ##Scenario two - TTR strategy. Maximum \$50,000, \$60,000 TTR pension. ### TTR strategy. Concessional contribution cap cut to balance is \$21,250 less after first year because of lower cap. However, member can make