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Transition to Retirement Strategy – down, but not out

Thanks to changes to superannuation, from 1 July 2017 Transition to Retirement (TTR) pensions will lose a little of their gloss. Instead of the earnings on the investments that support the pension being exempt from tax they will be taxed at 15%. This applies to both new and existing pensions.

However, that's about the extent of the bad news. For those over 60, the pension payments will remain tax-free and TTR strategies can continue to provide a number of benefits for people nearing retirement. Let's look at some options available to 62-year-old accountant, Brian. He works full time and is on an annual salary of $100,000.

Easing into retirement

First up, Brian might consider reducing his hours as he prepares for retirement. Dropping from five to three days a week will see his $100,000 annual salary reduce by $40,000 to $60,000. But as his tax bill also falls, from $26,632 to $12,147, his net income only drops by $25,515. Subject to minimum and maximum pension payment rules, and as the pension payments are exempt from tax, Brian only needs to start a TTR pension paying $25,515 each year to maintain his current lifestyle.

One thing to be aware of: based on Brian's reduced hours his employer's super contributions will decrease by $3,230 after contributions tax of 15% is taken into account. Most simply, Brian could add this amount to his pension payments, and make a non-concessional contribution to his super.

Bridging a gap

TTR pensions can also help bridge the gap if household income takes a hit. What if Brian has no plans to reduce his hours, but illness prevents his partner from working for several months? He could start a TTR to tide them over and help meet mortgage repayments or medical expenses. However, once the crisis has passed the TTR pension will need to continue, as it can't be withdrawn as a lump sum. Alternatively, it can either be converted to a regular account based pension when Brian either turns 65 or permanently retires, or rolled back into the accumulation phase.

Boosting super savings by reducing tax

With his partner restored to health and back at work, and Brian still working full time, what can he do with the now surplus income from the TTR pension? One strategy is to make salary sacrifice contributions to super.

From 1 July 2017 Brian will be able to salary sacrifice up to $15,500 of his pretax income to superannuation (the difference between the concessional cap of $25,000 less compulsory employer contributions of $9,500). Taken as salary, $5,932 of that $15,500 would go in tax. Make a concessional contribution to super and the tax could be reduced to just $2,325, a difference of $3,607!

If there's still money to spare after the salary sacrifice contribution is made Brian can look at making non-concessional contributions to superannuation where earnings will only be taxed at 15%, significantly less than his marginal tax rate.

Getting it right

> The tax benefits of TTR pensions may be reduced after 1 July 2017, but all the other benefits remain in place. If you're approaching retirement, it's worth checking out what a TTR strategy may be able to achieve for you. It's a complex area, so make sure you talk to your licensed financial planner before you act.

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