CASE STUDY: TRANSITION TO RETIREMENT (TTR) – HIGHER INCOME

Build wealth for retirement

Transition to Retirement at a glance

Transition to retirement is a strategy available to those who have reached their 'preservation age' but who have yet to retire permanently, and who wish to either reduce their working hours and supplement their employment income or build their wealth for retirement. The TTR Wealth Creation strategy works by replacing taxable employment income with concessionally taxed or tax free pension income.

Until 2005, super benefits could generally only be accessed prior to age 65 upon total retirement after reaching 'preservation age'. This meant that it was difficult for those who wished to 'transition to retirement' to reduce their working hours and maintain their income. The rules were therefore changed to allow those who had reached their preservation age but not yet retired to access their super via a non-commutable retirement income stream.

What's in it for me?

If you are thinking of reducing your working hours gradually prior to permanent retirement, a Transition to Retirement (TTR) strategy can provide additional income to replace the employment income forgone due to your reduced working hours.

Alternately, a TTR strategy can be used to build your wealth between preservation age and retirement, with the benefits continuing to flow through retirement. It is this TTR as a wealth creation strategy that is the focus of this Case Study.

How does the TTR wealth creation strategy work?

The wealth accumulation benefits of a TTR strategy are substantially the result of various taxation benefits. Firstly, income from employment or self-employment is taxed at a marginal tax rate of up to 47%. Whereas, income received from a superannuation pension is either:

- Age 55-59 – taxed at your marginal tax rate on the taxable component only and also receives a 15% tax offset that reduces the effective tax rate
- Age 60+ - tax free

Preservation Age

Date of Birth	Preservation Age :
Before 01/07/1960	55
01/07/60 – 30/06/61	56
01/07/61 – 30/06/62	57
01/07/62 – 30/06/63	58
01/07/63 – 30/07/64	59
On or after 30/06/1964	60

What is a Non-Commutable Retirement Income Stream?

A non-commutable retirement income stream is one from which lump sum withdrawals generally cannot be made; capital can be accessed only via income payments. Income payments are limited to a **maximum of 10%** of the account balance either at commencement or at 1 July each year. The most common type of retirement income stream used for a TTR strategy is an Account Based Pension.

What is an Account Based Pension?

An Account Based Pension (ABP) is a super pension which has an account balance, generally offers a wide range of investment options and provides the ability to vary the income payments. Except in the case of a Non-Commutable ABP for a TTR strategy, there is no maximum income level. Income each year must only be at least the minimum income based on age:

Age	Pension Min	Age	Pension Min
<65	4%	85-89	9%
65-74	5%	90-94	11%
75-79	6%	>95	14%
80-84	7%		

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Secondly, the income paid by the super pension allows you to then direct part of your salary to super via salary sacrifice contributions or allow you to pay personal contributions to super for which you are then able to claim a tax deduction.

Salary sacrifice contributions are deducted from your salary before income tax is debited and are instead taxed as income to your super fund at the super tax rate of up to 15% for incomes below $250,000 pa or up to 30% for incomes above $250,000 for the 2019 financial year. The same tax outcome applies to personal contributions to super for which you claim a tax deduction. In any case, the tax applicable to super contributions is a substantial discount to the tax applied to personal taxable income whenever that income is higher than $37,000 per annum at which the marginal tax rate is 34.5% including the Medicare levy. Even for those with incomes above $250,000 whose concessional contributions to super are taxed at up to 30% in total receive a substantial discount relative to the 47% tax rate including Medicare that applies to their taxable income.

Thirdly, as noted above, the income paid from the pension may be taxed at a lower rate than your employment income. This potentially allows you to draw down less from the pension than you are contributing to super via salary sacrifice contributions. Thereby increasing your wealth over time.

Concessional Contributions

'Concessional Contributions' is the financial jargon for super contributions for which the payer claims a tax deduction. Concessional Contributions are taxed at up to 15% within your super fund, and include super guarantee, salary sacrifice, additional employer and personal contributions for which a tax deduction has been claimed.

Concessional Contributions Cap

An annual cap on Concessional Contributions applies each financial year and contributions exceeding this amount will be exposed to additional tax. For the 2018/19 financial year the Concessional Contributions Cap is:

» **$25,000 per annum per person**

The contribution caps mean that there are now limits to the ability to accumulate non-super wealth and make large contributions to super just before retirement, especially tax effectively; it is therefore now more advantageous to make smaller contributions throughout our working lives. There has always been a benefit to doing so however the contribution caps reinforce this benefit. Salary sacrifice contributions or personal contributions for which a tax deduction is claimed can be an ideal way of making such contributions

The TTR Wealth Creation strategy involves the following steps:

» Rollover most (but not all) of your super into a TTR pension (usually a type of Account Based Pension)
» Commence a pension and receive income
» Salary sacrifice employment income to super – being mindful not to exceed the Concessional Contributions Cap. Alternately, if the full Concessional Contribution Cap is utilised, Non-Concessional Contributions can be made from after-tax salary
» Adjust super pension income and employment income to provide your desired take home pay
» Regularly review the strategy to ensure it continues to meet your requirements, takes account of any legislative changes and that you do not incur unnecessary taxes,
» Periodically consider whether the strategy should be 'refreshed' to maximise the tax concessions and contributions to your net wealth outcomes over time

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Please note that specialist advice is required when considering a TTR strategy to ensure the strategy adds value in your circumstances. If the TTR strategy is suitable for you, Ongoing Planning is essential to ensure that you make the most of the opportunities provided by this strategy over time

Who can benefit from a TTR Wealth Creation Strategy?

TTR can work effectively if you:

- Want (i.e. need) to grow your retirement savings and/or have a comfortable retirement
- Have reached preservation age
- Are eligible to contribute to super, including anyone under age 65
- Have a marginal tax rate above 15% (in the 2019 financial year, taxable income over $37,000 pa). Higher income earners receive higher benefits
- Do not use the full amount of your Concessional Contributions Cap or your Non-Concessional Contribution Cap
- Have a reasonable super balance

What are the catches?

- Excess Contributions Tax – exceeding the Concessional Contributions Cap will result in additional tax which may reduce the benefits of the strategy (although the previous harsh penalty taxes have now been removed)
- [Salary sacrifice only] You should check whether sacrificing some of your salary to super adversely affects your employee entitlements, including whether your super guarantee or employer contributions would be reduced
- [Salary sacrifice only] Ideally have a written agreement/request with your employer for the salary sacrifice arrangement

Case Study: Transition to Retirement (TTR) Wealth Creation

Meet Judy: Judy is 57, earns $180,000 pa plus super. Judy characterises herself as a ***'pre-retiree'*** as she has started to think about what her life in retirement will look like. Judy currently intends to work until age 65 however she would like to keep her options open in case she wishes to (and is in a position to afford to) reduce her working hours before then. Judy also realises that as she hasn't had super throughout her full working life and has previously focused on repaying her mortgage, she has some ground to make up if she wants to have options in retirement.

Judy wishes to build her wealth however she requires the same take home pay to meet her day-to-day living expenses. she was therefore finding it difficult to see how she could add to her wealth prior to retirement. However, Judy decided to speak with Mammoth Financial to see if there was a better way.

Throughout their discussions, Mammoth Financial discusses the following options with Judy:

1. **No Transition to Retirement Strategy** – continue with the existing arrangements whereby her super is maintained unaltered and she continues to receive only super guarantee contributions to super
2. **Transition to Retirement Strategy** – rollover all of her super into a TTR pension; select an income from the super pension which enables him to make the most productive use of the available super contribution caps; her super guarantee contributions continue; she commences salary sacrifice to super and also pays Non-Concessional Contributions from her continuing excess after-tax income; review this arrangement on an ongoing basis

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Judy's take home or after-tax income is the approximately the same in both scenarios.

Please note that this Case Study is an illustration and actual results with vary. You should seek specialist personal financial advice before taking in action in relation to the strategies considered in this Case Study

Assumptions:

- Timeframe: 8 years to age 65
- Inflation: 2.3% pa
- Salary increases: 3.5% pa
- Super Contributions - Current: super guarantee only - 9.50% in the 2019 financial year ($17,100 pa), increasing to 12% in accordance with the current law
- Existing super - $400,000
- Investment Profile – Balanced Growth - for both super and pension: income: 3.79%; growth – 2.70%; total – 6.49%; franking credits – 18.07%
- Ongoing Advice & Investment Costs: 2.00% pa (this is illustrative only and not intended to reflect any individuals actual costs)
- Judy has and maintains private health insurance
- Current legislation
- TTR Strategy Refresh: yearly
- TTR Strategy - Super Pension Income: Year 1 - $16,000
- TTR Strategy - Salary Sacrifice / Personal Tax-Deductible Contributions: Year 1 - $7,900
- TTR Strategy – Non-Concessional Contributions: Year 1 - $11,181

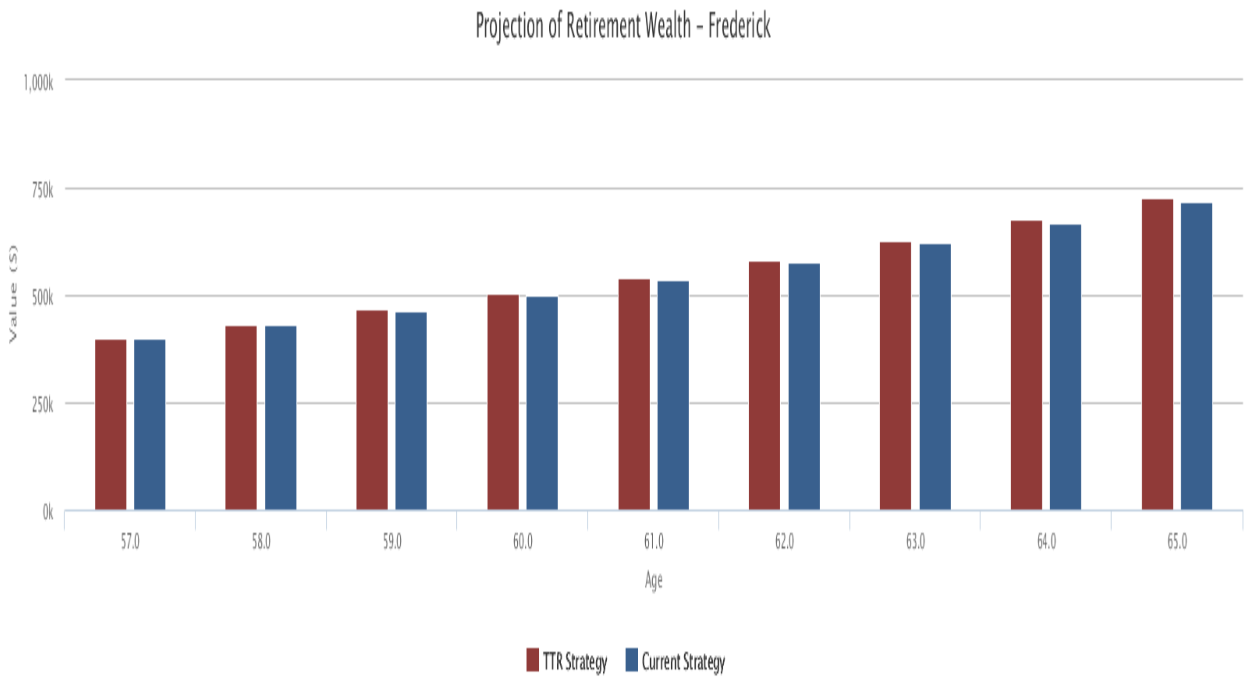
In the Transition to Retirement strategy, Judy adjusts her super pension income each year such that her total Concessional Contributions which include super guarantee and salary sacrifice contributions, to super approach yet remain within the Concessional Contribution Cap each financial year. The income that Judy is required to draw from her super pension exceeds the amount of the Concessional Contributions Cap tat Judy has available after her super guarantee contributions that must be paid in relation to her salary, and therefore Judy also pays Non-Concessional Contributions from her after-tax income

What hasn't changed?

Judy's cash flow has been managed throughout the timeframe of this strategy to be substantially the same. In the first year, Judy's take home income is $122,303 without the TTR strategy and the same with the TTR strategy.

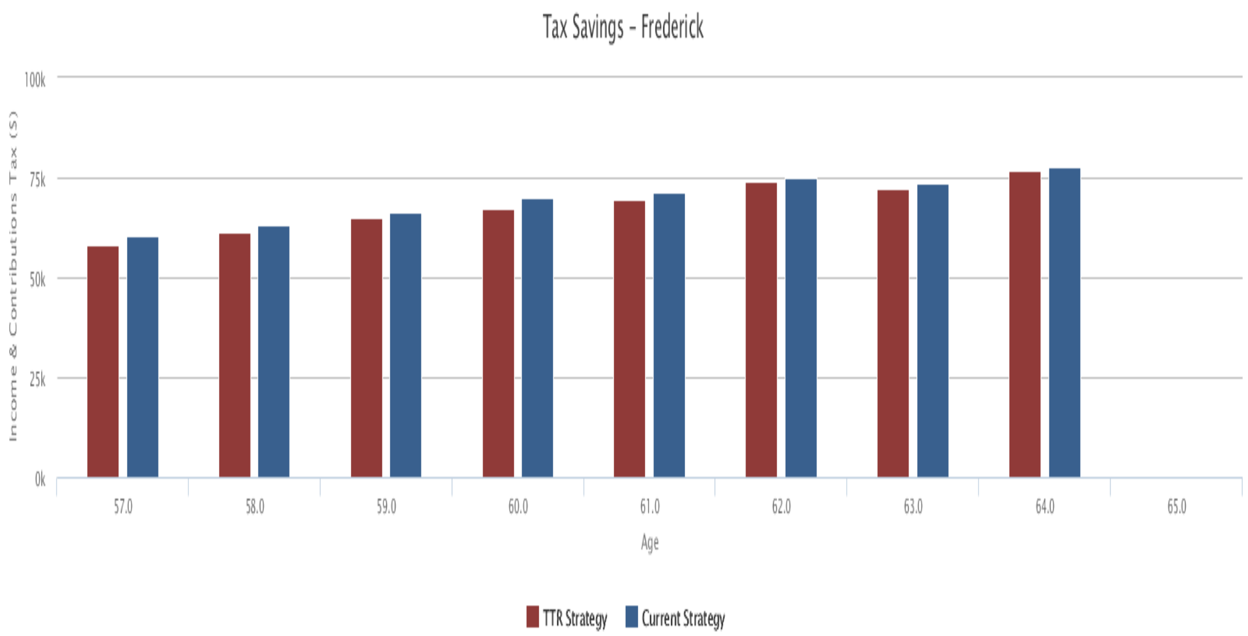
How is Judy better off?

Judy has **saved income tax** each and every year of the TTR Strategy, as shown below where the **blue bars** are No TTR Strategy and the **red bars** are the TTR Strategy:



The tax savings increase from age 60 when the super pension income becomes tax free.

The graph below shows the value of Judy's **investment assets** (super and pension) over time to age 65 where the **blue bars** are No TTR Strategy and the **red bars** are the TTR Strategy:



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The table below summarises the benefits provided by the TTR Strategy:

	No TTR Strategy	TTR Strategy	Benefit of TTR Strategy
Income Tax Payable until Retirement	$532,589	$512,313	**-$20,275** [tax saving]
Investment Assets – at age 65	$747,311	$761,665	**+$14,354**

Judy decides to establish a TTR Strategy and looks forward to living off the same take home income, saving **$20,275** in income tax (excluding super contributions tax) and being better off by **$14,351** in the level of her assets at age 65 ***even though her cashflow remains unchanged***. Judy then looks forward to benefiting further from these additional assets as they provide tax free income potentially throughout the 20-30 years of her retirement!

Clearly the TTR strategy adds value even for those whose super guarantee contributions in relation to their salaries utilise most of the available Concessional Contribution Cap and result in the minimum income that the super pension must pay exceeding the amount that can be salary sacrificed to super or paid as personal tax-deductible contributions provided that they also do not already utilise the full amount of their Non-Concessional Contribution Cap as well.

Why does the strategy add value?

At Mammoth we appreciate that understanding why strategies add value increases the opportunities for you to benefit from them so we have provided the list below summarising what makes the strategy work:

- Concessionally taxed super pension income to age 60 – while the taxable portion of Judy's pension is taxable income until she reaches age 60, she receives a 15% tax offset that results in the less tax being paid on the pension income than is payable on her employment income. We note that the tax-free portion (which we have assumed to be nil in this Case Study as that illustrates a less favourable outcome) of super pension income is paid tax free even prior to age 60
- Tax free super pension income from age 60
- Lower tax on employment income – tax of 15% on salary sacrifice contributions relative to tax of 39% for Judy if paid as salary
- Compound investment returns – the magic of compound investment returns operates in both scenarios however due to the lower tax rates discussed above, there is a larger amount invested and added to the investments each year in the TTR Strategy to benefit from the magic
- Existing super balance – Judy has sufficient existing super to make the strategy add value in her circumstances
- Asset ownership – the TTR strategy increases assets that are owned in super which means that they are already owned by the ownership structure that provides the most effective outcomes throughout retirement, and therefore there are no tax or other transaction costs incurred at retirement to reach that asset ownership position
- Retirement Income & Tax – super is able to be held in a retirement phase super pension after satisfying a super retirement condition of release (such as permanent retirement after preservation age, termination of employment after age 60 or attaining age 65) where all investment income and realised capital gains are free from tax, and therefore a given level of assets will provide the same

income in retirement for longer or a higher income for the same period or both than the same level of assets owned via almost any other asset ownership structure, including in your personal name

Important note: the TTR strategy can be made even more effective if you meet a retirement condition of release for super by enabling the TTR pension to be converted to an Account Based Pension without the TTR restrictions (subject to the terms of your product provider or SMSF allowing this) which will result in the tax rate applicable to investment income and realised capital gains on assets held in the super pension reducing from up to 15% to 0% from that date forward. If your product provider or the Governing Rules of your SMSF do not allow a simple 'conversion' of the existing super pension from a TTR pension to a retirement phase Account Based Pension, you may need to cease the existing TTR pension and commence a new retirement phase Account Based Pension

What would alter the effectiveness of the strategy?

- Existing super – a higher existing super balance will generally enhance the value of the strategy or at least provide greater flexibility
- Salary Income – the tax savings are greater for those with higher salaries and therefore marginal tax rates, however this is somewhat limited by the amount of salary that can be sacrificed within the Concessional Contribution Cap and the additional tax paid on certain Concessional Contributions by those with incomes above $250,000. If your income is higher please refer to the higher income version of this Case Study
- Starting Point – as with many strategies, time is a key ingredient and therefore starting earlier will generally result in a greater amount of value being created
- Self Managed Super Fund – operating a TTR strategy within a SMSF offers a high degree of flexibility including the ability to readily rollback and recommence pensions if your income requirements change or other adjustments are required, potentially without the need to make any changes to the investments you own via super

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Need more information?

If you wish to discuss how this strategy can apply to your situation & potentially increase your ability to achieve your objectives, please feel welcome to contact Mammoth Financial on:

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