

# Transition to retirement

A transition to retirement strategy may give you more flexibility and allow you to take advantage of tax concessions to help you achieve the lifestyle and super balance you want.

## Beginning the transition to retirement

The years before you retire can be challenging. While you are probably looking forward to having more time to do the things you enjoy, you may not be ready to stop working just yet. Many people are also concerned about whether or not they have saved enough to provide them with a comfortable retirement – especially with retirees living longer than ever before. A transition to retirement (TTR) strategy can help you ease into retirement and boost your super in a tax effective way.

## What is a transition to retirement strategy?

Transition to retirement strategies are designed to give you greater flexibility as you move towards retirement. Once you reach what's known as your 'preservation age', you can access your super by starting a transition to retirement income stream (a regular income stream drawn from your super savings).

## What's your preservation age?

By law, super contributions are generally locked away or 'preserved' until you reach your preservation age. Your preservation age is based on your date of birth (as set out in the table below). Once you reach your preservation age, you can start a transition to retirement income stream. You will need to check with your super fund as not all funds offer a transition to retirement income stream.

| Date of birth              | Preservation age |
|----------------------------|------------------|
| Before 1 July 1960         | 55               |
| 1 July 1960 – 30 June 1961 | 56               |
| 1 July 1961 – 30 June 1962 | 57               |
| 1 July 1962 – 30 June 1963 | 58               |
| 1 July 1963 – 30 June 1964 | 59               |
| On or after 1 July 1964    | 60               |

## What is a transition to retirement income stream?

A transition to retirement income stream allows you to draw a regular income from your super while you're still working, provided you have reached your preservation

age. There are restrictions on accessing your super as a lump sum, and limits to the level of payments you can receive each year, during this pre-retirement phase.

Unlike retirement phase income streams, which are subject to a \$1.7 million 'transfer balance cap' from 1 July 2021, there is generally no limit to how much you can transfer into a transition to retirement income stream from your super savings. So you don't have to worry about excess transfer balances until you reach age 65 or notify your fund that you have met another eligible condition of release such as retirement.

Since 1 July 2017, earnings on assets supporting transition to retirement income streams are taxed at up to 15% in the same way as assets supporting your accumulation phase super (prior to 1 July 2017, earnings on assets supporting transition to retirement income streams were tax free). However, once you reach age 65 or notify your fund that you have retired, are incapacitated or have a terminal illness, the assets supporting transition to retirement income streams are tax free – at that time the value of your transition to retirement income stream counts towards your transfer balance cap.

## Why start a transition to retirement income stream?

If you would like to ease your way into retirement, a transition to retirement strategy could enable you to reduce the number of hours you work. While working less will mean a smaller pay packet, if you decide to take out a transition to retirement income stream, you could supplement your work income with the pension payments. This would give you more time to do the things you enjoy, while maintaining your pre-retirement income and lifestyle. Your retirement savings will be reduced by this strategy.

If you continue to work without reducing your working hours, a transition to retirement income stream gives you the flexibility to drawdown a pension income and at the same time make pre-tax super contributions (e.g. through salary sacrifice), in a way that may be more tax effective than just relying on your salary alone.

Depending on your personal circumstances and tax position, you may pay less tax on your income stream income than you would on the same amount of salary or

wages. Implemented correctly, the tax savings from this strategy can help boost your retirement savings.

Depending on your circumstances, it could also be beneficial to use payments from your transition to retirement income stream to:

- make after tax contributions to your super account
- make contributions to your spouse's super account
- pay off debt.

### **Is a transition to retirement income stream right for you?**

Transition to retirement strategies don't suit everyone's circumstances. You should discuss the following factors with your financial adviser when deciding if a transition to retirement strategy is right for you:

- your age
- whether you have sufficient super to support drawing a transition to retirement income stream
- whether or not your employer will:
  - allow you to work part-time at a rate that suits you
  - allow you to salary sacrifice
  - agree to continue to pay your super guarantee (SG) contributions at the pre-salary sacrifice level
- your tax position
- your financial objectives and retirement needs
- the costs associated with this strategy.

Financial advice can make all the difference and help ensure you are not disadvantaged from a tax or social security perspective if you decide to implement this type of strategy.

### **Salary sacrifice**

Once you're receiving payments from your transition to retirement income stream, the surplus income could allow you to salary sacrifice an equivalent amount of employment income to super (take care not to exceed the relevant concessional contributions cap). This could maintain your after-tax income while boosting your super with tax-effective contributions.

Salary sacrifice contributions are generally taxed at just 15%<sup>1</sup>, unlike the salary they replace which would be taxed at your marginal tax rate (which could be up to 45% plus applicable levies). Salary sacrificing may therefore reduce the amount of tax you have to pay.

In addition, investment earnings on contributions made to your super are also taxed at 15% or less, compared to your marginal tax rate (which would apply to assessable investment income on your investments outside super).

### **A word about contributions caps**

When considering any super strategy, it's important to assess how much you are contributing to super in any one year. The Government has set annual limits – known as contributions caps, and additional tax may apply where you exceed the caps<sup>2</sup>.

The contributions caps for the 2021-22 financial year are<sup>3</sup>:

- A basic concessional contributions cap of \$27,500 per financial year.
- Any amount of the basic concessional contributions cap you do not use in a financial year from 1 July 2018 onwards, may accrue for the following five financial years and be used to increase the basic concessional contributions cap in financial years from 1 July 2019 onwards. To be eligible to increase your basic concessional contributions cap in this way, you must have a total super balance<sup>4</sup> of less than \$500,000 just before the start of the financial year.

For example, if you made no concessional contributions in 2018-19 when the basic concessional contributions cap was \$25,000, you may contribute an extra \$25,000 in total between 1 July 2019 and 30 June 2024, on top of the basic concessional contributions cap, if your total super balance is less than \$500,000 at the end of the previous financial year.

- A non-concessional contributions cap of \$110,000 per financial year, or up to \$330,000 over a three-year period (known as the bring-forward rule) if you are under age 67 any time during a financial year<sup>5</sup>. In addition:
  - Your non-concessional cap reduces to Nil once your total super balance<sup>4</sup> (just before the start of the year) is \$1.7 million or more.
  - The cap you have available under the bring-forward rule will reduce once your total super balance<sup>4</sup> (just before the start of the year) is \$1.48 million or more.

### **Transition to retirement income streams at a glance**

- You must draw an income stream payment of between 2% and 7% of your account balance each financial year, depending on your age.
- Earnings on assets supporting transition to retirement income streams are taxable at up to 15% (prior to 1 July 2017 these earnings were

tax free). Once you turn 65 or notify the fund that you have retired, are permanently incapacitated or terminally ill, the earnings are once again tax free.

- The value of your transition to retirement income stream will only count toward the \$1.7 million transfer balance cap if: you are age 65 or over; you have notified the fund that you have retired, are permanently incapacitated or terminally ill; or the income stream reverts to an eligible beneficiary in the event of your death.
- Transition to retirement income streams can be started with preserved and restricted non-preserved superannuation benefits<sup>6</sup> (as well as unrestricted non-preserved benefits, which can be accessed at any time).
- Lump sum withdrawals can only be made from a pre-retirement pension if:
  - they are from unrestricted non-preserved benefits<sup>6</sup>
  - you have reached preservation age, have ceased a gainful employment arrangement and do not intend to return to work for 10 hours or more per week
  - you are at least age 60 and have ceased gainful employment since turning 60
  - you have reached age 65
  - you meet another eligible condition of release such as being terminally ill or permanently incapacitated.
- Once you are aged 60 or over in most cases you will pay no tax on the income stream payments you draw from your transition to retirement income stream. If you are between your preservation age and age 59, part of each payment you receive may be tax free, with the remaining assessable income in your hands and taxed at your marginal tax rate, but in most cases you will receive a 15% tax offset on the taxable payment.

## Why financial advice is important

Transition to retirement strategies can be complicated so it's best to speak to your financial adviser for more information. They can explain the options available for your specific goals and objectives.

- 1 If you have income greater than \$250,000, an additional 15% tax may apply to some or all of your concessional contributions.
- 2 Excess non-concessional contributions tax of 47% is imposed on excess non-concessional contributions that remain in a superannuation interest. However, from 1 July 2018 excess non-concessional contributions, plus 85% of an associated earnings amount, will be released from super where possible by the ATO as a default option, to prevent a taxpayer paying 47% tax on the excess non-concessional contributions. The associated earnings amount is assessable income of the member personally and is taxed at their marginal tax rate less a 15% non-refundable tax offset. Alternatively, a member may elect that the excess amount not be released from a superannuation interest. In this event, the ATO will issue the individual an excess non-concessional contributions tax assessment for 47% of the excess amount. An individual may also be liable to pay a general interest charge where the excess non-concessional contributions tax liability is not paid by the due date.
- 3 Contributions caps were significantly reduced from 1 July 2017. Higher concessional and non-concessional contributions caps applied for the 2016-17 financial year.
- 4 Total super balance is broadly the total of all your superannuation accounts, whether in the accumulation or pension phase.
- 5 The Government proposed in the 2019 Federal Budget, effective 1 July 2021, to allow people age under 67 at any time during a financial year (e.g. 65 and 66 year olds) to trigger the non-concessional bring-forward rule.
- 6 Preserved and restricted non-preserved benefits are accumulated super benefits that are unable to be cashed out because you have not satisfied the appropriate condition of release e.g. being permanently retired after reaching your preservation age. Unrestricted non-preserved benefits may be accessed at any time. For more information, contact your super fund or seek professional financial advice.

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