Case Study

Using a Transition to Retirement Pension

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A Transition to Retirement (or TTR) Pension allows people who have reached their 'preservation age' (now 56 years of age and above, or 55 years of age if you are born before 1 July 1960), to draw a regular income from their superannuation. This can be of particular benefit if someone wants to reduce their working hours as it can supplement a loss of income. Alternatively if a person wants to legally minimise their tax, they can do so while still increasing their superannuation savings, for their eventual retirement.

How does a Transition to Retirement Pension work?

This strategy allows a person to draw a pension from superannuation to supplement their income while they 'transition' from full time employment to retirement.

There are limits on the amount of income that a person with a TTR pension must adhere to. Once the pension is commenced, a person who is under the age of 65 must draw a minimum of 4% of the balance over the Financial Year (note the minimum increases at set age brackets). Additionally, no more than 10% of the balance can be drawn per Financial Year and no lump sums can be drawn.

One of the key points that needs to be considered is that before the age of 60, the 'taxable component' of the pension drawn is added to assessable taxable income, less a 15% tax rebate. However, after the age of 60, all pension payments are received tax free, regardless of the 'taxable component'.

How does a TTR pension work in real life?

Jane, 59 years of age, works Full-Time earning $70,000. Jane currently has $200,000 in super. Her current tax position is summarised below (Scenario 1).

	Scenario 1
Ordinary Wages	$70,000
Tax on Assessable Income	$ 14,297
Medicare Levy	$ 1,400
Tax Liability/(Refund)	$ 15,697
Total After Tax Income	$ 54,303

If Jane decides to reduce her working commitments by 1 day a week, it's natural that her take home pay would reduce (Scenario 2). To supplement Jane's income, she converts her superannuation into a pension, and draws the maximum amount (10%) from her pension. As Jane is under 60 years of age, the taxable component is added to her assessable income, and the 15% pension rebate is added back (Scenario 3). The next year, once Jane reaches 60 years of age, all pension payments are tax free – increasing her after tax income even further (Scenario 4).

	Scenario 2	Scenario 3	Scenario 4
Ordinary Wages	$56,000	$56,000	$56,000
Taxable Pension Payment	$ -	$9,000	**$ -**
Taxable Income	$56,000	$65,000	$56,000
Tax on Assessable Income	$9,747	$12,672	$9,747
Less: Low Income Rebate	$160	$25	$160
Net Tax Payable	$9,587	$11,297	$9,587
Medicare Levy	$1,120	$1,300	$1,120
Tax Liability/(Refund)	$10,707	$12,597	$10,707
After Tax Income	$45,293	$52,403	$45,293
Tax Free Pension Payments	$ -	$11,000	$20,000
Total After Tax Income	$45,293	$63,403	$65,293

So, how do you increase your superannuation?

This strategy may also be considered if there is no change in your working hours. Salary sacrificing into superannuation reduces the amount of personal income tax you would ordinarily pay. This is because all pre-tax superannuation contributions are taxed at 15%, regardless of your personal marginal tax rate (MTR). As your own MTR increases, the greater the benefit is in making pre-tax contributions into superannuation. For example, if your personal MTR is 49%, this is a difference of 34%.

While contributing additional funds into superannuation further reduces your take home pay, this difference in take home pay can be supplemented by the income received from a TTR pension. Again, this can be of particular benefit after the age of 60 years, when all pension payments are tax free.

How does a TTR pension and salary sacrificing work in real life...

Again let's look at Jane's situation. However, in this instance Jane doesn't want to reduce her working hours. As Jane is over the age of 49, she can concessionally contribute a total of $35,000 p.a. each Financial Year (including the 9.5% superannuation contribution from her employer). This leaves an additional $28,350 that can be contributed into superannuation.

If Jane commits to this arrangement (Scenario 5), not only does her superannuation contributions increase, but her tax liability and take home pay decreases. Depending on her income requirements, she may no longer have sufficient after tax income to maintain her lifestyle. Therefore, by commencing a TTR Pension, and drawing an income from the pension (Scenario 6), Jane's total after tax income increases, while maximising her superannuation contributions, and decreasing her overall tax liability. This decrease in tax liability becomes even more apparent once Jane turns 60 years of age, when no tax is paid on any pension payments drawn from superannuation (Scenario 7).It is important to be conscious of any change to your situation, which may impact your Age Pension entitlements.

	Scenario 5	Scenario 6	Scenario 7
Ordinary Wages	$70,000	$70,000	$70,000
Taxable Pension Payment	$ -	$ 9,000	**$ -**
Less: Salary Sacrifice	$ 28,350	$ 28,350	$ 28,350
Taxable Income	$41,650	$50,650	$41,650
Tax on Assessable Income	$ 5,083	$ 8,008	$ 5,083
Less: 15% Pension Rebate	$ -	$ 1,350	$ -
Less: Low Income Rebate	$ 375	$ 240	$ 375
Net Tax Payable	$ 4,708	$ 6,418	$ 4,708
Medicare Levy	$ 833	$ 1,013	$ 833
Tax Liability/(Refund)	$ 5,541	$ 7,431	$ 5,541
Contributions Tax	$ 4,253	$ 4,253	$ 4,253
Total Tax Liability/(Refund)	$ 9,794	$11,684	$ 9,794
After Tax income	$ 36,109	$ 43,219	$ 36,109
Tax Free Pension Payments	$ -	$ 11,000	$20,000
Total After Tax Income	$36,109	$54,219	$56,109

But it gets even better...

Another benefit is the tax treatment that superannuation assets within the pension phase receive. Ordinarily, superannuation funds that are in the 'accumulation phase' have their earnings taxed at 15%, and any capital gains are taxed at a maximum rate of 10%. However, compared to when superannuation assets are in the 'pension phase' all earnings and capital gains are taxed at a 0%.

The table below summarizes the benefit of moving to the pension phase, based on a total return of 8.50% p.a., comprising income of 4.75% p.a. (of which 30% is fully franked), capital growth of 3.75% p.a. as well as a fee of 1.10% p.a.:

	Accumulation	Pension
Income Return	4.75%	4.75%
Franking Credits	0.61%	0.61%
Fees	-1.10%	-1.10%
Tax Payable	**0.64%**	**0.00%**
Less Franking Credits	0.61%	0.61%
Net Tax Payable	0.03%	-0.61%
Net Income Return	**3.62%**	**4.26%**
Capital Growth	3.75%	3.75%
Total After Tax Return	**7.37%**	**8.01%**

As can be seen, there is a return differential of 0.64% p.a. simply by moving your superannuation assets from the accumulation to the pension phase. Therefore, in the first year alone, the additional benefit to Jane on $200,000 of superannuation would be $1,280 p.a.

Where to from here?

If you are 55 years of age and over, are thinking about reducing your working hours, want to contribute additional money into superannuation, or just want to minimise the amount of tax that you pay while you work, then these strategies may be of financial benefit to you.

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