Case Study

Transition to Retirement Pensions - Are They Still Worth it?

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What is a Transition to Retirement Pension?

Like the name suggests, Transition to Retirement (TTR) Pensions are a form of income stream commenced from superannuation funds, with the intention of assisting a person to move from full time to part time employment without forgoing any loss of income.

From these Pensions, a person can take anywhere between 4% and 10% of the 1 July account balance. The 10% restriction is lifted upon reaching age 65 or upon retirement. For people aged 60 years and over, the pension payments drawn are completely tax free. While people between their preservation age (which is dictated by your birth date) and 59 years, there are potential tax consequences upon receiving these pension payments. The percentage of the pension payment that is from a taxable component, less a 15% offset, is taxed at their marginal tax rate. No tax is payable on the tax free component of the income taken.

What is the benefit of a TTR Pension?

Supplementing a person's income, while moving into retirement is one major benefit.

A number of people also use TTR Pensions to tax effectively increase their concessional (pre-tax) contributions into superannuation. As all concessional contributions into superannuation (for those with an adjusted taxable income of less than $250,000) are taxed at 15% compared to a person's marginal tax rate which can be as high as 47% (including Medicare Levy), there is a taxation arbitrage of up to 32%.

Another significant benefit prior to 1 July 2017 was that TTR Pensions also had an internal taxation benefit to them. All income and realised capital gains from the investments supporting TTR Pensions were taxed at zero. Many people therefore legitimately ran TTR Pensions due to this internal tax benefit, rather than supplementing their take home pay or assisting them to make additional superannuation contributions.

From 1 July 2017, this internal taxation benefit for TTR Pensions has ceased. All income and realised capital gains from investments supporting TTR Pensions are now internally taxed as if the assets were in the accumulation phase, which is 15% on income and 10% on capital gains for assets held greater than 12 months.

With the reduction in the concessional contribution cap from $35,000 to $25,000 into superannuation, the tax effectiveness of running these pensions to support a person's concessional contributions does appear to have reduced.

Are TTRs still worthwhile?

The answer is that it depends on your situation.

For a person under the age of 60 who is already contributing to the concessional contribution cap, the taxation benefits from 1 July 2017 are marginal. This is outlined in the example below:

Jack (age 59) has a salary of $60,000 and a super balance of $250,000. Jack converts his entire super balance to a TTR Pension, and salary sacrifices a total of $19,300 p.a. To ensure the total amount of income received from all sources remains the same, Jack draws a pension payment of $15,635 p.a. which is assumed to be 100% taxable (and therefore receives a 15% tax rebate).

Benefit of TTR over one year	TTR (old rules)	TTR (new rules)
Net additional super contribution	$770	$770
Internal tax saving	$1,463	NIL
TOTAL BENEFIT	$2,223	$770

However, if Jack is over the age of 60, all of the pension payment is tax free in his personal name. As Jack no longer needs to pay any tax on the pension payment, then he only needs to take $12,352 p.a. to allow him to continue to salary sacrifice $19,300. This increases the personal tax savings of this strategy, as outlined below.

Benefit of TTR over one year	TTR (old rules)	TTR (new rules)
Net additional super contribution	$4,053	$4,053
Internal tax saving	$1,463	NIL
TOTAL BENEFIT	$5,516	$4,053

Alternatively, if a person was already maximising their concessional contributions under the old $35,000 cap, the $10,000 decrease to $25,000 has the reverse impact as an additional $10,000 is now taxed at a person's marginal tax rate.

TTR Pensions may also still be worthwhile if one of these situations also applies to you

- You are reducing your working commitments and therefore wish to use the TTR Pension income to supplement your income, upon the reduction of employment hours.
- You need to take funds out to pay for a large expense or you want to pay down some accumulated debt or a mortgage.
- You and your spouse have uneven superannuation account balances and you may want to either;
  - Rebalance your respective accounts now that there is a $1.6 million cap on the amount of money a person may have in an Account Based Pension, or
  - Increase one member of a couple's superannuation account balance to maximise future Centrelink opportunities.
- Estate planning considerations may also be of importance, as recycling superannuation which has a high taxable component back into superannuation as a non-concessional contribution can increase a member's tax free component. This reduces the amount of tax paid by non-financial beneficiaries upon receipt of the funds, through the member's death.

In summary

While changes to super legislation reduce the effectiveness of running these TTR Pensions after 1 July 2017, every person's situation is unique and therefore an analysis of the benefits of running a TTR Pension is required.