



A GUIDE TO PRE-RETIREMENT PENSIONS

A pre-retirement pension presents an opportunity for you to access your super once you reach your preservation age. Unlike other rules for accessing your super, you don't need to retire or change jobs to access your money.

Examples of how you could use a pre-retirement pension include:

- Moving from full-time work to part-time work and replacing lost salary with a pre-retirement pension
- If you operate your own business, using pre-retirement pension to supplement your income needs in quiet times.
- A pre-retirement pension may also help reduce your overall tax bill while boosting your total super balance before you retire.

Here's how it works. You contribute part of your salary to super (where it's typically taxed at 15 per cent rather than at your marginal tax rate). You then move your super money into a tax-free pre-retirement pension and draw a pension to supplement your salary. The 15 per cent pension rebate also reduces your personal income tax.

Your preservation age

Under current superannuation law you must reach your 'preservation age' before you can access your super. Your preservation age depends on the date you were born.

Non-commutable income stream

Your pre-retirement pension must be via a 'non-commutable' income stream. Non-commutable means you can't convert the income stream to cash and take it as a lump sum payment until you satisfy a full condition of release from super, such as retirement or turning 65.

Your pre-retirement pension will work in exactly the same way as a standard superannuation pension, subject to the non-commutable requirements. For example, if you use an Account Based Pension, there are set minimum and maximum payments each year (currently determined by your account balance and aged). You also have the flexibility to vary the payment at any time during the year within the set ranges.

| Date of Birth | Preservation Age |
|-----------------------------|------------------|
| Before 1 July 1960 | 55 |
| 1 July 1960 to 30 June 1961 | 56 |
| 1 July 1961 to 30 June 1962 | 57 |
| 1 July 1962 to 30 June 1963 | 58 |
| 1 July 1963 to 30 June 1964 | 59 |
| After 30 June 1964 | 60 |

Self managed super funds

If you plan to use this strategy through a self managed super fund you should make sure the trust deed is drafted broadly enough to allow you to take out any pension allowed under superannuation law.

Things you should consider

Because pre-retirement pension is non-commutable, you should set funds aside to offset those funds that are preserved.

You should also keep in mind the possibility of redundancy or a forced or unplanned early retirement once you're over 55, which could interrupt this retirement strategy. You may need to review the strategy so that you stop drawing from your retirement savings.

Transition to Retirement

Case Study 1 - Part-time work plus a transition to retirement income stream

David is 55. He is paid a gross salary of \$85,000 per annum for a 5 day week, and receives a net income of \$62,625 after-tax and Medicare Levy is deducted. He needs approx. \$62,500 per annum after tax for his living expenses but he would like to work for just four days per week. If he moves to 4 days per week, his gross income would be reduced to \$68,000 and his net income would reduce as follows:

| | |
|-------------------------------------|-----------------|
| Gross Income p.a. (4 days per week) | \$68,000 |
| Less PAYG Tax & Medicare levy | (\$16,020) |
| Net income | \$51,980 |

In other words, David's take home pay is short by \$10,645 (\$62,625 - \$51,980).

Assuming David has \$300,000 (all from taxed sources) in superannuation to overcome his cash flow deficit, David can use \$250,000 of his super to start a Non-commutable Account Based Pension.

David has a choice of how much pension payment he wishes to receive between the minimum and maximum limits. David chooses to receive pension payments of \$13,600 in the first full year. Now his position looks like this:

| | |
|---|-----------------|
| Gross Income p.a. (4 days per week) | \$68,000 |
| Vision Non-commutable Account Based Pension | \$13,600 |
| Taxable Income | \$81,600 |
| Less PAYG Tax & Medicare levy | (\$20,964) |
| Add Tax Rebate on Account Based Pension | \$2,040* |
| Net income | \$62,676 |

Using transition to retirement rules, David can maintain his lifestyle working only four days a week. If he chooses, he can slowly phase down to full retirement over several years by decreasing his expenses and eventually his working hours. This can be done with periodic reviews of his super strategies.

Case Study 2 - Full time work plus a transition to retirement income stream.

A transition to retirement strategy can be used by those who have not retired to create greater wealth in super while working.

Tasha is 55 and earns \$60,000 gross per annum. Tasha, however, wants to continue working full-time and to save for her retirement. She wishes to boost her current super balance of \$300,000 by the time she retires at age 60. Her current expenses are \$43,000 a year.

Current Super Balance \$300,000

Current Position

| | |
|-------------------------------------|-----------------|
| Gross Income p.a. (4 days per week) | \$60,000 |
| Less PAYG Tax & Medicare levy | (\$13,500) |
| Net income | \$46,500 |

Under this scenario Tasha doesn't contribute to her super but her employer places the 9% Super Guarantee Contributions into her fund. By age 60 her balance would be worth \$333,235.

Super Balance at age 60 (in today's dollars) \$333,235

Tasha has two options for boosting her super:

One option is for Tasha to increase her super contributions via a salary sacrifice arrangement with her employer, which will allow her to make contributions in pre-tax dollars.

1) Full time work and Salary Sacrifice only

| | |
|-------------------------------------|-----------------|
| Gross Income p.a. (4 days per week) | \$60,000 |
| Less Salary Sacrifice p.a. | (\$4,000) |
| Less PAYG Tax & Medicare levy | (\$12,240) |
| Net income | \$43,760 |

Super balance with salary sacrifice at age 60 (in today's dollars) \$351,519

This gives Tasha an extra \$18,194 in her super at age 60, however reduces her take home pay by \$2,740 per year. Another option is to commence a Non-commutable Account Based Pension and salary sacrifice more.

2) Full time work, Salary Sacrifice plus transition to retirement income stream.

| | |
|---|-----------------|
| Gross Income p.a. (4 days per week) | \$60,000 |
| Non-commutable Account Based Pension Income | \$14,218 |
| Less Salary Sacrifice p.a. | (\$21,000) |
| Less PAYG Tax & Medicare levy | (\$11,363)+ |
| Tax offset on Account Based Pension | \$2,133* |
| Net income | \$43,987 |

Combined Super balance and Non-commutable Account Based Pension balance at age 60 (in today's dollars) \$369,632

With option 2 Tasha is able to maintain her living expenses the same as scenario 1 but is increasing her overall super lump sum balance from her current position by over \$36,000 to age 60 by salary sacrificing a higher amount.

Tasha will also save on income tax by setting up a non-commutable income stream and making greater salary sacrifice contributions. By making salary sacrifice contributions her assessable income is also reduced within the threshold limits to be eligible for the Government Co-contribution, provided she makes the appropriate personal contribution. Account Based Pension investment earnings are not subject to tax, and therefore there is a further savings on tax on investment earnings. **Super income streams paid to people over 60 are tax-free making this option even more attractive (taxed funds only).**

This publication doesn't take into account your personal objectives, financial situation or needs. It provides a summary only and it shouldn't be considered a comprehensive statement on any matter relied upon as such. It's important for you to consider these matters before making any financial decision and we recommend you seek help from a financial adviser.