SMSF Pensions 1
Transition to Retirement Pensions

July 2015

Agenda

- What is Transition to Retirement?
- Benefits of TTR pension
- Reduce work hours and maintain income
- Boost retirement savings whilst working
- Lump sums treated as pension payments
- Issues for consideration
- How can we help?

What is Transition to Retirement?

How does it work?

- Once an SMSF Member has reached Preservation Age, can commence an income stream from the Fund.
- Do not have to retire from the workforce.
- Benefits remain Preserved, unless a further condition of release is satisfied.
- The original purpose of the TTR pension was to encourage people to remain in the workforce for longer.
- The aim was to preserve super savings for longer and reduce reliance on the Government Age Pension.

What is Transition to Retirement?

How does it work?

- There are strict rules in place with regard to TTR pensions.
- The income stream is non-commutable, meaning lump sums cannot be withdrawn from super.
- Unless another condition of release is satisfied, such as retirement.
- Again, the policy intention was to help people ease into retirement and not dissipate their retirement savings.

What is Transition to Retirement?

How does it work?

- TTR was introduced to allow people to ease into retirement – i.e. reduce their workload and supplement their income with a pension.
- But it has provided opportunities to reduce the overall tax paid and maximise wealth creation.
- For example, once a Member starts a TTR pension, the Fund may become a tax exempt entity.
- This means franking credits may be use to offset Contributions Tax on concessional contributions.

What is Transition to Retirement?

How does it work?

- An attractive strategy is to continue to work full-time, commence a TTR pension and salary sacrifice to superannuation up to the maximum threshold.

- In most cases, the net result of this strategy is a higher retirement accumulation when permanently retire from the workforce and reduced personal income tax.

- This strategy is not strictly in line with the original policy intention, so could this be considered tax avoidance? No.

What is Transition to Retirement?

Key features of a TTR income stream

- Member must have reached Preservation Age.
- Pension is non-commutable, unless the pension consists of an Unrestricted Non-Preserved benefit.
- Minimum drawdown is 4% of the account balance at pension start date (pro-rata if started part way through the financial year).
- The maximum drawdown is 10% (this amount is not pro-rata if pension started part-way through the financial year).

What is Transition to Retirement?

Preservation Age

- To commence a TTR pension a Member must have reached at least Preservation Age.

- Preservation Age is determined by the Member's date of birth as indicated in the following table:

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
After 30 June 1964	60

Benefits of TTR pension

The benefits of a TTR pension

- Generate tax-exempt investment earnings (no CGT, no tax on distributions, interest, etc and a refund of franking credits).
- Reduce tax on income salary sacrificed into the SMSF (may be reduced to zero in some circumstances).
- Receive tax-free income under age 60 due to the tax free component in the member benefit.
- Before reaching age 60, a 15% tax offset applies to the taxable portion of the income stream, which may be less than marginal tax rates.
- From age 60, Members can receive tax free pension income.

Benefits of TTR pension

Janet – easing into retirement

- Janet, 57, has a full time job as a School Teacher earning $75,000 pa.
- Her Daughter has recently had her first child.
- Janet is looking to reduce her work so she can help care for her Grandchild.
- She wants to reduce her hours from 35 hours a week to 25 hours a week.
- Janet has $250,000 in her super account – all a taxable component.

Benefits of TTR pension

Janet – easing into retirement

- Her reduced salary is now $53,500 pa.
- As she has reached her Preservation Age, she can commence a Transition to Retirement pension.
- The minimum pension drawdown would be $10,000 ($250,000 x 4%).
- The maximum pension drawdown would be $25,000 ($250,000 x 10%).
- Janet decides to draw $17,490 pension from her Fund.
- Janet can still receive the same take-home income as when she worked full time – even after reducing her work hours.

Benefits of TTR pension

Janet – easing into retirement

	Before	After
Salary	$75,000	$53,500
TTR Pension	$0	$17,490
Gross Assessable Income	$75,000	$70,990
Income Tax*	-$17,422	-$13,415
Take home pay	**$57,578**	**$57,575**

* Includes Medicare Levy, Lower Income Tax Offset, Pension Tax Offset and Mature Age Workers Offset.

- By commencing a TTR pension, Janet can still receive the same take-home income as when she worked full time.

- It is important to be aware that drawing down super benefits to supplement income can result in less super in retirement.

Boost Super – Salary Sacrifice

Boost super balance through salary sacrifice

- If working full-time, starting a TTR means receiving extra income (in addition to a person's salary).
- Rather than spending this amount, the Member can salary sacrifice an equivalent (or greater) amount of their salary into superannuation.
- This way they can build a greater retirement nest egg without compromising their standard of living.
- Investing salary sacrifice contributions in a tax-free environment and replacing salary with a TTR pension leads to a lower overall tax impost.

Boost Super – Salary Sacrifice

How does salary sacrifice work?

- Under a salary sacrifice arrangement, an employer makes additional contributions to super on a pre-tax basis.
- This is then an Employer Contribution to super (concessional contribution).
- The employee's salary for tax purposes is reduced by the amount contributed to super.
- As the contributions are Employer Contributions, the employee does not pay income tax on these amounts.
- They are subject to Contributions Tax within the SMSF.

Boost Super – Salary Sacrifice

How does salary sacrifice work?

- Any super contribution under a salary sacrifice arrangement is treated as a concessional contribution.
- It will be counted against the concessional contributions cap.
- For 2015/16 the cap for those 50 or over is $35,000.
- Amounts contributed over the concessional cap may be refunded to the Member and taxed at their marginal tax rate.

Boost Super – Salary Sacrifice

Trevor - Boost super balance through salary sacrifice

- Trevor, aged 56, earns $80,000 pa as an Accountant.
- He currently receives 9.5% Super Guarantee contributions ($7,600 pa).
- He is looking to retire at 65 and has no plans to reduce his work hours for the foreseeable future.
- He has $300,000 in super – all a taxable component.
- Trevor is considering a TTR strategy that requires him to salary sacrifice a greater portion of his pre-tax income to superannuation and replace it with a pension from his SMSF.

Boost Super – Salary Sacrifice

Trevor - Boost super balance through salary sacrifice

- Trevor currently receives take home pay of $60,853.
- If Trevor was to implement a TTR strategy and salary sacrifice $27,400 into his SMSF he would receive a gross salary of $52,600.
- To supplement this income, he could draw a TTR pension of $22,300.
- If he was to undertake this strategy, his take-home pay would be unchanged at $60,853.

Boost Super – Salary Sacrifice

Details shown for year 1	Current	TTR Strategy
Age 56 (Start of Year)		
Income		
Salary (Excludes SG Contribution)	80,000	80,000
Salary Sacrifice Contributions	0	27,400
Taxable Salary	80,000	52,600
Pension Income	0	22,300
Pension Tax-free Component	0	0
Total Income (Taxable Salary + Pension)	80,000	74,900
Income Tax & Medicare & Pension Offset	19,147	14,043
Net Income	60,853	60,858
After Tax Contributions	0	5
Spare Cash	0	0
Net Income Required	60,853	60,853
Contributions		
Salary Sacrifice Contributions	0	27,400
SG Contributions	7,600	7,600
After Tax Contributions	0	5
Contributions Tax	1,140	5,250
Net Contributions	6,460	29,755

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Boost Super – Salary Sacrifice

Trevor - Boost super balance through salary sacrifice

- Implementing this strategy would result in an increased benefit in year one of $4,040.
- If Trevor was aged 60 or older his net income would increase to $65,417 and the strategy would result in an increased benefit in year one of $8,734.
- This is because pension income is tax-free from age 60.
- This means the surplus income can be contributed to the Fund as a non-concessional contribution.
- Alternatively pension income could be reduced to $17,800 to maintain the same after tax income.

Boost Super – Salary Sacrifice

Trevor - Boost super balance through salary sacrifice

- By fully utilising the concessional contributions cap (Superannuation Guarantee + salary sacrifice = $35,000) and commencing a TTR to supplement the reduced take-home pay, Trevor will benefit from:
  - Having the amount salary sacrificed into super taxed at 15% rather than his MTR.
  - Any investment earnings on his TTR will be tax exempt compared with 15% if it remained in accumulation phase.
  - A 15% tax offset on the taxable component of the TTR.
  - After reaching age 60 all amounts from the TTR will be tax free.

Boost Super – Salary Sacrifice

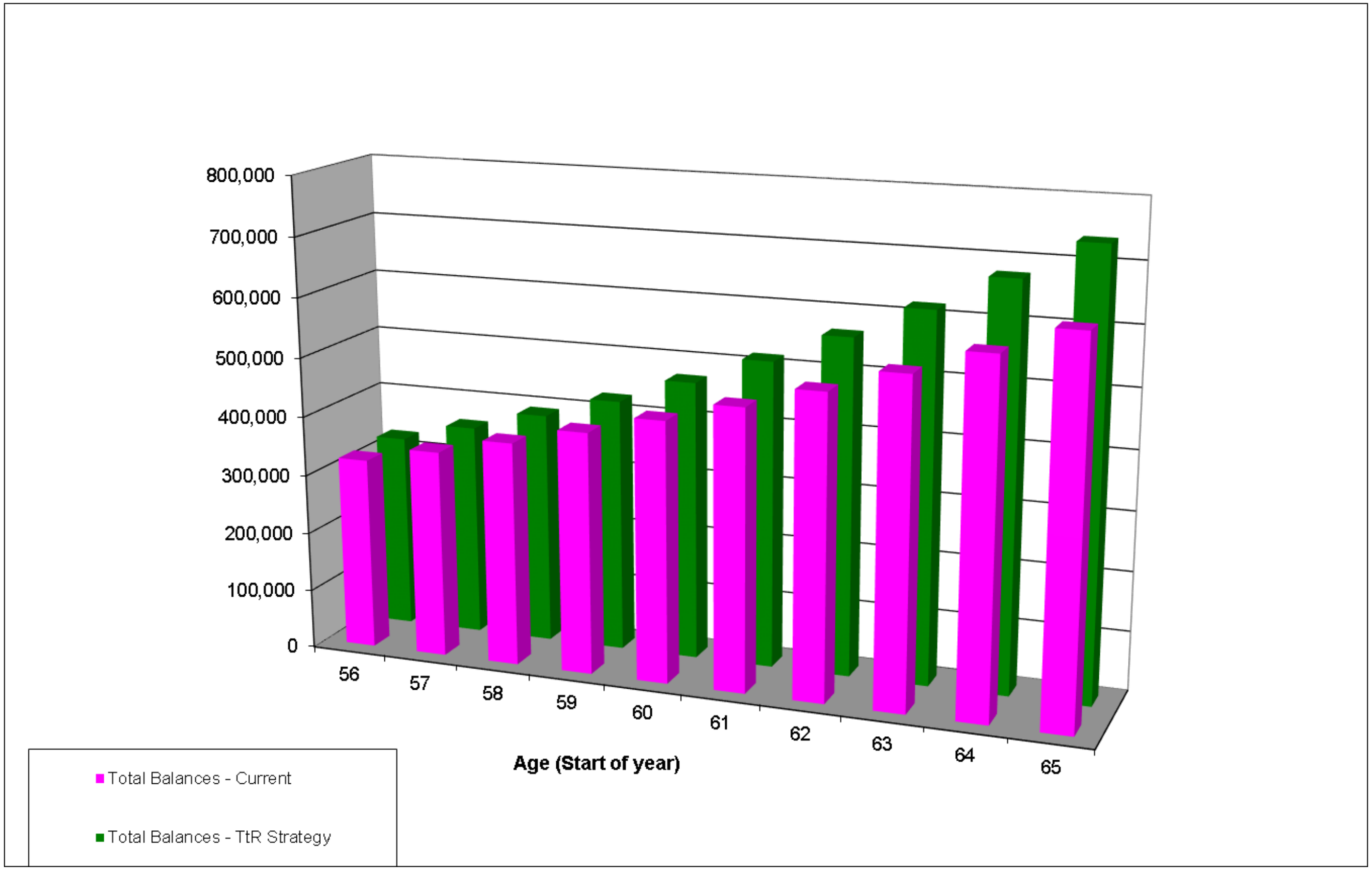
Trevor - Boost super balance through salary sacrifice

Comparison Summary - Year by Year			
Age Start Year	Balance Current	Balance With TTR	Benefit of TTR
56	324,399	328,439	4,040
57	350,375	359,075	8,700
58	378,023	392,069	14,047
59	407,445	427,590	20,146
60	438,748	470,246	31,498
61	472,048	516,025	43,977
62	507,859	565,443	57,584
63	546,348	618,766	72,418
64	587,693	676,319	88,626
65	632,083	738,379	106,296

- The TTR strategy means that, over a 10-year period, Trevor ends up approximately $106,000 better off.

Boost Super – Salary Sacrifice

Trevor - Boost super balance through salary sacrifice



Lump Sum Pension Payments

Lump sums treated as pension payments

- When a Member commences a TTR pension, the benefit is usually Preserved.
- That means an income stream can be paid, but no lump sums are accessible.
- Payments received by the Member are taxed as superannuation income stream payments under the Tax Act.
- For those over 60, no tax is payable.
- For those under 60, the taxable portion will be taxed at their MTR less a 15% tax offset.

Lump Sum Pension Payments

Lump sums treated as pension payments

- Most member accounts consist of Preserved benefits.
- Occasionally, a Member will have an Unrestricted Non-Preserved benefit.
- This may be due to super benefits accrued before July 1999.
- *Unrestricted Non-Preserved benefits can be withdrawn from super at any time.*
- Unrestricted Non-Preserved benefits can be withdrawn as part of an income stream, or as a lump sum.

Lump Sum Pension Payments

Lump sums treated as pension payments

- The payment made from the pension consisting of an Unrestricted Preserved benefit can be treated as a lump sum for income tax purposes.
- Under the Tax Act (an associated Regulations) pensions are referred to as ‘superannuation income streams’.
- Under Regulation 995-1.03 of the ITAR (1997), a pension payment can be taxed as a lump sum.
- The taxpayer must make an election to for the payment to not be treated as a ‘superannuation income stream’ benefit.

Lump Sum Pension Payments

Lump sums treated as pension payments

- As a consequence of the election the payment will be a lump sum benefit payment and taxed as such.
- However the payment is still a payment from the Member's pension account.
- Under the superannuation rules, even though the payment is taxed as a lump sum, it will still count against the pension payment standards.
- Therefore we can have the best of both worlds – taxed as a lump sum but considered a pension payment.

Lump Sum Pension Payments

Lump sums treated as pension payments

- If a Member is under age 60 (but at least Preservation Age), the first $195,000 of the Taxable component is tax-free.

- So if an election is made to no treat the payment as a ‘superannuation income stream’ benefit, but rather a lump sum, then $195,000 of the Taxable component can be received tax-free.

- The Tax Free component is received tax-free if the member is at least Preservation Age.

Lump Sum Pension Payments

Barry - Lump sums treated as pension payments

- Barry is 56 and thinking of starting a TTR.
- He has a Member balance of $400,000 – all a Taxable component.
- He earns 65,000 pa.
- He has an Unrestricted Non-Preserved benefit of $105,000.
- He has not used any of his low rate (taxable lump sum) threshold.
- What is the benefit of the TTR strategy?

Lump Sum Pension Payments

Barry - Lump sums treated as pension payments

- If Barry was to have the TTR payment taxed as a pension, he would pay tax of approximately $8,500 in year one.
- When compared with the no TTR option, he would have a benefit of $5,235 at the end of year one.
- The TTR strategy means that, over a 10-year period, Barry ends up approximately $124,000 better off.

Lump Sum Pension Payments

Details shown for year 1	Current	TTR Strategy
Age 56 (Start of Year)		
Income		
Salary (Excludes SG Contribution)	65,000	65,000
Salary Sacrifice Contributions	0	28,761
Taxable Salary	65,000	36,239
Pension Income	0	23,300
Pension Tax-free Component	0	0
Total Income (Taxable Salary + Pension)	65,000	59,539
Income Tax & Medicare & Pension Offset	13,947	8,486
Net Income	51,053	51,053
After Tax Contributions	0	0
Spare Cash	0	0
Net Income Required	51,053	51,053
Contributions		
Salary Sacrifice Contributions	0	28,761
SG Contributions	6,175	6,175
After Tax Contributions	0	0
Contributions Tax	926	5,240
Net Contributions	5,249	29,696

Lump Sum Pension Payments

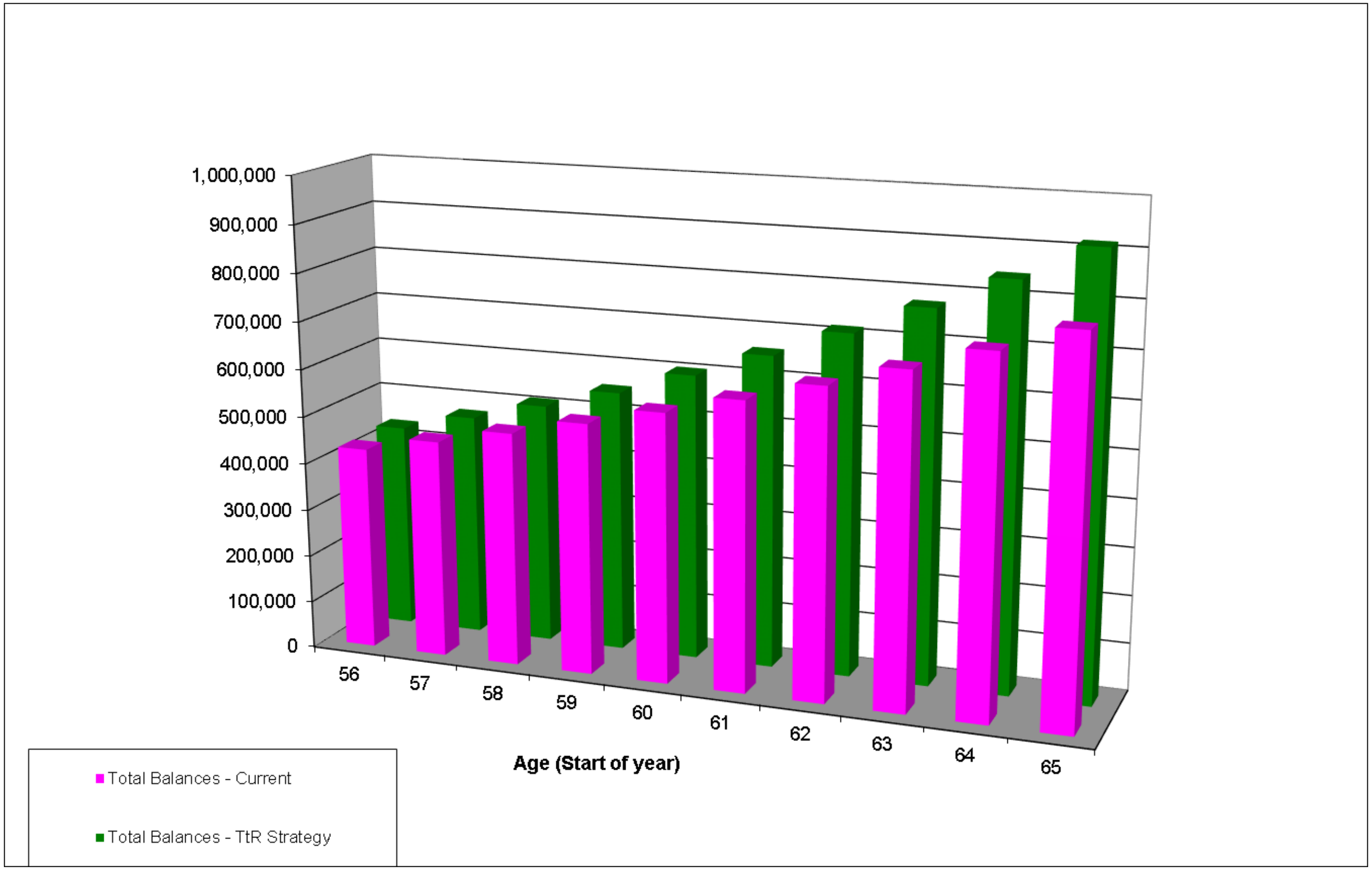
Barry - Lump sums treated as pension payments

Comparison Summary - Year by Year			
Age Start Year	Balance Current	Balance With TTR	Benefit of TTR
56	429,068	434,303	5,235
57	459,964	471,097	11,133
58	492,798	510,539	17,741
59	527,686	552,807	25,120
60	564,754	603,081	38,328
61	604,131	656,911	52,780
62	646,277	714,785	68,507
63	691,372	776,994	85,622
64	739,605	843,852	104,247
65	791,178	915,647	124,469

- The TTR strategy means that, over a 10-year period, Barry ends up approximately $124,000 better off.

Lump Sum Pension Payments

Barry - Lump sums treated as pension payments



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Lump Sum Pension Payments

Barry - Lump sums treated as pension payments

- However if Barry is able to utilise his $105,000 Unrestricted Non-Preserved benefit, he would be even better off.
- The $105,000 can count against his low tax Taxable Threshold of $195,000.
- But it will be treated as a pension payment for superannuation purposes.
- Barry can effectively take $105,000 as tax-free pension payments.
- The TTR strategy is more beneficial as no tax is paid on TTR income prior to age 60.

Lump Sum Pension Payments

Barry - Lump sums treated as pension payments

- If Barry was to have the TTR payment taxed as a lump sum, he would pay tax of approximately $4,000 in year one.

- When compared with the TTR option taxed as a pension, he would be $5,000 better off at the end of year one when compared with the standard TTR strategy.

- The ‘enhanced’ TTR strategy means that, over a 10-year period, Barry ends up with approximately $158,000 better off when compared with the no TTR option.

Lump Sum Pension Payments

Details shown for year 1	Current	TTR Strategy
Age 56 (Start of Year)		
Income		
Salary (Excludes SG Contribution)	65,000	65,000
Salary Sacrifice Contributions	0	28,825
Taxable Salary	65,000	36,175
Pension Income	0	18,600
Pension Tax-free Component	0	0
Total Income (Taxable Salary + Pension)	65,000	54,775
Income Tax & Medicare & Pension Offset	13,947	3,694
Net Income	51,053	51,081
After Tax Contributions	0	28
Spare Cash	0	0
Net Income Required	51,053	51,053
Contributions		
Salary Sacrifice Contributions	0	28,825
SG Contributions	6,175	6,175
After Tax Contributions	0	28
Contributions Tax	926	5,250
Net Contributions	5,249	29,778

Lump Sum Pension Payments

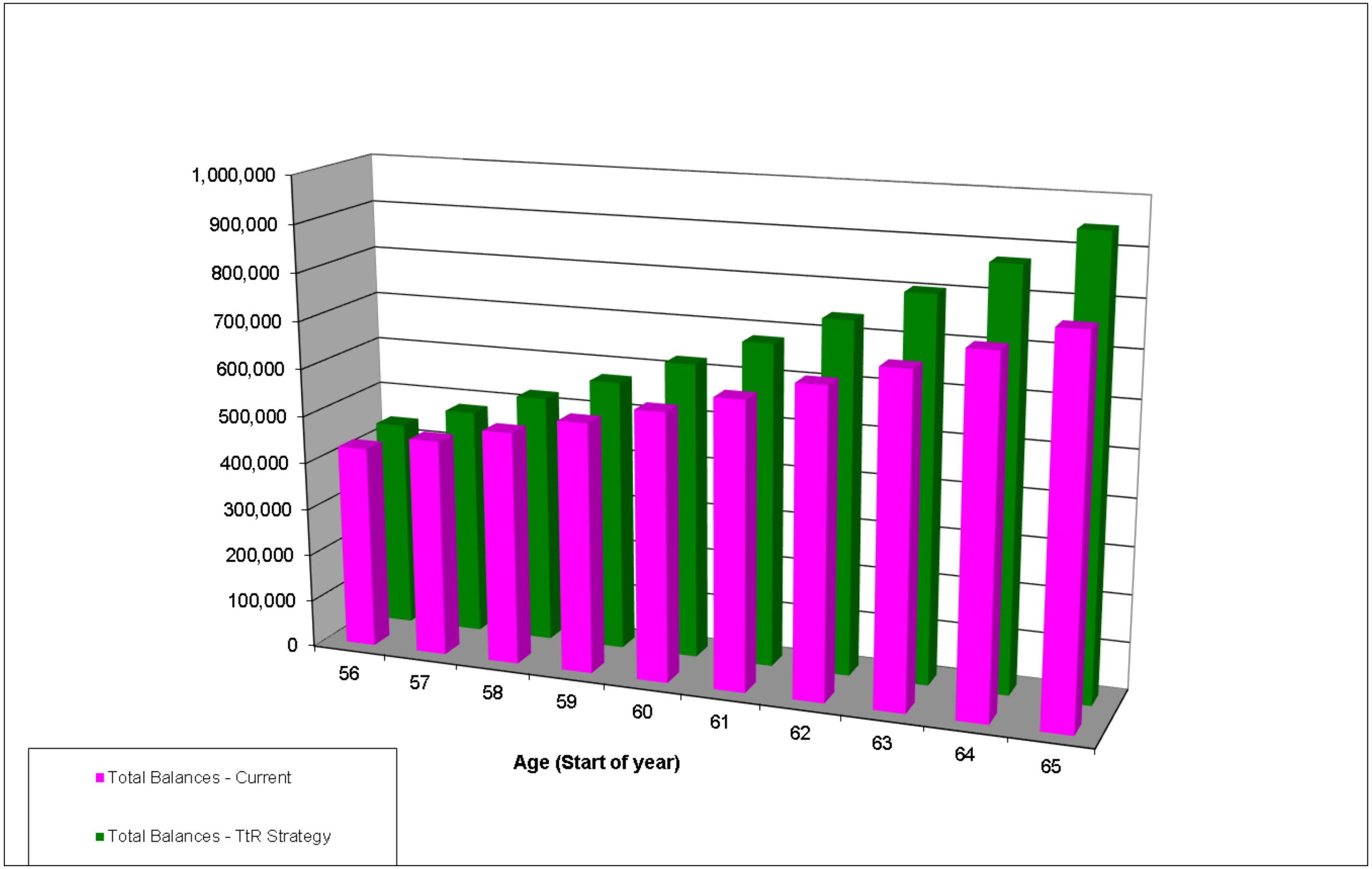
Barry - Lump sums treated as pension payments

Comparison Summary - Year by Year			
Age Start Year	Balance Current	Balance With TTR	Benefit of TTR
56	429,068	439,252	10,184
57	459,964	481,445	21,482
58	492,798	526,639	33,842
59	527,686	575,033	47,347
60	564,754	626,850	62,096
61	604,131	682,296	78,165
62	646,277	741,896	95,619
63	691,372	805,948	114,576
64	739,605	874,773	135,168
65	791,178	948,712	157,534

- The TTR strategy now means that, over a 10-year period, Barry ends up approximately $158,000 better off.

Lump Sum Pension Payments

Barry - Lump sums treated as pension payments



Issues for Consideration

Seek guidance before commencing a TTR arrangement

- Trust Deed must allow for TTR!
- Salary sacrifice contributions are concessional contributions - $35,000 cap for 50 and over (and $30,000 cap for everyone else).
- The salary sacrifice arrangement must be in writing prior to contributions commencing.
- Your employer may not agree to salary sacrifice.

Issues for Consideration

Seek guidance before commencing a TTR arrangement

- Be careful of SG entitlements – some employers may reduce the 9.5% SG as your salary reduces.

- It may be worthwhile commencing a TTR pension with Preserved components only.

- Make sure you meet your minimum pension payments!

- If looking to have the pension payment taxed as a lump sum, make sure an election under Reg 995-1.03 is made prior to the pension payments commencing.

Services to support SMSF Trustees

How can we help?

- Contact your Fund Accountant or Client Service Representative for:
  - Trust Deed upgrade
  - TTR documentation
- Use your Dashboard functionality to ensure you track your pension payments and caps.
- Advice – technical, structuring and procedural advice for your specific circumstances.

Services to support SMSF Trustees

Pension Review Service

- We can review your current pension structure and entitlements to look at ways to enhance your arrangements.
- Fee for service consultation ($385 inclusive of GST).
- Written report outlining current structures and provide options to enhance your pension structures.
- You can then decide if you want to implement the options we provide.
- There may be additional fees if you require assistance in the implementation of options, but we will discuss these with you prior to implementation.

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Trevor - Boost super balance through salary sacrifice

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SG Contributions	7,600	7,600
After Tax Contributions	0	5
Contributions Tax	1,140	5,250
Net Contributions	6,460	29,755

Pension Income Drawn	0	22,300
Net into Super	6,460	7,455

Benefit of the strategy Income Tax Savings	Year 1
Income Tax	5,105
Contributions Tax	-4,110
Super Fund Earnings Tax	3,016
Total Tax Savings	4,010

Value of strategy	Year 1	Cumulative to Year 1
Additional into Super	995	995
Earnings Tax Savings	3,016	3,016
Additional Earnings	29	29
Total Value	4,040	4,040