

ENHANCING THE TRANSITION TO RETIREMENT INCOME SWAP STRATEGY BY USING THE PENSION REFRESH STRATEGY

Overview

Many people have a transition to retirement income stream in place once they turn 55 as a tax effective means of receiving income or a way to enhance their income and begin to reduce their work hours. This strategy can be further enhanced by '*refreshing*' the strategy either every year or at a particular age. This strategy involves a method of combining both the transitional pension balance with the accumulation balance. The accumulation balance is from superannuation contributions made after the transitional pension began. Once combined a new transition to retirement income stream is started.

Strategy

Transition To Retirement Income Swap Strategy

This strategy involves an individual who is still working and has reached their preservation age entering into a salary sacrifice agreement with their employer. Salary sacrificing is an agreement with your employer where a portion of your salary is directed towards superannuation rather than paid to the individual. A self employed person could achieve the same effect by making personal deductible contributions to superannuation. As an amount of income is redirected to superannuation the individual supplements their income back to the same level after tax by starting a transition to retirement pension from their superannuation fund.

The strategy has a number of benefits:

- ✓ In the superannuation fund the income earned from the assets that support the transitional pension are tax exempt
- ✓ Individuals between the ages of 55 and 59 receiving the transitional pension will receive the tax-free portion of their income stream free of any tax and the taxable portion of their income stream will carry a 15% tax offset
- ✓ Individuals over 60 will receive the transitional pension tax-free
- ✓ The transitional income stream is generally more tax effective than income taken purely as a salary, depending on marginal tax rates. When this is combined with the 15% concessional

tax rate on the contributions made to super from salary sacrificing the growth on the super balance is enhanced.

The strategy means that each individual undertaking the strategy will have two separate superannuation interest:

- A pension balance from which the transitional pension income stream is paid; and
- An accumulation balance which receives the salary sacrifice contributions, super guarantee contributions or personal contributions.

If this strategy is begun at age 55 then by the age of 65 the accumulation balance will be growing while the transitional pension balance may be either the same or have decreased depending on how much has been drawn down, as there are minimum and maximum draw down amounts, and the earnings on the balance over time. In some cases the accumulation balance may be larger than the pension balance.

Refreshing The Transitional Income Swap Strategy

As the transitional income stream cannot be cashed out as a lump sum refreshing the strategy involves:

- Commuting or rolling back the transitional income stream into the accumulation account; and
- Beginning a new transitional income stream with the larger accumulation balance.

Benefits of this strategy:

- ✓ The assets in the fund are now all supporting an income stream and so all the earnings are tax exempt
- ✓ As the income you receive is higher due to the larger balance in the pension account, it allows you to salary sacrifice more of your current salary into super while still enjoying the same after tax income. This enhances retirement benefits further.

Key Issues

- Salary sacrifice changes the character of your salary into a concessional contribution into super, like your super guarantee payments. The cap on the amount of concessional contributions you can make into super is \$50,000 p.a. However, if you are over 50 then your cap is \$100,000 p.a. under transitional rules that end on 30 June 2012. Contributions in excess of these amounts attract a penalty rate of tax that effectively tax amounts above these caps at 46.5% and also count towards the non-concessional cap amounts.

- Super contributions are subject to preservation rules which means that access to super is dependent upon a condition of release being met.
Transitional income streams cannot be cashed as a lump sum, this is called a non-commutable income stream. To be able to cash the income stream a condition of release must be met. The exception to this rule is where the transitional income stream was started with unrestricted non-preserved benefits.
- If personal contributions are made to super and an individual would like to claim a tax deduction for the contribution then a ***notice of intent*** to claim the deduction **must be completed, provided to and acknowledged by the fund's trustees before a transitional income stream is started**. It is not possible to lodge or vary a notice of intent after a transitional income stream has begun. In this case the contribution will be considered a non-concessional contribution.
- Once an income stream has begun Centrelink count the assets towards a means test for an Age Pension.
- Life insurance premiums may be paid from the accumulation balance of the individual so enough money must be left in the account to ensure these are paid.