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Not ready to retire? 'Try before you buy' with a Transition to Retirement strategy

As people age, the everyday grind of full-time work can become increasingly tiresome. At the same time, many still enjoy the interest and challenges of the workplace. One way to help with this "work-life balance" at this stage of life is a Transition to Retirement (TTR) strategy.

Transition to retirement strategy explained

If you have reached your preservation age, (between age 55 and age 60 depending on your date of birth) this strategy allows you to reduce working hours and at the same time, commence a special type of pension withdrawal arrangement from your superannuation fund.

This means your take-home pay does not have to be reduced (and potentially increased) but allows more time away from work to experience other aspects of life whilst you're still active and healthy.

Sometimes these arrangements are coupled with a "re-contribution strategy" where concessional contributions into the fund are maximised using a combination of pension withdrawals and tax savings to cover any shortfall in disposable income.

The table below outlines the preservation age applying to an individual:

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

Transition to retirement strategy options

I. Cut your hours, not income

This strategy focuses on using income from your transition to retirement pension so you can reduce your work hours, enjoy the same level of after-tax income and still maintain your lifestyle. The downside? Your super savings may decrease earlier than expected.

II. Ramp up your super

Choosing this option means you can continue to work full time, make additional super contributions via salary sacrifice and draw an income from your TTR pension to help fund your living expenses.

Remember that your salary sacrifice super contributions are taxed at 15% provided your concessional contributions fall within the applicable super contribution caps, while an additional 15% tax may be applicable for higher-income earners.

While still working full time, the 15% tax rate may potentially be lower than your marginal tax rate had you received this money as salary – this can help to reduce your tax bill and give your retirement savings a boost.

In a nutshell, this transition to retirement strategy allows you to contribute more to super than you draw as an income stream, while keeping your after-tax income the same.

Transition to retirement strategy – is it still relevant?

In the past, one of the significant advantages of a so-called "Transition to Retirement Income Stream" (TRIS) was that the income and capital gains derived in the superannuation fund from assets supporting the TRIS were exempt from tax in the fund.

This concession was removed with the raft of changes that applied to all superannuation funds from 1st July 2017. Note that the receipt of a TRIS by a member over the age of 59 is exempt from income tax and partially exempt for members between preservation age and 59. This aspect has not changed.

A question often asked is, "are transition to retirement strategies still relevant?". The answer is clearly yes but it also depends on individual circumstances!

Case Study

Peter is 60 and has a senior position with a small financial institution. He is currently earning $140,000 per annum and has accumulated $1Million in superannuation. His employer has made available flexible work arrangements to senior staff and Peter decides that he would like to reduce his work hours to 3 days per week and spend some more time with grandchildren, writing a book he has been thinking about for some time, and exploring the "travel bug" that seems to have infected some of his friends. He is keen not to take a cut in pay. He plans to work for at least another 5-7 years and would like to ensure his super is not adversely affected by the reduction in working hours.

It is assumed that the net earnings of the superannuation fund are 5% before tax.

The following table summarises Peter's position regarding annual net salary and annual net increase in his superannuation in three different scenarios.

(a) Current position working full time

(b) Reducing to 3 days a week and not altering existing superannuation arrangements

(c) Reducing to 3 days a week, paying additional concessional super contributions (to max $25,000) and using a transition to retirement strategy to fund these changes and ensure net disposable income remains unchanged.

Peter's personal income			
	(a)	(b)	(c)
Employment level	Full-time	3 Days	3 Days
Gross Salary	140,000	84,000	84,000
Less - PAYG tax	(42,097)	(19,447)	(13,575)
Net salary	97,903	64,553	70,425
Add - TRIS received			44,498
Less-Personal Concessional contributions			(17,020)
Net disposable personal income	97,903	64,553	97,903
Superannuation fund			
Opening Balance	1,000,000	1,000,000	1,000,000
Net Income earned @ 5%	50,000	50,000	50,000
Employer/Personal contributions received	13,300	7,980	25,000
Less-income tax paid @ 15%	(9,495)	(8,697)	(11,250)
Less-TRIS paid			(44,498)
Closing balance	1,053,805	1,049,283	1,019,252
Increase in super balance	53,805	49,283	19,252
Net salary and super increase	151,708	113,836	117,155
Reduction due to reduced work hours		37,872	34,553

We can see in (a) that Peter's current disposable income is $97,903 pa and his annual super balance increase would be expected to be $53,805 – an overall total of $151,708. If he reduces to 3 days per week as in scenario (b), his disposable income reduces by around 35% to $64,553 and his combined total reduces by $37,822 and this would be the effective "cost" (in the first year) of reducing work hours from full time to 3 days per week. On the other hand, scenario (c) illustrates that if Peter implemented a TRIS and withdrew $44,498 from his superannuation to cover the reduction in income and maximize concessional contributions, he could maintain his current disposable income and reduce the overall "cost" from $37,822 to $34,553.

The above example illustrates how a Transition to Retirement Strategy can be used to maintain disposable income where work hours are significantly reduced. Other strategies can revolve around objectives such as paying down debt as a member is approaching retirement, equalizing superannuation balances between partners, reducing the relative taxable component of the total superannuation balance and others.

The clear takeout from the above is that although the after-tax effectiveness of a Transition to Retirement Strategy has been reduced by the changes applying from 1/7/2017, there are still potential financial benefits. These benefits are of course, in addition to other non-financial benefits that can flow from such strategies.

Things to consider

Keep in mind there are some technical issues around Transition to Retirement Strategies that should be fully considered in the light of the personal circumstances of the individual including:

- **Member age**: Not everyone can access a TTR pension – it is only accessible when you reach preservation age, which for most is the age of 60.
- **Withdrawal cap**: The amount that you withdraw each year is capped at 10% of the balance of the pension. This means you may need to top up this account through contributions in the years prior so that you have smooth cash flow.
- **Total superannuation balance:** Accessing a TTR pension can mean that you exhaust your retirement savings earlier. Your savings may need to last for up to 30 years and withdrawing these funds early may have a significant impact in later years. Plan carefully and calculate the funds available to you today and how this may impact your retirement savings.
- **Income level**: A TTR pension is not a 'set and forget' strategy. An annual review of your plan should be done so that income streams and contributions can be fine-tuned to fit your situation.

Lastly, not all super funds offer TTR pensions, so speak to an adviser and seek appropriate personal advice before making any decisions.

The information provided in this article is general in nature and does not take into account your personal circumstances, needs, objectives or financial situation. This information does not constitute financial or taxation advice. Before acting on any information in this article, you should consider its appropriateness in relation to your personal situation and seek advice from an appropriately qualified and licensed professional.

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