Smooth out your income

It's now easier for over-55s to work and play, says **Tim Blue**

OLDER people thinking of kicking back into a better mix of work and lifestyle have been given a big break with new rules on super.

From 55, it is now possible to use your superannuation to buy an allocated pension, which gives you an income stream and all the freedoms that come with a cash flow. You might, for example, stay working but cut back to part-time or casual work. Yet because you are still working, your employer is still contributing super on your behalf and you may also be making salary sacrifice contributions, too, so your super savings are still building.

In short, the transition-to-retirement strategy makes possible a shorter working week with much the same after-tax income as before, or a way to smooth an irregular income.

Big players such as AMP and Navigator have launched products to take advantage of the so-called transition-to-retirement rules.

A cost benefit analysis

Investors still need to keep an eye on the costs — for example, in the front-end purchase price of an allocated pension and its annual running costs.

Nor should they be dazzled by short-term advantages that might lead them to long-term disadvantages, such as the possibility of running into "excess benefits" when they actually retire. An excess benefit is where you exceed your reasonable benefit limit.

If you create an excess benefit problem, you might be:

- Locked into a pension where access to capital is restricted.
- Prohibited from running a re-contribution strategy (where you take out benefits from one super scheme and pay into another to gain further tax benefits).
- Less able to pass on assets to dependants on your death — the benefits might be taxed at the top marginal rates instead of nil.

A more general criticism is that such schemes tend to work well only when large superannuation sums are involved: for example, superannuation savings of more than $600,000. That might not seem big to some but it is much larger than the average balance now held by most super fund members.

Costs, especially, have to be closely monitored, according to Vicki Arnett, a superannuation specialist at accountant Pitcher Partners in Melbourne, who warns that people should be careful before signing up.

"In most of the cases we have seen, the numbers simply don't add up," she says. "For most over-55s, such schemes are unattainable or not worthwhile after fees and taxes."

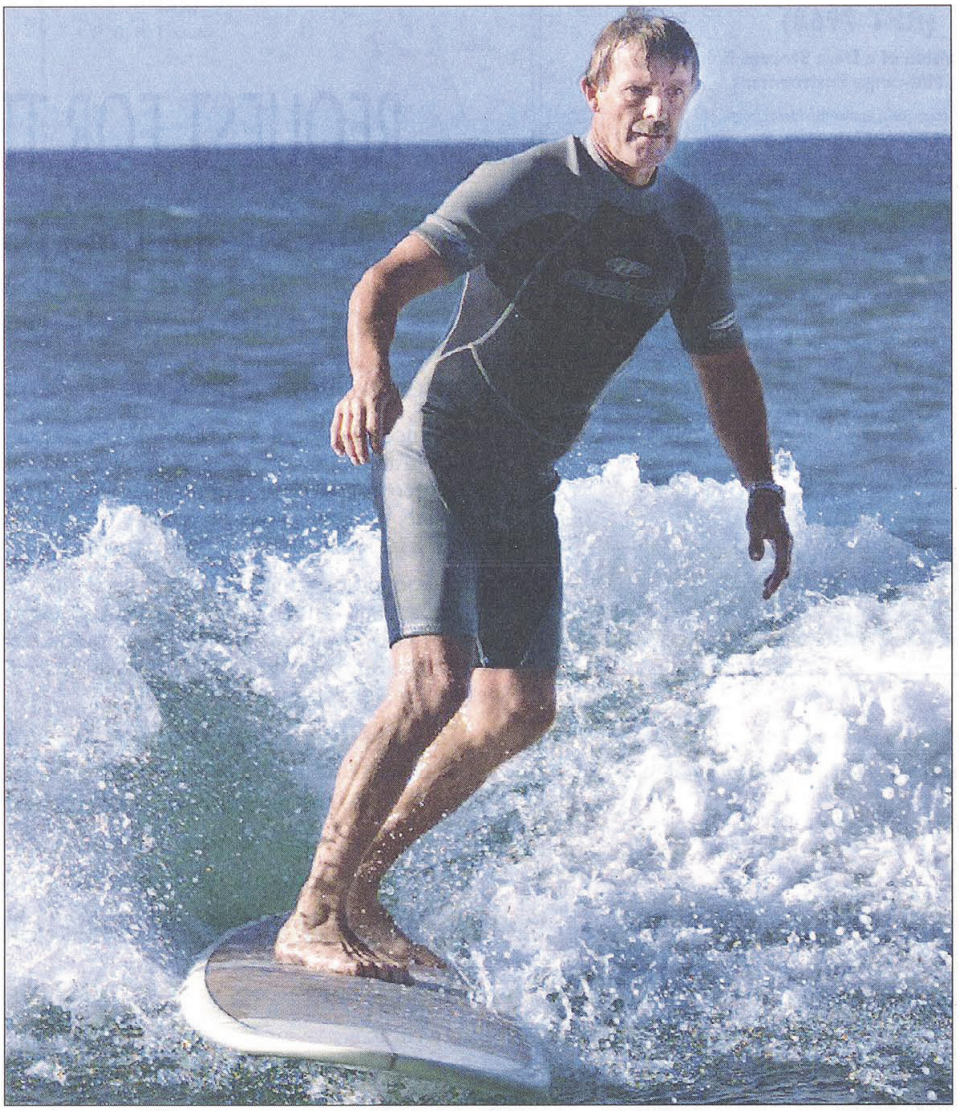
As a rule of thumb, according to Arnett, such arrangements become worthwhile only when super assets of $600,000-plus are used.

"Using such a sum to buy an allocated pension can cost between $2000 and $3000, leaving a tax saving of around $4500 in the first year."

This is why, assuming the tax office allows the strategy to continue, you need to commit yourself to the strategy for five or more years before all the manoeuvring has a benefit.

"We have seen the strategy marketed to individuals with superannuation balances as low as $200,000, who, in a best-case scenario, would save $500 to $600 a year in income tax. There's an additional saving of about $1000 in the first year because fund earnings will not be taxed when converted to an allocated pension. This is pre-fees, which we have heard can reach upwards of $3000," Arnett says.

There is common agreement that new allocated pension rules can be used to smooth the cash flow into a household.



Ride the wave: Stay afloat with a steady income plan

Picture: John Hargest

How it works

Let's say Richard is 56 and well paid but it comes in uneven lumps over a year — for example, with bonuses at year's end. He doesn't want more income in total, just a way of coping with the bumps.

A transition-to-retirement pension in conjunction with a salary sacrifice arrangement may be the answer.

Say Richard has $600,000 in super, from which he decides to draw $53,500 in pension to provide the bulk of his income needs on a regular basis. It will be the foundation of his income.

Because of his regular pension income he decides he can afford to salary sacrifice a big slice of his lumpy bonus income. He decides to contribute about three-quarters of his salary income into a salary sacrifice arrangement — a figure of $74,556. He does this by electing in advance to receive only $21,600 by way of a regular salary or retainer paid directly to him, with all the excess (including the lumpy bonus payments) paid directly to his super fund as salary sacrifice contributions, instead of being paid to him.

SALARY SACRIFICE

A transition-to-retirement strategy in action

	Without income stream ($)	With al. pension plus salary sacrifice ($)
Salary package	98,100	98,100
Salary	90,000	21,600
Salary sacrifice	0	74, 556
Super Guarantee (9 %)	8100	1944
Take home salary	90,000	21,600
Plus		
Allocated pension	0	53,500
Gross take home pay	90,000	75,100
Less		
Income tax on taxable income	26,100	19,842
Medicare levy	1350	1127
Plus		
His pension tax offset	0	8025
Total take home pay	62,550	62,157

Source: Navigator

The result is Richard has a more regular and less lumpy net income of just over $62,000, which is not very different from before. It is made up of $21,600 of regular salary and $53,500 from his allocated pension. His gross pay is less at $75,100, so his tax and Medicare bill is cut by $6481. Then he picks up a full 15 per cent pension tax offset because he is using an allocated pension, which adds $8025 to his income.

Financial planner Theo Marinis says: "His take-home pay is virtually unchanged, but he has a regular and consistent gross income of $4458 a month — from the allocated pension plus his smaller retained annual salary of $21,600 a year, which should see him easily jump over any cash-flow problems at home."

What is the downside? The government will collect less tax, yet Richard is more likely to work longer (and save more super as a result of this strategy and ultimately claim less in social security and other benefits).

The results

So, what's his financial position now? He has invested in an allocated pension, which has reduced his original super balance to $588,500, but has enjoyed an annual gross income from his allocated pension of $53,500. In addition, while decreasing his allocated pension balance by drawing down on it, he has at the same time salary sacrificed into his new super fund, now with a balance of $69,577. His combined super and pension balance is $658,077.

Before the strategy, his super would have grown to $643,067. But with the strategy it has grown to $659,754, and he still has a net income of $62,157.

This is very close to his income before implementing the strategy — $62,550 after tax.

He might have lost several hundred dollars a year in take-home pay, but he has a smoother income flow and is saving an additional $15,010 into his retirement assets.

Marinis says: "Under this arrangement his total super savings have increased considerably, while he has the same level but a more even base to his income."

The tax office will closely monitor such arrangements, since they achieve significant tax savings.

Yet it achieves the wider purpose that the Government appears to want, in better social outcomes such as encouraging people to work longer and use the time to save more for retirement.

They are likely to be less of a drain on the social security system, now and later on.

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