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Getting money out of super

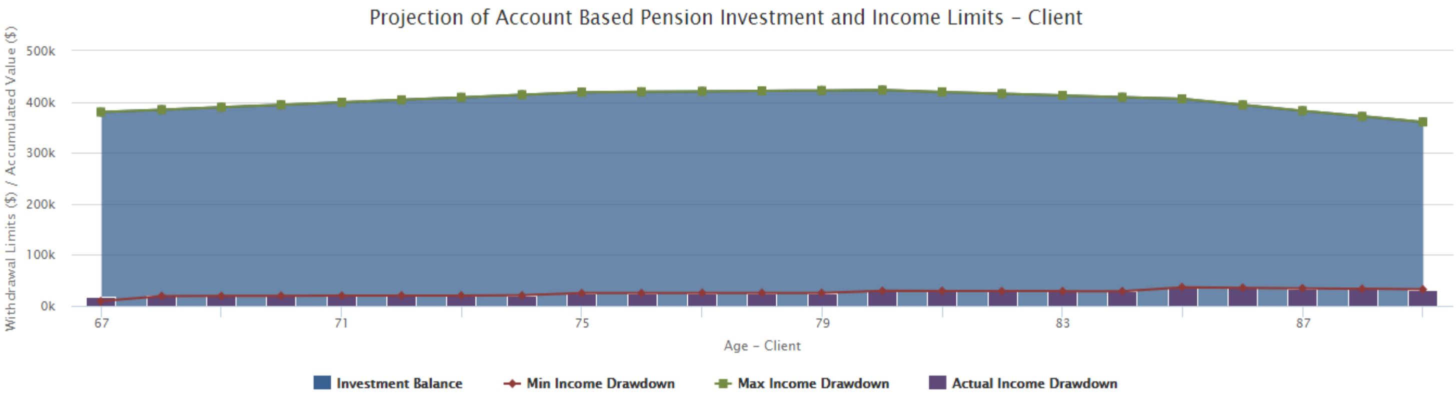
This is the second and perhaps, the most exciting instalment in what I call my ‘Getting to know super’ series.

The point of superannuation – or the ‘sole purpose test’ (for super nerds like me) is to provide a comfortable retirement for all. I prefer to call it “retiring with dignity”.

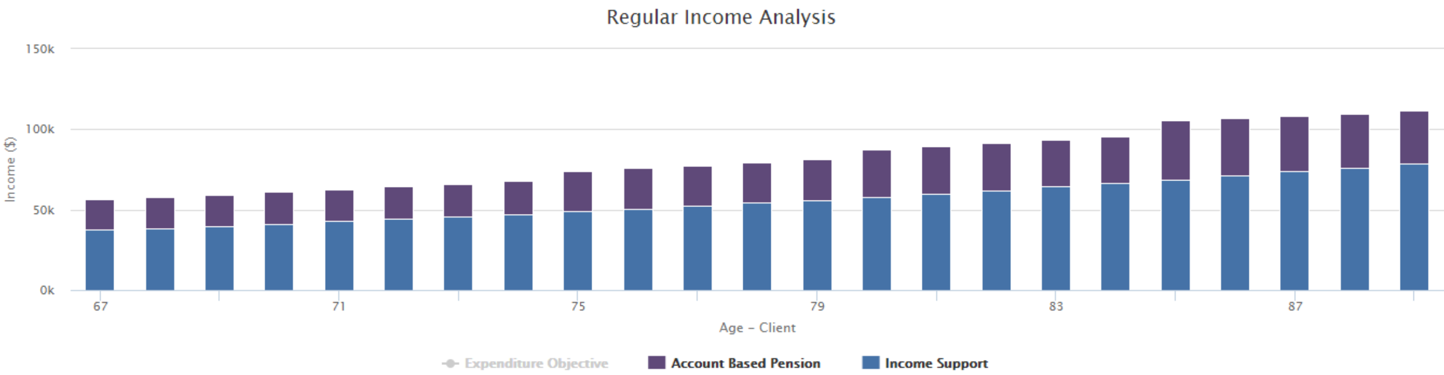
As a case in point, a couple, both aged 67 and without retirement savings, will generally be eligible to receive income of $36,000 pa in combined Centrelink Age Pension benefits. Far from being comfortable, for most people this would a be very basic and stressful retirement.

With just $380,000 in combined super benefits (the Account Based Pension [ABP] ‘sweet spot’) the same couple could currently achieve tax free retirement income of approximately $55,000 (Age Pension $36,000 + ABP ‘minimum’ income of $19,000). Given a choice between this and the former scenario, I know what I would prefer.

By way of explanation, the minimum Account Based Pension drawdown rate is mandated by the government actuary. It is intended to act as a retirement income ‘glide plane’ and designed to provide an indexation factor to the future income to be drawn, as illustrated by the following graphs.



Projection of Account Based Pension Investment and Income Limits for a Single client with $380,000 starting balance at age 67. Assumptions: Income 3.71%, Franked 31.76%; Growth 2.859%; Total Return 6.4%, Total ongoing fee 0.5%.



Projection of Regular Income (Account Based Pension and Centrelink Income Support) for a Single client with $380,000 starting balance at age 67. Assumptions: Income 3.71%, Franked 31.76%; Growth 2.859%; Total Return 6.4%, Total ongoing fee 0.5%.

Prior to COVID-19, the minimum income levels required to be drawn from retirement income streams were based on the following percentages, in line with the following designated age ranges:

Age	Annual payment as % of account balance
55—64	4%
65—74	5%
75—79	6%
80—84	7%
85—89	9%
90—94	11%
95	14%

(The government has recently legislated to extend the reduction of these levels by 50 per cent into the 2021/22 financial year to allow retirees to preserve their capital during these unusual pandemic times. It is a temporary measure, and normal limits will eventually be reinstated, as they were after the GFC).

An Account Based Pension is the only legal, government approved, tax exempt investment vehicle.

When I began a career in the superannuation advice section of the ATO in the late 1980s, ABPs were not yet tax-free, but they were still very ‘tax friendly’. I realised that I could legally tell taxpayers (although not, of course, recommend) that if they chose to transfer their super from ‘accumulation’ to ‘pension’ phase, they would pay little or no tax.

That realisation ignited my imagination; I wanted people to get the most out of their retirement savings – and the thought continues to engage me.

Whilst governments do have a habit of changing the rules, not all government changes are bad. Under its so called “Simple Super” rule changes which took effect from 1 July 2007, the Howard government made super and ABPs tax exempt for those aged 60 and over.

Since then, any lump sum withdrawn from super after age 60 is tax exempt. It means that you can legally omit declaring it to the ATO on your tax return!

Better still, since the “Simple Super” changes, transferring your accumulated superannuation to an ABP means that not only is the pension (or any lump sum) you receive income tax exempt, the investment earnings within the fund are also tax exempt (compared with 15% tax on earnings in accumulation phase). You do not have to be a Rhodes Scholar to appreciate that 0% tax is better.

There are two ‘catches’ associated with Account Based Pensions. The first is that you must be over your “preservation age” (currently 59 but due to increase to 60) and permanently retired to “trigger” a “condition of release” on your preserved super benefit, and be permitted to roll over (transfer) to an ABP.

At any time after age 60, however, if “an employment arrangement ceases” you can access your super and legally commence an ABP, even if you quit the old job to start a new full-time one!

At age 65, an ABP can be commenced regardless of whether you are still in full time (or part time) employment.

The second ABP ‘catch’ is that it is not designed to be an estate-planning tool.

An ABP reduces at prescribed age-based rates, and, as demonstrated in the projection above, it is scheduled to be exhausted by around the age of 102. The income is drawn from capital as well as earnings, so you need to discuss your approach and intentions with your financial adviser.

Note however, that due to the ongoing pandemic uncertainty, the federal government has legislated to keep the drawdown rate at 50% of the normal prescribed rate for at least another 12 months.

A further aspect of getting the most out of super is the protection it provides in the event of death or disability.

As we age, these realities become an increasing risk.

When someone dies, all savings and life insurance held within super can be paid tax-free to a spouse and/or dependent children, to ensure that at least financially, they will be OK. Where there is no spouse or financially dependent children (as defined by superannuation law) "taxable component" super benefits are taxable to the estate at 17%. Subject to current super rules, there are planning strategies which can help to mitigate this 'death benefits' tax.

In the unfortunate and generally lengthy medical process of being able to be considered Totally and Permanently Disabled (or being unable ever to work again in any occupation) a condition of release is met which legally brings forward retirement. All savings and TPD insurance held within super becomes fully accessible and treated as it would for normal age retirement.

Despite this protection, what we all hope will happen is that we will become self-funded retirees after reaching our superannuation preservation age (originally age 55 but currently gradually increasing to age 60) thanks to a tax-exempt super ABP income stream. For around 20% of the retiree population this is currently the case, with the remainder being self-funded in part, with some Age Pension support.

In the interim, you can get even more out of super with a Transition to Retirement Strategy (T2R).

There are many who are eligible but have not yet considered the benefits of T2R, with the result that they may be missing out on thousands of dollars per year. For example, someone over their preservation age and earning $150,000 pa could be paying $3,000 pa less in net tax by employing a T2R strategy.

T2R is possible after attaining preservation age (59 in 2021/22, rising to 60 from 1 July 2022). Known as the 'virtuous circle,' a T2R strategy allows people who have reached preservation age to start drawing on their super using a 'purpose built' ABP, while contributing more of their take home pay into retirement savings via salary sacrifice.

(This was not an option 20 years ago until Peter Costello, then Treasurer within the Howard Government, changed the super rules and introduced it). In my view, T2R will go down as one of his least-recognised brilliant ideas.

Clearly, there are tremendous opportunities within the superannuation system especially when you are already (or fast approaching) 60 years of age. Let's face it, most 'Boomers' are already there, and many of the "young" Boomers (like me) are fast approaching it.

Yes, the rules around superannuation are constantly changing, but in my experience, as governments close one door (or head into an election with a last 'thought bubble' strategy) they open another. As a case in point, this year's May 11 Budget saw more changes announced, which, if legislated, will help us to contribute more to super, for longer.

By commencing a T2R strategy on reaching my own preservation age of 58 in December 2020, I can happily say I have taken my own advice. My time as a public servant has provided valuable insights and experience within the super arena; the past 20+ years in financial planning has provided opportunities to build on this knowledge and experience for the benefit of my clients. As a result, some might say I have become a superannuation addict. I prefer to call myself a 'super nerd'.

Super remains the greatest way to provide dignity in retirement. And for those who argue against the compulsory nature of our system, all I can say is that the argument has been tested over 5,000 years of civilisation – with the proof that human beings do not voluntarily save for their own future. What we have built in the last 30 or so years is a system that alleviates the financial burden of aging, protects families from some of the financial impacts of premature death or disability, and provides us with the opportunity to live a dignified, if not excellent, final third of our lives.

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