TRAC

The Retirement Advice Centre

The “Your Guide To” Series

Transition to Retirement

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Your Guide to Transition to Retirement

Transition to retirement is a superannuation rule which allows you to use your superannuation savings to start a non-commutable account based pension (a 'TTR' pension) before permanently retiring.

What are the benefits?

- A TTR pension provides regular, tax-effective income.
- The extra income can be used to supplement employment income if you want to increase your income or reduce your working hours.
- Combining a TTR pension with salary sacrifice can boost your superannuation or help you to repay your mortgage faster.
- Earnings and capital gains within the pension account are exempt from tax, thereby potentially increasing your effective earning rate.

How does transition to retirement work?

As a general rule, to access your superannuation, you must have either turned age 65 or be permanently retired after reaching your preservation age.

Transition to retirement is a condition of release that gives you limited access to your superannuation before retirement. You just need to have turned preservation age (preservation age is currently age 55 but is gradually increasing to age 60) and have sufficient funds in super to commence a TTR pension. Under the transition to retirement rules, you can use some or all of your superannuation savings to commence a TTR pension.

Transition to retirement (TTR) pension

A TTR pension is essentially an account based pension with the following restrictions:

It is non-commutable (which means lump sum withdrawals are generally not allowed)
The maximum annual income is capped at 10% of the account balance.

A minimum income of 4% of the account balance must be taken from the TTR pension each year. The minimum and maximum income limits are based on the account balance on the day of commencement and then every 1 July thereafter.

Once you permanently retire or reach age 65, your TTR pension will convert to a 'commutable' account based pension and the restrictions above will no longer apply.

Taxation

When you commence a TTR pension, your tax-free and taxable 'proportions' will be calculated based on your tax-free and taxable 'components'. The tax proportions will apply for the life of your pension and will impact your income payments, withdrawals and final death benefit.

For example, if your TTR pension is commenced with $100,000 of which $30,000 is tax-free component and $70,000 is taxable component, then the tax proportions of the pension would be 30% tax-free and 70% taxable. Assuming $5,000 is taken as income in the first year, $1,500 (30%) would be tax-free component and $3,500 (70%) would be taxable component.

Taxable components of the income payments you receive whilst you are under age 60 must be included as assessable income in your tax return but will attract a 15% tax offset. TTR income payments received after age 60 are tax-free, irrespective of the underlying tax components.

Combining a TTR pension with salary sacrifice

A TTR pension, combined with a salary sacrifice arrangement, can be used to boost your retirement savings without impacting your cash flow.

The tax benefits that make this strategy work are:

- Tax-free earnings and capital gains within the pension account, which can increase your effective earning rate.
- Tax-free pension income after age 60, which replaces taxable employment income.

To implement the strategy, you need to enter into an agreement with your employer to sacrifice some of your pre-tax pay into super. It is important that your salary sacrifice contributions do not cause you to exceed your concessional contributions cap. You then commence a TTR pension to replace the pay that you are sacrificing into super, so that your income stays the same and the tax benefits are retained in super, thereby boosting your retirement savings.

This strategy can be further enhanced by 'refreshing' the TTR pension on an annual basis. This involves rolling the pension back to accumulation phase to combine it with the rest of your superannuation, before commencing a new TTR pension. The outcome is that you'll have a larger TTR pension enabling you to draw a higher level of income and salary sacrifice more of your pay. Altogether, this means more tax savings.

Death benefits

When you set up your TTR pension, you should consider whether to add a beneficiary nomination so that, in the event of your death, any remaining balance in your pension is paid to your intended beneficiary. Nomination options usually include:

- *Reversionary nomination* – this nomination type is commonly only available if the beneficiary is your spouse. In the event of your death, the pension will continue to your spouse who can convert it to a lump sum after reversion if they choose.

- *Binding nomination* – a valid binding nomination binds the trustee to pay your death benefit to the nominated dependants or your estate in the proportions you choose. It is generally only binding as to who will receive your death benefit, not how the benefit is paid, so whether the benefit is paid as a lump sum or a pension is decided by the super fund trustee.

If a beneficiary nomination is not made, in the event of your death, the fund will determine who receives any remaining balance (which may be a surviving dependant or your estate).

Other things you should know

Prior to commencing a TTR pension, if you have made personal contributions to super for which you wish to claim a tax deduction, you must lodge your notice of intent to claim a deduction form with the superannuation fund (and wait for confirmation that they have received the notice).
If you still working, you will need to retain an amount in your superannuation accumulation account to accept future employer contributions.
Drawing a pension prior to retirement reduces your superannuation balance at retirement if you do not offset this with sufficient contributions.