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# Appendix 7: Retirement Planning

These appendices provide more technical detail to the subjects that have been referred to within this Statement of Advice. They are included to give you more detail about the topics discussed. They are not intended to be comprehensive in the information that you may require. You should seek professional advice from your taxation and/or legal adviser, Centrelink or the relevant Government authorities.

## Protecting Super

Trustees are prohibited from providing insurance to members to members with inactive superannuation accounts; either choice or MySuper products.

Small account balance accounts (less than $6,000), that have nil insurance attached will be transferred to the ATO holding account with the aim of ultimately transferring these funds to the member’s active superannuation fund.

The affected clients must not have met a condition of release nor been active on that account for a continuous period of 16 months.

‘Activity’ is defined as

* Making a contribution
* Rolling over funds to that account
* Switching investments
* Altering an existing insurance policy
* Making or changing a death benefit nomination.

However, the client can elect to the ATO to be exempted from the legislation.

Trustees may request that the account balance not be transferred to the ATO if they are owed money.

Additionally, product providers are unable to charge fees which, in aggregate, exceed 3% of the members account balance; also, Exit Fees cannot be charged at all. This applies if, at the end of the financial year, the account balance is less than $6,000.

## Downsizer Contributions

If a contract for the sale of a qualifying main residence is exchanged on or after 1 July 2018, sale proceeds may be contributed to superannuation under the following conditions:

* Contributions must not exceed $300,000 for each eligible (former) spouse and the aggregate of all these contributions cannot exceed the total proceeds of the sale.
* Each eligible spouse must be aged over 65; no work test applies.
* Each eligible spouse, including former spouses, must have had an ownership interest of at least 10 years immediately prior to the sale
* Each eligible has not previously contributed under this scheme from the sale proceeds of another main residence.

The contribution must be made with 90 days of settlement and must be accompanied by an approved form.

These contributions are not limited by the Total Superannuation Balance (TSB) restrictions nor affect other personal contribution caps.

## Transfer Balance Cap (TBC) & Transfer Balance Account (TBA)

The Government has legislated to limit the amount that can be invested in retirement income streams; usually Account Based Pensions.

* What is the Transfer Balance Cap?
* How does it apply to me?
* Are there any pensions, or other amounts, excluded?
* Indexation
* Estate Planning consequences

**What is the Transfer Balance Cap (TBC)?**

An aggregate limit of $1.6m has been placed on amounts that are invested in all of an individual’s retirement phase pensions:

* account based pensions
* market linked income streams
* pensions that are ‘inherited’ (reversion) upon the death of another person
* capped defined benefit income streams
* any ‘other’ retirement phase pension types

In aggregate, the sum of any existing or new retirement phase pensions cannot exceed $1.6m. Amounts in excess must be withdrawn from the superannuation system or rolled back into a superannuation accumulation account.

An income stream commenced under the Transition to Retirement rules is not assessed under the $1.6m cap as it is not classed as a retirement phase pension. This classification can change when a condition of release is met.

An initial amount contributed in excess of the TBC attracts penalty tax of 15% on notional earnings. The notional earnings are calculated using the General Interest Charge compounded daily. Any subsequent breach is taxed at 30%.

The Australian Tax Office will notify individuals of the amount of excess contributions and tax payable.

**How does it apply to me?**

Once an individual first receives a retirement phase pension, a person’s retirement phase income stream(s) aggregate balance is tracked ongoing. This is called a Transfer Balance Account (TBA).

For a person commencing their first retirement phase pension after 1 July 2017, the individual’s maximum TBA would be equal to the Transfer Balance Cap (TBC) $1.6m.

A person’s TBA can alter:

Increase:

* as new retirement phase pensions commence or are inherited
* notional earnings that accrue on excess transfer balance amounts
* a reversionary beneficiary receives an automatically reversionary pension; the credit arises 12 months after the original pensioner’s date of death

Decrease:

* when a special lump sum capital payment (commutation) is made from a retirement phase pension
* when a required minimum pension payment is not made by the Trustee
* by family law splits, repayments of fraudulent or voided contributions, that relate to retirement phase pensions.
* by the amount of retirement phase pension capital that has come from a structured settlement
* when a Market Linked Income Stream (TAP) is commuted
* when an excess transfer balance arises in a member’s account and there is no legal way to offset it

**Excluded from the calculation of TBA:**

* Movements of existing pension balances, due to earnings or investment losses, neither increase nor decrease the TBA.

**Indexation**

The Transfer Balance Cap (TBC) is expected to index and will increase in $100,000 increments in future years.

When indexation occurs, the opportunity for an individual with a pre-existing pension(s) to increase their aggregate pension balance may increase too. The situation is complicated.

If a person’s account Transfer Balance Account (TBA) balance:

* has ever previously been equal to the TBC that applied at that time; there is no future opportunity for increase as the TBC indexes for other superannuants.
* if the highest balance ever achieved has never equalled the TBC, then proportionate indexation is available for the individual’s TBA as the TBC indexes for other superannuants.

For example, assume the TBC has now indexed to $1.7m for superannuants, and the highest TBA balance ever achieved by a specific individual was $1.275k (75% of $1.7m). Further assume that this peak TBA occurred when the TBC was then $1.6m.

Then that specific individual has an ‘effective’ transfer balance cap of $1.625m. This is a 25% (100%-75%) increase on the TBC that previously applied to the individual at the date that person’s highest TBA was achieved.

Given that we now have an ‘effective’ cap limit applying uniquely to an individual, it is useful to distinguish between a General Transfer Balance Cap and a Personal Transfer Balance Cap (PTBC).

**Estate Planning Consequences**

When a pension is ‘inherited by’ (reverts to) an adult individual, it increases the recipient’s Transfer Balance Account and may result in exceeding the personal transfer balance cap (PTBC).

If that occurs, to avoid penalty taxation:

* any other pre-existing retirement phase pension the recipient may have could be rolled back to accumulation in whole or part
* an amount of any other pre-existing pension may be withdrawn (commutation) and paid to the individual subject to preservation and pension rules.

In the event of the superannuation being paid to surviving eligible children, two examples are shown:

1. the deceased has not yet started a pension but has $4m in accumulation (say)
2. the deceased has started a pension within the applicable TBC but it has subsequently grown to $4m with investment earnings (say)

Situation 1 – the eligible children (assume 3 children) can ‘inherit’ (reversion) pensions that do not exceed 1/3 of the Transfer Balance Cap (TBC) applicable at the time of death. On the further assumption that the TBC was then $1.6m, each child could only receive death benefit pensions to the value of $533,333.

Situation 2- the eligible children (again assume 3 children) can ‘inherit’ (reversion) pensions of 1/3 of the full $4m.

If the deceased instead had a mixture of accumulation ($4m) and pension ($4m), then the deceased's pension would revert proportionately, in full (situation 2). The accumulation would then have to be received by the children entirely as a death benefit lump sum.

## Total Superannuation Balance (TSB)

An individual’s Total Superannuation Balance (TSB) is the sum of:

* superannuation interests in accumulation
* account balances of Transition to Retirement pensions
* the value of the individual’s Transfer Balance Account

TSB may impact:

* the amount of non-concessional contributions that can be made in a financial year
* eligibility for catch up Concessional Contribution payments
* eligibility for the Government’s co-contribution
* a contributing spouse’s eligibility for the Spouse Contribution tax offset
* ability to use asset segregation to calculate a pension’s exempt income component

## Defined Benefit Pensions

Defined Benefit superannuation is a superannuation entitlement that may be partially accrued through savings but is typically determined by a formula based on the employee’s length of service.

Such schemes can be unfunded, constitutionally protected or funded.

* Unfunded and constitutionally protected fund benefits are taxable at marginal rates. From 1 July 2017, a 10% tax offset will apply to only the first $100,000 of income received. Above $100,000 there is nil tax offset.
* Members of funded schemes will have 50% of annual pension amounts above $100,00 taxed at marginal rates.

**Capped Defined Benefit Schemes**

These are defined in the Superannuation Regulations and include lifetime pensions, life expectancy pensions (prior to 1 July 2017) and market-linked pensions (prior to 1 July 2017).

Capped Defined Benefit funds have a special methodology to determine an asset value for the purpose of an individual’s Transfer Balance Account.

Lifetime pensions Annual Payment x 16

Life Expectancy / Market- Linked Annual Payment[1] x remaining term of the pension

[1] first annual payment after a valuation is required.

Capped Defined Benefit funds have a special methodology to determine payments that can be given concessional tax treatment. Payments in excess of a Defined Benefit Income Cap do not receive concessional tax treatment.

Defined Benefit Income Cap Applicable [2] general Transfer Balance Cap / 16

[2] Each year that a valuation is required.

Expert advice should be sought regarding Defined benefit income streams as matters may be complex with unexpected consequences.

For example, under certain conditions, recipients of both a Defined Benefit income stream and an otherwise tax-free Death Benefit income stream can find that the latter loses its tax concessional status in whole or part.

## Superannuation Guarantee and Multiple Employers

To ensure that an employee doesn’t unintentionally exceed their Concessional Contributions Cap, the person can apply to the Commissioner of Taxation that a specific employer pay an equivalent cash amount to the employee directly.

The application must be on the approved form and include:

* Identification of the employer
* The specific Quarter of the financial year to be affected.

It must be lodged with the Commissioner 60 days before the commencement of the relevant Quarter.

The Commissioner will issue an ‘Employer shortfall exemption certificate’ that will cover that specific Quarter.

## Salary Sacrifice

Salary Sacrificing involves foregoing salary income and subsequently using pre-tax money, through an arrangement with your employer, to obtain benefits which don’t incur income tax.

The benefit from Salary Sacrifice comes from the difference between the income tax that would have been paid on the amount, and the rate of tax (contributions tax or fringe benefits tax) payable on the item under the Salary Sacrifice arrangement.

Salary sacrifice contributions are classified as Concessional Contributions. Concessional Contributions are typically limited to $25,000 per annum This threshold includes any Superannuation Guarantee (SG) payments made by your employer. Where the ATO identifies that a person’s overall concessional contributions have exceeded the $25,000 concessional cap, the gross amount in excess will be included in the contributor’s assessable income for tax. The contributor will receive a tax offset of 15% but will also incur a penalty interest charge which is calculated using the RBA 90-day bank bill rate plus 3%. `

The employee can elect to the Australian Tax Office that 85% of the original gross excess contribution be refunded in cash.

Like Superannuation Guarantee (SG), the law categorises salary sacrifice payments as ‘employer’ contributions that are not mandatory but are requested by the employee in an agreement made in advance of the first payment. This helps to explain why salary sacrifice is more formally known as a Reportable Employer Superannuation Contribution (RESC).

## Transition to Retirement

‘Transition to Retirement’ refers to the opportunity for people who have reached their preservation age to continue working on a part-time or full-time basis and supplement their salary with a regular income from their superannuation savings via a non-commutable income stream.

Transition to Retirement strategies provide the following opportunities:

* You can increase your income prior to retirement.
* You can reduce your hours of work and receive a similar level of income.
* You can reduce your tax payable prior to retirement.
* You can increase your retirement savings.

## Transition to Retirement Income Stream (TRIS) \_ Pre COVID 19 Pandemic

A TRIS is a superannuation income stream which counts for the assessment of your Total Superannuation Balance (TSB). This means that superannuation that was being accumulated for retirement may now be drawndown periodically subject to legislated rules.

A minimum limit applies to TRIS payments. Payments must be equal to, or exceed, 4% of the account balance. A maximum limit equal to 10% of the account balance also applies to the aggregate of the periodic payments.

TRIS payments are tax free for individuals over 60 years of age and do not have to be included in tax returns.

Payments made to individuals less than 60 years of age are taxable but receive tax concessions. The superannuation pension drawn, less any tax-free amount, is taxed at your marginal tax rate. A 15% tax rebate applies to the difference, which is taxable income. The tax rebate can be used to reduce an income tax liability arising from this pension as well as other income sources.

When you retire or reach 65 years of age, or you meet some other condition of release (eg. retirement) that does not restrict the access to lump sums, your TRIS enters the retirement phase:

* Preserved components become unrestricted non preserved, meaning you can access your capital as a lump sum (commutation).
* The balance of that TRIS now counts in the determination of your Transfer Balance Account (TBA).

The benefits of commencing a Transition to Retirement Income Stream are:

* The income received from your TRIS can assist in meeting your cost of living requirements.
* Pension payments are tax effective.
* You have the flexibility to adjust your pension payment between the minimum and maximum limits.
* The pension is paid as regularly as you require to enable you to manage your cashflow, eg: monthly, quarterly, half yearly or annually and can be credited to your nominated bank account, building society, credit union or paid to you by cheque.

The risks associated with commencing a Transition to Retirement pension are:

* If the income drawn from your TRIS exceeds the level of superannuation contributions, you will accelerate the depletion of your retirement capital.
* You are restricted from making commutations from your TRIS. There are however exceptions which include, but are not limited to, the following:
  + Unrestricted Non-Preserved funds can be accessed.
  + Capital can be rolled back into the accumulation phase.
  + You meet a full condition of release (eg. retirement) which has no limitation upon accessing lump sums
  + You use the proceeds to purchase another non-commutable income stream

Lump sum withdrawals from a TRIS (eg. unrestricted non-preserved component) are not classed as a payment meeting the minimum pension standards. Consequently, they do not reduce an individual’s Transfer Balance Account (TBA).

## Account Based Pension (ABP) \_ Pre COVID 19 Pandemic

An Account Based Pension (ABP) is purchased with superannuation monies and is designed to provide you with a regular, flexible, tax effective income stream in retirement. Account Based Pension balances increase with positive investment returns and decrease with pension payments, negative investment returns and fees.

The balance of the ABP counts for the determination of both the Total Superannuation Balance (TSB) and an individual’s Transfer Balance Account (TBA)

Earnings from the underlying portfolio of your Account Based Pension are tax free, making Account Based Pensions a very tax effective retirement structure.

Lump sum withdrawals from an Account Based Pension cannot be classed as a payment meeting the minimum pension standards.

The income received from your Account Based Pension is referred to as a pension payment.

|  |  |  |
| --- | --- | --- |
| **Age** | **Minimum Pension Payment[1]**  **(% of Account Balance)** | **Maximum Pension Payment**  **(% of Account Balance)** |
| Under 65 | 4% | Standard Account-Based Pensions: No Maximum Pension Payment  Transition to Retirement Account-Based Pensions: 10% Maximum Pension Payment |
| 65 - 74 | 5% |
| 75 - 79 | 6% |
| 80 -84 | 7% |
| 85 – 89 | 9% |
| 90 -94 | 11% |
| 95+ | 14% |

Notes:

|  |  |
| --- | --- |
| [1] | Minimum pension payments are calculated annually at 1 July. |

For individuals over 60 years of age, Account Based Pension payments are tax free and do not have to be included in tax returns.

The benefits of commencing an Account Based Pension are:

* You receive a regular income stream to assist in meeting your retirement income needs
* Payments made to individuals less than 60 years of age are taxable but receive tax concessions. The pension drawn, less any tax-free amount, is taxed at your marginal tax rate. A 15% tax rebate applies to the difference, which is taxable income. The tax rebate can be used to reduce an income tax liability arising from this pension as well as other income sources.
* Once you reach 60 years of age your pension payments will be tax free.
* You can choose the frequency of your pension payments (e.g. monthly, quarterly, half yearly or annually) and payments can be credited to your nominated bank account or paid to you by cheque.
* Your Account Based Pension fund pays no tax on income or capital gains generated within the fund.
* Upon rollover of your superannuation benefits to an Account Based Pension, there is generally no lump sum tax payable.
* Your Account Based Pension portfolio will be invested in accordance with your risk profile. This would not be possible through non account-based retirement income streams such as Annuities.

You typically have the option of nominating a reversionary beneficiary (usually a spouse) who will receive the pension in the event of death. This will increase the recipient’s superannuation balance assessable against the recipient’s personal Transfer Balance Account.

The risks associated with this recommendation are:

* There is no guarantee you will receive income from your Account Based Pension for your lifetime.
* The account balance of your Account Based Pension may reduce to a level which is insufficient to meet your income needs later in life, depending upon the performance of the underlying investments and the level of income and capital you draw over time.

## Fixed Term (Term Certain) Annuity

Fixed Term (or Term Certain) annuities pay a guaranteed income to you for a defined period of time predetermined in the annuity contract. You can purchase an Annuity with superannuation or non-superannuation monies.

The features of this type of investment are:

* There can be between 0% - 100% of your capital left at the end of the term (known as Residual Capital Value), depending upon the option you choose.
* If you change your mind you can commute (cash in) your investment at any time (subject to lump sum tax if purchased with superannuation monies).
* You can receive your income payments monthly, quarterly, half-yearly or yearly.
* You may choose to have each year’s income payment increase through indexation.
* In the event of death, the income payments can continue to be paid to a nominated person (known as a beneficiary).

## Lifetime Annuity

Lifetime annuities pay a guaranteed income to you. You can purchase this investment with superannuation or non-superannuation monies.

The benefits of lifetime annuities are:

* Peace of mind and security. Income is guaranteed to be paid for the rest of your life, regardless of the investment performance of the assets backing the income stream. The investment risk for these types of products resides with the provider.
* You can receive your income payments monthly, quarterly, half-yearly or yearly.
* When purchased with superannuation monies, payments are tax free where you are over 60 years of age. Where less than 60 years of age you may be eligible to receive a deductible amount and tax offset.
* You may choose to have each year’s income payment increase through indexation.
* In the event of death, the income payments can continue to be paid to a nominated beneficiary until the end of the guaranteed period.

The risks associated with lifetime annuities are:

* If you die early in the life of the plan, and you have a short-guaranteed period, total payments may be substantially less than your initial investment.
* You lose access to your capital. Access to lump sums is only available in certain circumstances.
* Lack of flexibility. Income payments and frequency of payments are fixed at the time you invest.
* Returns are relatively low compared to that which may be achieved via investment in growth assets. The returns are offered are based on that which the provider can achieve via capital stable and cash investments, with a discount applying to cover the risk taken on by the provider (i.e. you may substantially outlive your life expectancy).
* Your investments may not be invested in accordance with your risk profile.