THE DOVER GROUP

The Dover Guide to Transition to Retirement Income Streams

First Published January 2008

This guide is intended to be general in nature. Readers should conduct their own research before acting on any aspect of this article.

SUPERANNUATION

Transition to Retirement Income Streams

Sometimes acronyms can be really unhelpful. This was the case when transmission to retirement pensions were first made available on the first of July 2005. The full name of it this facility is a transition to retirement allocated pension, which of course led to the acronym TRAP.

Now that allocated pensions have gone the way of reasonable benefit limits, the proper name to this facility has become transition to retirement income stream, queuing hours are much more friendly acronym: TRIS.

Perhaps because of the unfortunate acronym, transition to retirement income streams are a bit of a sleeper within the superannuation industry. They seem to be being used less than common sense - and smart financial planning - would predict.

Some commentators believe that the relatively light take-up of transition to retirement income streams is the result of a general misunderstanding which arose when the facilities first became available. Prior to the introduction of transition to retirement facilities, are aged over 55 had two choices: they could either continue to work, which allowed them to keep earning employment income but meant that they had to leave their superannuation benefits intact within their superannuation fund; or they could completely retire, making their superannuation benefits available but forcing them to forego employment income.

This created a particular problem for individuals who wanted to reduce their working hours, due either to health or lifestyle motivations. A person on a full-time income who reduced their working hours reduced their disposable income accordingly. Many people found that they could not live on part-time earnings. Therefore, for people who did not wish to work full-time, there was often no choice other than to completely retire so as to be able to access their retirement benefits. They needed to do this simply to be able to live.

The last thing the government and the community wanted was a situation that encouraged people to retire earlier than they otherwise would choose to. Therefore, from the first of July 2005, it became possible for people aged over 55 to begin to access their superannuation even while they continued to work.

Because the most salient problem that this new facility was intended to address was the situation of people who wished to reduce their working hours, it appears that many people developed an understanding that they needed to reduce their working hours in order to qualify for a transition to retirement facility. This is actually not the case. Transition to retirement income streams suit a wide variety of working situations.

There is only one requirement for the commencement of a transition to retirement income stream: the member must reach the minimum preservation age of 55. Having done this, they are free to commence a simple pension from their superannuation fund. The minimum amount of pension payable is 4% for a person aged under 65. No more than 10% of total benefits can be taken in any one year.

Tax-Free Earnings within the Fund

Assets that are used to finance the transition to retirement income stream are placed within what is colloquially known as 'pension mode' within a superannuation fund. The main benefit of this is of course that earnings on those assets become tax-free from that point on.

The beauty of the transition to retirement arrangements is that a member can simultaneously continue to contribute into their superannuation fund whilst also drawing some of the benefits as an income stream. Basically, the member's account is divided into two. Those assets that are used to finance the income stream are placed in pension phase. New contributions into the fund remain in the accumulation phase until they too are converted to partially finance a future income stream.

The move to pension phase within the superannuation fund can be of particular benefit where there are substantial unrealised capital gains within a fund. capital gains that I realised after the establishment of a transition to retirement income stream will be tax-free. While the relevant rate of tax on capital gains within superannuation is only 10%, for assets that have been held for lengthy periods 10% can still be a sizable figure. The ability to not have to pay this tax can mean that the transition to retirement income stream pays for itself as soon as it is created.

Self Managed Superannuation Funds

In many ways, transition to retirement income streams work best with a self managed superannuation fund. This is because a self managed fund is the most flexible form of superannuation fund: most members are able to convince the trustees of a self managed fund to make full use of any and every available benefit of superannuation, because to do so they need only to look into the mirror.

As with anything but a superannuation fund does, transition to retirement income streams must be allowable under the trust deed that governs the particular fund.

Reduce Re-use Recycle

Every time I put something in the bin, my six year old daughter repeats the mantra that she is learning at school: reduce, reuse, recycle Daddy. With the advent of transition to retirement income streams I have been able to educate her about a

particular form of recycling.

Because of the person making use of a transition to retirement income stream is able to simultaneously make new contributions into their superannuation fund, it is possible for amounts withdrawn from a superannuation fund to effectively be immediately reached contribution back into the same superannuation fund - with the member receiving a tax deduction in the process.

Alternatively, many members are choosing to sacrifice all of the first $30,000 of their salary into superannuation. If $30,000 is insufficient for them to live, they then augment this amount with a transition to retirement income stream equal to up to 10% of their superannuation benefits.

In the best of all worlds, superannuation benefits continue to grow because the contributions into the fund exceed the pension withdrawn from the fund. This can happen while the member experiences no reduction in actual disposable income - it is the taxman whose income is reduced.

There has Never Been a Better Time to be 60

For members of self that he superannuation funds who have turned 60, the transition to retirement income stream should be almost mandatory. This is because pension payments made by the fund are received tax-free in the hands of the recipient. Basically, this creates a situation where people aged over 60 are unlikely to need to pay marginal income-tax at a rate greater than 15%.

Non-Commutability

A transition to retirement income stream cannot be commuted while the member continues to work. However, it is difficult to see why a person would want to commute it while they are still working. And, of course, prior to transition to retirement income streams lump-sum benefits were not available to people who continued to work. In this context, non-commutability is not so much a weakness as the absence of an additional strength.