

understanding retirement income

WHAT IS AN ACCOUNT BASED PENSION?

Savings are accumulated in superannuation during our working lives to fund retirement. In retirement, a pension can be drawn from your superannuation capital through a number of approved income streams including an account based pension.

An account based pension is a superannuation account that pays you a regular income. Compared to superannuation in

accumulation phase, an account based pension has additional concessions and is a convenient, flexible and tax efficient way of receiving your superannuation benefits.

WHAT ARE THE BENEFITS?

Account based pensions have the following features:

- Earnings and capital gains within your superannuation pension account are tax-free. In comparison a maximum of 15% tax is levied on earnings and realised capital gains within superannuation in accumulation, and up to 46.5% (depending on your marginal tax rate) for investments held outside superannuation.
- You have discretion over the frequency of payments and can draw up to your entire balance.
- If you are under age 60, income drawn is subject to tax at your marginal tax rate, however, you may be entitled to a tax deduction (known as the 'deductible amount') depending on the components of your account based pension account. In addition, you are generally entitled to a 15% rebate on the portion of the pension that is subject to tax.
- If you are aged 60 and over, all withdrawals are tax free.

IMPORTANCE OF SUPERANNUATION COMPONENTS

While you are under age 60, the tax-effectiveness of the income you receive from an account based pension will depend upon the components of your account based pension account. These components are classified as either:

- Taxable, or
- Tax-Free

The tax-free component of your superannuation comprises of contributions made with after-tax salary or savings, while the taxable component comprises of contributions for which a tax deduction has been claimed by you or your employer (please refer to the 'Superannuation Contributions' flyer for more information on contribution types).

The greater the tax-free component, the more tax-effective the income from your account based pension will be. Importantly, with proper management, you can structure your superannuation to maximise your tax-free component and improve the tax efficiency of your account based pension.

THE DEDUCTIBLE AMOUNT

The deductible amount is the proportion of an account based pension that is paid to you tax free in the form of a tax deduction. This amount is calculated based on the proportion of tax-free benefits within your account based pension account. Along with the 15% rebate, the deductible amount can result in little or no tax being paid on account based pension income.

When an individual turns age 60, account based pension withdrawals become tax free and the deductible amount no longer applies.

CASE STUDY

James is 58 years of age and fully retired. He rolls over his superannuation benefit of \$500,000 into an account based pension. This includes an tax-free component of \$200,000.

The ratio of the tax-free component to the account based Pension's commencement amount is 40% (\$200,000 ÷ \$500,000). James is therefore entitled to claim a deductible amount of 40% on the withdrawals he makes from his account based pension. When James completes his tax return, he is able to include this amount as a tax deduction against the income from his account based pension.

When James turns age 60, no tax would be payable on his account based pension income, at which point the deductible amount and 15% pension rebate ceases to apply.

MINIMUM PENSION PAYMENT

With an account based pension you have the flexibility of choosing the amount and frequency of income payments, however a minimum amount must be drawn each year. The minimum amount is based on the applicable minimum payment factor (table 1) and your account based pension balance on 1 July each year.

The minimum pension payment factor is dependant upon your age and progres-



This article by Frank Camilleri (above), National Technical Manager.

sively increases as you get older. The amount that must be drawn each year is calculated by multiplying this factor by your account balance, however, you are allowed to draw up to your entire balance if required.

Table 1: Account-based Pension Factors

Age	Minimum Payment
55–64	2 %
65–74	2.5 %
75–79	3 %
80–84	3.5 %
85–89	4.5 %
90–94	5.5 %
95 +	7 %

CASE STUDY

Based on James' age of 58, his minimum pension payment factor is 2% of his account based pension balance. As he is commencing an account based pension with \$500,000, the minimum amount that he must draw in the first year is \$10,000 (\$500,000 X 2%), however, he is able to draw up to the entire balance of \$500,000.

James decides to draw the minimum annual income of \$10,000. Given that he is entitled to a deductible amount of 40% (from the previous case study), the taxable portion of his account based pension income would be \$6,000 rather than \$10,000 (\$10,000 – \$4,000 deductible amount).

In addition, James is also entitled to a 15% tax rebate on the taxable portion of his account based pension income. Therefore he will be able to claim a tax rebate of \$900 (\$6,000 x 15%) against his tax liability for the year. At 2010/11 tax rates, if James did not have any other sources of income, the deductible

amount and the 15% pension rebate would reduce his tax liability and no tax would be payable on the \$10,000 account based pension income.

HOW CAN I INCREASE THE TAX-EFFECTIVENESS OF AN ACCOUNT BASED PENSION (AGED 55–59)?

The tax-effectiveness of an account based pension income is largely determined by the amount of tax-free component used to commence the pension. The greater this component, the more tax-effective the account based pension income stream. If your superannuation benefit does not contain an tax-free component, there will not be a deductible amount.

You can increase the deductible amount and the tax-efficiency of an account based pension by increasing the tax-free component of your superannuation account prior to rolling over to an account based pension. Specific strategies are available to achieve this, including a cash out re-contribution strategy. This strategy makes use of the lifetime tax free withdrawal threshold to increase the tax-free portion of your superannuation benefits. By doing this, you are able to reduce your tax bill or draw a larger income payment without incurring significantly more tax.

If you are about to start an account based pension, it is important that you consider these strategies prior to commencing your pension. Once an account based pension has commenced, you may be unable to make the required adjustments to improve the tax position of your pension income.

WHEN CAN I START AN ACCOUNT BASED PENSION?

An account based pension can only be commenced with 'unrestricted non-preserved' superannuation benefits. Superannuation becomes unpreserved only in specific situations known as a

condition of release. The most common condition for release is attaining your preservation age and meeting retirement conditions or reaching age 65. However if you leave a job between ages 60 and 65, you may also be able to access your superannuation.

Your preservation age is the minimum age at which you are able to access your superannuation benefits (provided you meet retirement conditions). Historically, this has been age 55, however for those born after 30 June 1960 it is being progressively increased to age 60 (refer table 2).

Table 2: Preservation Age

Date of Birth	Preservation Age
Prior to 1 July 1960	55
1 July 1960 to 30 June 1961	56
1 July 1961 to 30 June 1962	57
1 July 1962 to 30 June 1963	58
1 July 1963 to 30 June 1964	59
On or after 1 July 1964	60

CASE STUDY

Cindy's date of birth is the 15 December 1962. Referring to table 2, her preservation age is 58. This is the age at which Cindy is able to access her superannuation if she permanently retires. However, if Cindy continues to work until age 65, she may not be able to commence an account based pension until she turns 65 as she has not fully retired. However, she may be able to commence a 'Transition to Retirement' pension while she remains working (refer to the 'Transition to Retirement' information flyer).



Shadforth Financial Group

To contact us call 1300 308 440
or visit our web site at www.sfg.com.au



Disclaimer

This information flyer has been prepared as general information only and does not take into account your investment objectives, financial situation or personal needs. Before making any financial decision based on this information, you should consider speaking to a financial adviser and assess whether the information is appropriate to your specific needs, objectives and circumstances. The information contained in this publication has been given in good faith and is believed to be accurate and reliable. Neither The Shadforth Financial Group, or its affiliated entities, employees, officers or directors gives any warranty of accuracy or reliability nor accepts any responsibility or liability for any errors or omissions or for loss or damage suffered by any person as a result of any inaccuracies or omissions.