Transition to Retirement 'Income Swap Strategy'

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FINANCIAL STRATEGIES

Increase your super balance with a Transition to Retirement 'Income Swap Strategy'

A popular strategy used to increase your superannuation balance is to commence a Transition to Retirement (TTR) pension while working, allowing you to take a pension and salary sacrifice into super at the same time. Also known as the 'Income Swap Strategy', this tax efficient way of improving your financial position is available to anyone who has reached 55 years and is not permanently retired.

ESSENTIALLY, the strategy works because on commencing the pension, your existing super balance is transferred out of 'accumulation' mode into 'pension' mode. This is important because you don't pay tax on your fund's investment earnings in pension mode. Meanwhile, the amount salary sacrificed into super is taxed at the lower concessional rate available to super funds.

The pension income you receive substitutes the cash salary forgone by salary sacrificing, and the re-contribution of the salary sacrifice amount back into your super fund compensates for the pension payment.

How it works

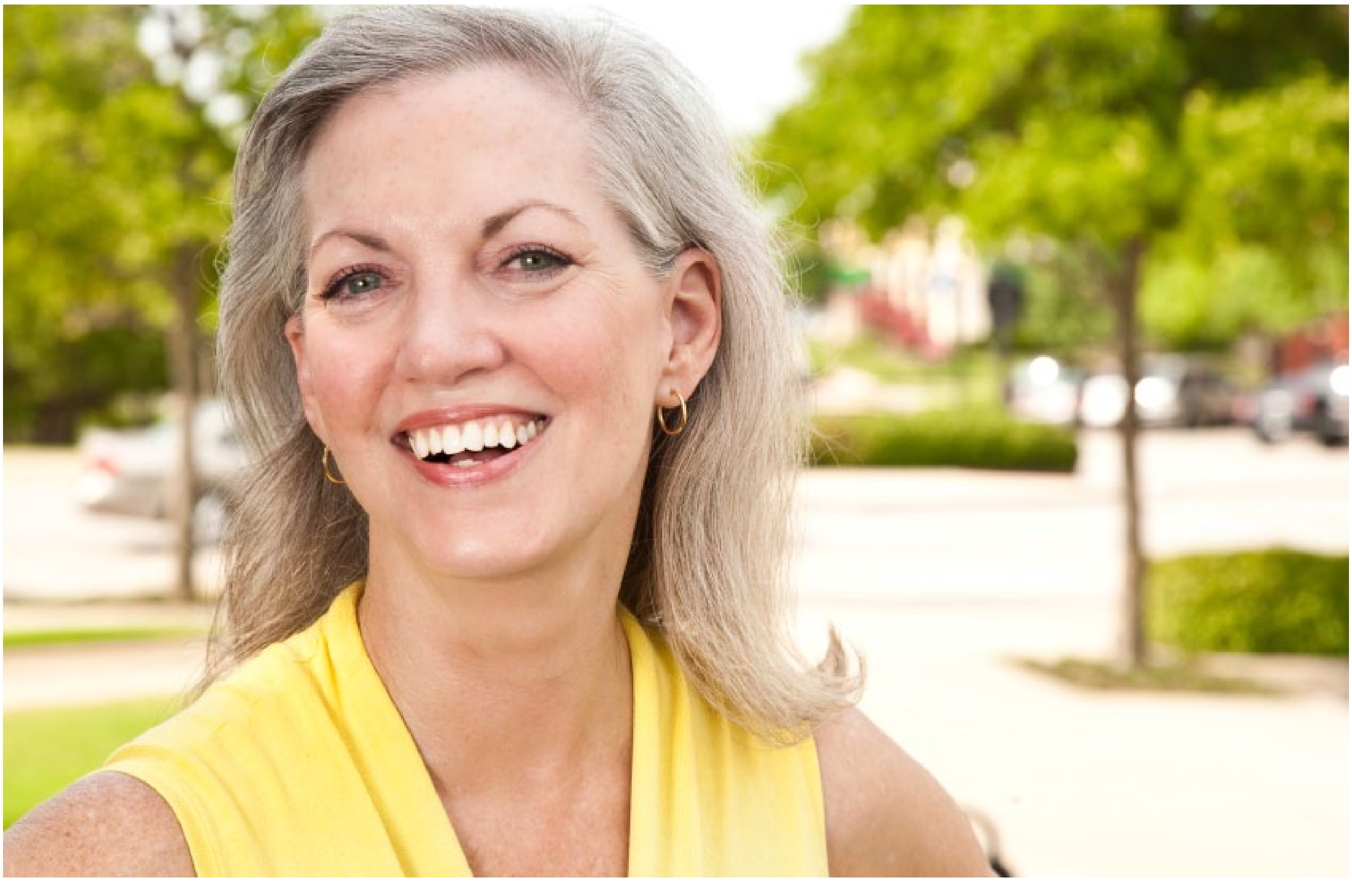
CASE STUDY

Let's look at an example where we assume that the member is 56 years old, earning a cash salary of $100,000 and their employer contributes an additional $9,000 into their super account (the compulsory 9%). The member also salary sacrifices to the maximum ($16,000) into super and their super account balance is $300,000 at the start of the year.

LET'S COMPARE THE NUMBERS WITH AND WITHOUT USING THE 'ITR INCOME SWAP STRATEGY

WITH AND WITHOUT A TTR STRATEGY	Without a TTR income swap strategy	With a TTR (salary sacrifice and TTR pension)
Salary	$100,000	$100,000
Less: Salary Sacrifice	Nil	$16,000
Cash Salary	$100,000	$84,000
Plus: TTR pension	Nil	$12,863
Taxable Income	$100,000	$96,863
Less: PAYG tax + medicare	$26,447	$25,239
Plus: pension tax offset	Nil	$1,929
Net Income	**$73,553**	**$73,553**
Super balance (start of year)	$300,000	$300,000
Plus: Investment earnings*	$21,000	$21,000
Plus: Employer contribution	$9,000	$9,000
Plus: Salary sacrifice contribution	Nil	$16,000
Less: Tax on contributions	-	$3,750
Less: Tax on earnings	-	Nil
Less: TTR pension	Nil	$12,863
Net Super balance	**$325,500**	**$329,387**
Amount of super in Accumulation mode (end year)	**$325,500**	**$21,250**
Amount of super in Pension mode (end year)	**Nil**	**$308,137**

* Assumes 7% net earnings. For simplicity, assumes all contributions and pension payment are made at the end of the year.



Breaking it down

In both cases, the member has the same after tax income of $73,553. However, by using the Transition to Retirement income swap strategy, the member's superannuation balance has grown by an additional $3,887.

THIS IS THE IMPACT OVER JUST ONE YEAR - if the strategy is commenced at age 55, the total increase in the member's account balance over 10 years would be in excess of $50,000.

THE STRATEGY BECOMES EVEN MORE TAX EFFECTIVE AT AGE 60 because the pension payment ceases to be taxable. Between ages 55 and 60, the pension is included in the member's taxable income. Although a tax offset of 15% is available, most members will pay some tax during this period.

Some points to note

Firstly, there are rules that govern maximum and minimum TTR pension payments. On the maximum side, the pension can't be more than 10% of the member's start of year balance. The minimum pension is 3% in 2012 /13, increasing to 4% in 2013/14. Also, once a TTR pension is commenced, it can't be commuted (back to a lump sum cash withdrawal) unless a condition of release such as permanent retirement is met.

Most importantly, the other limitation to this strategy is the concessional contributions cap limit, which in 2012/13 and 2013 /14, is $25,000. Excess contributions tax is payable if you break the cap, so don't go over it. The cap includes employer contributions, salary sacrifice contributions and for the self employed, contributions for which a tax deduction is claimed.

The TTR income swap strategy is one of the simplest ways to increase your superannuation account balance.

And in case you are worried, the ATO has stated (admittedly in a press release only) that this strategy doesn't breach the Part IV A general anti-avoidance rules.

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