Understanding retirement income

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This document provides some additional information to help you understand the financial planning concepts discussed in the SOA in relation to **understanding retirement**.

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This document contains general information about the benefits, costs and risks associated with certain product classes and strategies. It is designed for use in conjunction with a Statement of Advice that takes into account the circumstances and objectives of an individual. Before making a commitment to purchase or sell a financial product, you should ensure that you have obtained an individual Statement of Advice.

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HOW TO READ THIS DOCUMENT

Managing your finances to meet your day to day requirements as well as your long-term goals can be a complex task. There are all sorts of issues you need to consider such as taxation, legislation, protecting your wealth and assets, associated costs and the inherent risks of investment. When undertaking a financial plan it is important you understand how these issues will impact you and what you should expect over time.

Your financial adviser will provide you with a Statement of Advice (SOA) which sets out the details of the advice and how it will meet your goals and objectives.

This document provides some additional information to help you understand the financial planning concepts discussed in the SOA in relation to **retirement income**.

It is very important you read this document to help you understand the benefits of the strategies recommended to you and the associated costs and risks.

Please contact your adviser if you do not understand anything, or need further information or clarification.

Retirement income

When approaching retirement, an important consideration is how to invest your savings including superannuation so you are able to replace your wage with regular income throughout retirement.

When it comes to choosing how to structure your investments in retirement, it is important your savings are invested in a tax effective way while still maintaining flexibility to cover any unforeseen changes in your circumstances.

Some of the options available to fund your retirement include:

- investing outside the superannuation environment (this may involve cashing out all or part of your superannuation benefits as a lump sum payment)
- using all or part of your retirement savings to buy a regular income stream such as an annuity or a superannuation pension, or
- a combination of both the above.

Investing outside superannuation

Depending on your requirements for income and access to capital, you may choose to invest outside the superannuation environment. You could choose to purchase investments such as property, managed funds or shares, or you could use your funds to pay off loans or to take a holiday.

As part of this strategy, you may also choose to withdraw your funds from superannuation.

Be aware

- Depending on your circumstances, you may be liable to pay lump sum tax on any amounts you withdraw.
- Generating income from investments held outside superannuation may not be the most tax effective option for you.
- If you make a lump sum withdrawal from superannuation to invest into non-superannuation investments, you may lose access to tax-free income/ earnings or the tax offset generally associated with income streams commenced with superannuation benefits.
- If you make a lump sum withdrawal from superannuation to invest into non-superannuation investments, you may lose the opportunity to reinvest your funds into superannuation at a later date.
- Investing outside superannuation may impact on any current or future Centrelink benefits which you may be eligible for.

Superannuation – taxed and untaxed funds

Most superannuation funds are **taxed** funds, meaning earnings within the fund are taxed. This includes public offer funds, industry funds and self managed superannuation funds.

However, some funds are **untaxed** and different taxation rules apply for these, particularly when taking a benefit as a lump sum or an income stream.

Examples of untaxed funds include the Commonwealth superannuation scheme, Super SA, and GESB. Particular advice would need to be sought in relation to funds such as these.

Commencing a pension

The information below may not apply to certain funds (as detailed above). Your adviser will be able to assist if this does not apply to your circumstances.

The Federal Government encourages retirees to provide their own income in retirement rather than relying solely on the Age Pension. By providing incentives in the form of tax concessions and social security benefits, the Government helps to make investments that produce regular income streams more attractive to retirees. The main type of income stream available in today's market is a superannuation pension.

What is a pension?

A superannuation pension is a retirement income stream that can only be purchased with money held in superannuation.

With this type of investment, all earnings generated are reinvested back into the account. Regular income payments are paid until the account balance is exhausted. Furthermore, any earnings generated or capital gains in the account are not subject to tax.

From 1 July 2017, the amount that can be invested in the tax free superannuation pension environment will be limited by the transfer balance cap of $1.6 million (subject to indexation). Superannuation savings above this amount can either:

- remain in the accumulation phase of superannuation where earnings are taxed at 15%, or
- cashed out of the superannuation system and earnings taxed at marginal tax rates.

The benefit of a pension is income payments are tax free after the age of 60 or concessionally taxed between preservation age and 60.

Pension features

- You receive a flexible income stream in which you are able to choose the amount of income you receive subject to minimum payment percentages set by the Government. No maximum will apply (with the exception of pensions commenced under the TTR pensions, which have a maximum payment amount of the account balance each year). The minimum amount of your pension is the account balance multiplied by the percentage factor.

  You are able to choose the payment term ie monthly, quarterly, half-yearly or annually depending on the product offering.
- Depending on your circumstances, income payments may be tax free or concessionally taxed. Refer to the Taxation of superannuation pensions section for further details.
- Earnings including capital gains on assets supporting these pensions are tax exempt. From 1 July 2017, earnings and capital gains within a TTR pension are taxed at the superannuation fund rate of 15%.
- You are able to access your capital funds at any time with the exception of pensions commenced under the TTR condition of release. As a result, you have the flexibility to make withdrawals in addition to your income payments.
- You are generally able to choose from a number of different investment options from which your pension payments will be drawn. This gives you some control over where and how your money is invested.
- There is no mortality risk which means if you die before the capital invested (plus any investment earnings) is exhausted, the balance will be paid out to your nominated beneficiary, your estate, or legal representative.
- If, upon death, the account balance is paid to a dependant such as a spouse or a child under 18 years of age, the lump sum will usually be paid tax-free.

Be aware

- The term of the pension is not guaranteed which means your money may not last throughout your retirement. The pension ends once the account balance has been fully paid to you.
- Your investment returns will fluctuate depending on economic and market conditions which means your investment can increase or decrease in value.
- The amount of income you withdraw must be subject to the prescribed minimum limits, no maximum will apply with the exception of pensions commenced unless a TTR pension which is limited to a maximum annual payment of 10% of the account balance.
- For those under 60, lump sum withdrawals from a pension taken on top of regular payments may incur tax.
- Tax may be levied on any remaining pension balance on death (for example, if paid as a lump sum to a non-financially dependant beneficiary, such as an adult child).
- The introduction of the $1.6 million transfer balance cap applies to both existing income streams and those commenced from 1 July 2017. Action may need to be taken if the value of the superannuation pension is above the cap to avoid penalties.

Taxation of superannuation pensions

When you receive an income payment from either a new or existing superannuation pension you may incur tax, depending on your age and the components of your pension.

Taxation of superannuation pensions (this applies only to taxed funds)

New superannuation pension accounts may include both tax-free and taxable components.

Each income payment (and commutation amount) from a superannuation pension will be deemed to include both taxable and tax free components. The proportion of each is based on the fixed percentage of these components at the commencement of the superannuation pension. This means you cannot choose which component(s) to draw your pension from. This is known as the proportional drawdown regime.

Income payments for those aged 60 and over are entirely tax-free regardless of the underlying tax components.

For those preservation age to 59, the tax free component of the income payment is free of Pay As You Go (PAYG) tax and the remainder (taxable portion) of the pension payment, is taxed at your marginal tax rate with a 15% tax offset.

Annuities

Another method of providing an income stream in retirement is via an annuity. An annuity is an investment that pays a series of regular guaranteed income payments for either a fixed period of time or for life.

They may be purchased with superannuation funds or non superannuation monies.

If superannuation funds are used, income payments receive the same tax treatment as superannuation pensions.

If non superannuation monies are used, a tax free amount for each payment will be calculated, representing your return of capital.

Key features of fixed term annuities

- You nominate the term of the annuity and the payment frequency.
- You have certainty your income will not run out during the annuity term. The payments are guaranteed over this period.
- The flexibility to choose whether your income payments will remain level or be indexed each year to keep pace with increases in prices due to inflation.
- You can choose whether you would like to have a portion of your capital returned to you as a lump sum at the end of the term and the amount of this lump sum.
- As it is not market linked, you are protected from adverse movements in investment markets. Instead, you lock in the applicable interest rate at the time the investment is made.

Key features of lifetime annuities

- It can revert to a spouse upon death of the original annuitant.
- You have certainty your income will not run out during your lifetime. The payments are guaranteed.
- You can elect to apply a 'guaranteed period'. This means that if you die during this period a lump sum may be payable to your estate or nominated beneficiary. In some cases, this may be less than you originally invested as it is influenced by a number of factors including prevailing interest rates at the time the lump sum is paid and the original terms of the annuity.
- You can determine the frequency of the income payments.
- You can choose whether your income payments remain level or are indexed each year to keep pace with increases in prices due to inflation.
- As it is not market linked, you are protected from adverse movements in investment markets. Instead, you lock in the applicable interest rate at the time the investment is made.
- Part of the income you receive may be tax free.

Be aware

- A lifetime annuity with a nil residual capital value means nothing is paid to your dependants or estate upon your death. The exceptions are if you have selected a reversionary annuitant or if a guaranteed income period has been selected and you pass away within this period. In this event, your beneficiaries or estate will only receive what would have been paid to you during the guaranteed period. Depending on how long you live, there could be an overall loss of capital.
- It is not investment linked so your capital will not grow and you cannot take advantage of favourable market movements.
- From 1 July 2017, annuities purchased with superannuation money will be counted against the $1.6 million transfer cap. The taxation of payments to you may be impacted if you have superannuation income streams that exceed the transfer balance cap and are unable to lower your superannuation income streams below the cap threshold.
- You are locked in to a specific rate of return for the rest of the term (or life). If interest rates rise, you are not able to take advantage of the higher potential return without incurring penalties.
- Once the annuity is established, the amount and frequency of the income payments cannot be altered.
- Your options are restricted if your circumstances change as generally speaking, you cannot withdraw a lump sum. Penalties apply to any withdrawals.
- The income of an annuity is assessed by the Centrelink and Department of Veteran's Affairs income test as follows:
  - subject to deeming rates where the term is five years or less, or
  - total income is reduced by a 'deductible amount' where the term is more than five years.

  NOTE: If your life expectancy is equal to or less than five years, the income assessment will be total income reduced by a 'deduction amount'.
- The investment amount of an annuity is assessed under the Centrelink and Department of Veteran's Affairs Assets Test. If you choose to receive all of the capital at the end of the selected term, the assessed asset value does not change. If you choose to have some of the capital returned as part of the regular payments, the asset value is recalculated every six to 12 months, depending on payment frequency, and reduced by the amount of capital returned up to that time.

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