Retirement Victoria

CLIENT NEWS

SPECIAL EDITION - WINTER 2007

The New (2007) Superannuation Rules -

Core Changes and RV Client Strategy

A lot has been written about so called *simple super*. The many areas of change have been widely canvassed in the press and elsewhere. By now most of our clients will have come to the realisation that the changes are by no means simple. The laws, regulations and policies governing super, tax and Centrelink benefits continue to interact in a complex way.

As with the old rules there are opportunities and there are traps. These continue to relate to age, work status, your personal and financial situation and your lifestyle objectives. They require the same sort of diligent attention to strategy, structure and efficiency over time as did the old rules.

In this special edition of the *RV Client News* we summarise some key issues relating to super lump sums, pension incomes and Centrelink benefits and what they will mean for clients from 1st July 2007. These are the core areas which will have most significance for RV clients going forward.

The discussion addresses benefits from taxed super funds covering most RV clients. The changes as they apply to untaxed funds (CSS, PSS) are summarised for affected clients on the RV website.

Retirement: Super Lump Sums and Tax

Benefits in a super fund will consist of two components; the *Tax Free Component* and the *Taxable Component.* These components will be crystallised from the existing components at 1st July 2007 (most commonly the existing components will be the pre-83 component, undeducted contributions and the post-83 component)

Tax Free Component

The combined amount of undeducted (personal after tax) contributions to super and your pre-83 component will constitute the *Tax Free Component*. Any additional personal contributions which are made from 1st July 2007 will add to this component.

Taxable Component

The *Taxable Component* will derive from your post-83 component. Employer contributions, tax deductible contributions and fund earnings after 1st July 2007 will add to this component.

Withdrawals from Super Funds

New rules for taxing super lump sums withdrawn from the super world apply from 1st July 2007.

It is important to differentiate between **withdrawal** of amounts from the super world and **rollover** within the super world. Amounts rolled over are moved from one super fund to another: for example where an amount is moved from a super growth fund to a super allocated pension fund to start a regular income. As the super world offers major tax advantages for retirees most funds will be rolled over in the super world rather than be withdrawn. No tax is payable in this situation under either the old rules or the new rules.

Amounts are withdrawn when they are moved from the super world to the non-super world, most commonly from a super fund to a bank account. Typically this occurs where money is needed to satisfy capital needs such as paying out a mortgage, travel, home improvements or vehicle purchase. There is significant change to the tax rules which apply in these circumstances.

Withdrawals between ages 55 and 60

Tax Free Component – The full amount is exempt from tax on withdrawal at any time.

Taxable Component - The first $140,000 of withdrawal is tax-free. This is cumulative over a lifetime and the threshold will be indexed to Average Weekly Ordinary Time Earnings (AWOTE) in $5,000 multiples. Withdrawal amounts above the threshold are taxed at 15% plus the Medicare levy.

The tax free and taxable components cannot be separated for the purposes of withdrawal. They must be withdrawn proportionately.

Withdrawals from Age 60

All withdrawals will be exempt from tax. They will not appear on tax returns. For many retirees tax returns will no longer be required

Under the old rules retirees were required to withdraw their super from lump sum super funds at age 65 or commence an income stream. This is no longer the case. A retiree can leave their capital in, for example, a super growth reserve for as long as they wish.

Note that it may not always be efficient to do so as the earnings in a growth fund are taxed at 15% within the fund. Commencing a minimum annual allocated pension income from such a fund eliminates tax on the earnings and capital gains within the fund and the pension income paid is exempt from tax. The allocated pension performs as a surrogate super growth fund.

Preservation

Super capital must remain in the super environment unless a condition of release is satisfied which permits withdrawal. The rules which govern this are called preservation rules.

Only when super capital becomes *unpreserved* can it be withdrawn from the super world. Normally this happens with retirement from the workforce after age 55, resignation from an employer after age 60 or on reaching age 65. Some amounts in some super funds have unpreserved status for historical reasons and can be withdrawn on resignation if required, even if the member is not retiring from the workforce.

Preserved capital can be moved from one type of super fund to another while you are still working and it can be beneficial to do so. For example, moving capital to commence a transition pension income as part of income and capital strategy after age 55 can significantly enhance savings and capital growth opportunities from age 55.

Retirement: Super Pensions and Tax

GSO Pensions

A large number of RV clients are receiving or will receive State Super retirement pensions from the GSO Revised Scheme or from the SERB Scheme.

These pensions have been part of taxable income but eligible for a 15% tax rebate. Some have also had a tax deductible amount as part of the pension.

Changes to the rules from 1st July 2007 will result in changes to the way GSO pensions are treated for tax (and Age Pension) purposes. The changed treatment is summarised below.

- GSO Pensions which have commenced prior to 1st July 2007 will continue to be taxed in the same way as they are currently taxed through to age 60. For example, 54.11 GSO pensions will remain part of taxable income and will continue to receive a 15% tax rebate through to age 60.

- GSO Pensions commencing on or after 1st July 2007 will be assessed for an immediate exempt proportion for tax purposes between ages 55 and 60. The exempt proportion arises from the tax free component of the member’s benefit. As an example a member exercising 54.11 in July 2007 with 36 years continuous service (12 years pre-83/24 years post-83) would have an exempt proportion of 33% of the pension. For a pension of $21,000 p.a. from age 55, $7,000 would be tax exempt and $14,000 would be taxable income and would receive the 15% tax rebate. The exempt amount will rise as the pension rises, always remaining at 33% of the pension.

- From age 60 all GSO pensions will be exempt from the tax system. They will not appear on tax returns. (For those already receiving GSO pensions before 1st July 2007 the tax exempt proportion will be crystallised at age 60 and will be relevant for certain Centrelink benefits. (See later discussion).

- For those over 60 at 1st July 2007 the exempt proportion of GSO pension will be determined at that date and will be relevant for certain Centrelink benefits.

Allocated Pensions

Most RV clients have some regular monthly allocated pension income as part of their retirement income structure. Allocated pension incomes will receive the benefits of exemption from the tax system from age 60 and the benefit of an exempt proportion where relevant between ages 55 and 60. The pensions will continue to receive the 15% tax rebate on the taxable proportion between ages 55 and 60.

Under the rules which will operate from 1st July 2007 the minimum pension which must be drawn from an allocated pension each year will reduce. Between ages 55 and 65 the minimum annual pension which must be drawn will be 4% of the capital and between ages 65 and 75 will be 5% of the capital. The level of regular pension income drawn can be established at the minimum level or at a higher level and can be varied from time to time as desired.

Allocated pensions will continue as a most efficient form of super investment because there is no tax on the earnings or capital gains within a fund, the pensions they pay receive major income tax concessions from age 55 and pensions are tax exempt from age 60 as are withdrawals of capital. In addition allocated pension income continues to receive friendly treatment under the Age Pension income test.

Tax Effects from Age 60

The exemption of super income from taxable income from age 60 will influence the marginal rate of tax payable on other, non-super income, because it will now be taxed as the only taxable income rather than sitting on top of super income. Many retirees will thus no longer pay any tax on their share dividend income and interest income because it falls within the $11,000 p.a. tax free threshold for taxable income. Most will now not pay Medicare levy because taxable income will be below the Medicare levy threshold.

Others will have their marginal rate of tax reduced. For example, a person working past age 60 while receiving GSO pension or allocated pension income, will benefit from a lower marginal tax rate on their employment income because it no longer sits atop their super pensions for income tax assessment purposes.

One of the most prominent effects of the exemption of super income from the tax system is the opportunity it creates to save tax on other, non-super, income. Some RV clients will benefit from tuning of strategy to take account of these effects. Transition to retirement strategies mesh directly with them.

Transition to Retirement

Transition to retirement measures allow those who have reached preservation age (55) to commence transition to retirement pensions without having to retire from the workforce. Transition pensions can be commenced using preserved super capital.

Transition Allocated Pensions

The commencement of transition allocated pensions can offer multiple benefits for those continuing in the workforce because -

- the regular income from the pensions has an exempt component for tax purposes and the component which is taxable is subject to a 15% tax rebate, a core element in minimising tax payable on desired income between ages 55 and 60.
- there is no tax on the earnings or growth in the transition allocated pension whereas in the super growth environment earnings are subject to tax at the rate of 15%.
- receipt of transition pension income permits a higher level of salary sacrifice of employment income such as contract teaching income. The tax rate is 15% on the salary sacrificed amount rather than 31.5% (or 41.5%) if it is taken as net income. This can dramatically enhance saving capacity in the period to retirement.
- transition pensions are exempt from all tax on their earnings and growth from age 60 whereas super lump sum funds continue to be taxed at 15% on their earnings and growth.

Enhanced Salary Sacrifice

In many cases the commencement of transition allocated pensions permits salary sacrifice of employment income at very high levels, in some cases 90% to 100% of employment income. There can be significant additional savings accruing for ultimate retirement.

The benefits arising from transition pension strategies from age 60 are normally greater than those between ages 55 and 60 because the transition pensions become fully exempt from tax. In general the greater the exempt proportion the greater the net tax advantage of salary sacrifice to super of employment income.

Regular pension payments are received from transition allocated pensions but capital withdrawals cannot be made from the preserved funds. Normally capital becomes accessible with retirement from the workforce from age 55, ceasing employment from age 60, or at age 65.

Age Pension: New Rules

New rules will apply to Age Pension eligibility from 20th September 2007. The changes significantly relax the assets test for Age Pension entitlement. The effect will be to increase the maximum assets test thresholds for couples by more than $290,000 and for single applicants by more than $175,000.

The income test rules will remain unchanged. It is important to note that the exemption of super income from taxable income from age 60 will not affect assessment of income for Age Pension purposes. Centrelink assessment of Age Pension entitlement uses Centrelink assessment rules, not taxable income.

Arising from these changes many pensioners who are currently constrained by the assets test will receive an increase in their fortnightly Age Pension from 20th September 2007. And many people of eligible age who are currently outside the current assets test upper threshold will come within the new threshold, thereby becoming eligible to receive part Age Pension provided they are also assessed within the income test limit.

GSO Pension and Age Pension

An earlier section described the calculation of an exempt proportion of a GSO pension from age 60. This exempt proportion is reportable to Centrelink for benefit testing purposes from 1st July 2007. For many existing GSO pensioners of Age Pension age the exempt proportion could be 50% or more of their GSO pension. Where the Age Pension income test is the constraining test the exemption of this income from Age Pension income testing would permit a higher level of Age Pension.

Some Age Pension would become available to others who were previously above the income test limit but now fall within it.

The GSO will directly notify Centrelink of the exempt proportions for all GSO pensioners aged 60 and above. This will not commence until after 1st July 2007 and is likely to take a little time. Notification should allow Centrelink to make a new assessment and increase Age Pension where applicable without an existing Age Pensioner having to apply.

The exempt proportion also has application to the assessment of benefits other than Age Pension. For example, eligibility for the Low Income Health Care Card is assessed using Centrelink assessment rules not taxable income.

Other Issues

A section of the RV Website, ***Looking Ahead,*** addresses matters which may affect a limited number of clients in the immediate term. These relate to the making of *large contributions to super*, to *eligible service date* and to *term allocated pensions*.

The section also looks at other areas of change including the changes in tax rules as they affect our clients who receive super pensions or lump sums from untaxed funds – notably the Federal CSS and PSS Funds.

Forward Thinking

Clear benefits arise from efficient positioning and strategy both in retirement and in the run up to retirement. Building effective income and capital structures to serve retirement lifestyle must take account of transition opportunities and the evolving assessment regimes for tax and Centrelink benefits across the planning periods.

Retirement Victoria will continue to emphasise simplicity, efficiency , flexibility and durability as the cornerstones of effective planning over time.

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