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TRANSITION TO RETIREMENT

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The general decline in investment values during the 2007/2008 Financial Year and pension drawings may cause many Transition To Retirement income streams to exceed the maximum 10% of pension account 1 July 2008 value.

This bulletin revisits the rules associated with 'Transition to Retirement' income streams and highlights the issues that Trustees & members should be aware of.

WHAT IS THE TRANSITION TO RETIREMENT PERIOD

Transition to retirement relates to the period from preservation age until a member satisfies a further condition of release or attains age 65.

The current preservation age is 55 years for those born before 1 July 1960 graduating to age 60 for those born after 30 June 1964.

WHAT ARE THE RULES FROM 1 JULY 2007

Those in the 'transiting to retirement' phase of life can structure their superannuation arrangements and commence an income stream in advance of reaching a traditional condition of release such as permanent retirement.

Upon reaching preservation age benefits may be drawn down using an 'Account Based Pension'.

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HOW MUCH AND WHAT COMPONENTS

The regulations do not require that the member's entire value be used to commence an income stream.

There is no flexibility to determine the components used to commence a pension. The purchase price will be based on the proportions of taxed and tax-free immediately prior to the pension commencing.

SUPERANNUATION LUMP SUM WITHDRAWALS

Lump sum withdrawals may not be taken unless the member is retiring from the workforce permanently or upon reaching age 65. A lump sum benefit is payable only from unrestricted, non-preserved benefits.

Trustees need to be aware that pension payments will be drawn from any unrestricted non-preserved benefit first and preserved benefit last. All pension payments need to be subtracted from the unrestricted non-preserved benefits before determining the amount available for a lump sum payment.

TAX ON THE FUND'S EARNINGS

Investment earnings and capital gains on assets supporting an income stream are tax exempt. Any growth on the member's account will be allocated according to the taxed and tax-free components at commencement of the pension.

Concessional contributions to the fund are subject to contributions tax at the rate of 15%. **It is important to note that all contributions after pension commencement are allocated to the accumulation account and are not counted in determining the minimum and maximum pension levels unless the original pension is ceased and a new pension commenced.** The net earnings of the assets in the accumulation account are taxed at the prescribed rate of 15%.

COMMUTATION OF AN INCOME STREAM

A member may elect to commute a 'Transition to Retirement' income stream at any time although it should be noted that in such an event the account balance supporting the income stream would simply revert to an accumulation phase within the SMSF. In this instance the earnings of the fund would then become subject to taxation at the 15% tax rate.

In the event that a member wishes to commence a new pension with additional contributions made to the Fund they must elect to either commute their existing pension and commence a new pension with all or part of the account balance or establish a second pension alongside the existing pension.



MAXIMUM PENSION DRAWINGS

The Transition to Retirement imposes a maximum pension limit of 10% of the account balance at commencement and annually based on the members balance at 1 July.

A common strategy implemented since the introduction of this type of pension is to salary sacrifice employment income and draw down the maximum pension allowable. This often results in the member paying a lower Marginal Tax Rate on their income, potentially nil if they are over 60 years of age.

This strategy should be monitored very closely particularly if a member establishes a regular payment authority to pay the maximum pension. If the Fund value drops below the value at the previous 30 June or value at commencement, whichever is later, then the Fund will be at risk of paying an income stream in excess of the allowable amount, 10% of pension account value. An over payment of the pension could result in the matter being referred to the Regulator by the Fund Auditor.

SATISFYING A FURTHER CONDITION OF RELEASE

The 10% maximum restriction only applies to a member who has not satisfied a further condition of release. If after commencing a 'Transition to Retirement' pension the member retires or reaches age 65 the 10% maximum restriction is removed from that point onwards. There is no requirement to stop the existing pension and commence a new one. The Trustees only need to "minute" the change in circumstances.

PRO-RATA CALCULATION ON COMMENCEMENT

Like all 'Account-based' pensions the minimum requirement is pro-rata if commenced part way through a year based on the number of days from commencement to the following 30 June. There is no minimum pension requirement if the pension is commenced on or after 1 June each year.

Unlike the old Allocated Pensions, the maximum Transition To Retirement income stream is not calculated on a pro-rata basis. It is simply 10% of the account balance at commencement and thereafter the 1 July.

For further information please contact Cavendish Superannuation Pty Ltd

PHONE

1800 808 354

FACSIMILE

(08) 8212 6747

WEB

www.cavendishsuper.com.au

MAIL

GPO Box 9981
Adelaide SA 5001

*This article is written by Tim Miller, Technical Services Manager, Cavendish Superannuation Pty Ltd.
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