

SPECIAL REPORT

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# Baby boomers make transition to pensions

Before you jump into taking out a DIY pension, make sure you understand the small print, writes **John Wasiliev**.

**A** very noticeable social development now occurring in Australia is the vanguard of the expected army of post World War II baby boomers moving into retirement. An inevitable consequence of this has been the transformation of superannuation from a mainly savings arrangement to a retirement income solution.

Providing retirement income is the ultimate destiny of superannuation and for do-it-yourself funds the popular choice is the account-based pension. Five or six years ago maybe one out of 10 DIY funds had a member taking a pension. Since then there has been a boom in DIY-funded pensions.

Andrew Hamilton of Cavendish Superannuation says half of the nearly 5000 funds his company administers have at least one pensioner.

While a good proportion of them are transition-to-retirement pensions started by members older than 55 who are still working, a surprising number are former retirees who started a pension and then went back to work.

The major reason they have returned to work is to rebuild the sharp reduction in the value of their retirement savings caused by the global financial turmoil.

Hamilton says one reason many people have DIY funds is for the pension flexibility they offer. Getting advice on pensions is also a reason many consult a financial planner which, according to financial services industry researcher, Investment Trends, has become popular of late.

The chief executive of DIY super administrator Super Guardian, Olivia Long, says about 40 per cent of the 1000 funds her organisation looks after have pensions, with about one-quarter of them transition-to-retirement pensions.

Most transition pensions, she says, have been started on the advice of financial planners encouraging strategies to maximise super savings. Long says interest in DIY pensions is likely to continue as more people see their super reach balances where starting a pension is regarded as worthwhile.

Financial advisers are also becoming more interested in DIY super, especially super pensions. They consider giving advice on pensions as an important growth area for their businesses.

Pensions specialist Peter Crump of Portfolio Planning Solutions says there is a lot to know about pensions. To start with you generally need to be 55 to start a pension. This includes transition-to-retirement pensions.

With transition pensions, the maximum annual amount you can withdraw is 10 per cent of the pension account balance. This withdrawal limit is no longer a restriction once you reach 65 or retire permanently from work before 65. That's when a pension ceases to

be classified as a transition pension and becomes a standard pension.

In all cases, minimum pension amounts must be paid during each financial year. This minimum can be proportionally adjusted to allow for pensions that start during the financial year. Pensions that start after June 1 in any year are not required to make payments in that financial year.

One current concession that applies during the 2010-11 financial year as far as minimum pension amounts are concerned is an entitlement to halve the minimum payment requirements.

Crump says that there is no tax on pension payments made to recipients aged 60 and more, regardless of whether they are paid as income or a lump sum. But payments that are made from pension accounts before age 60 are subject to tax, with different treatments applying to income payments and lump-sum payments.

A major pension-related tax concession is that investment income earned by assets supporting a pension is exempt from tax.

This is where the greatest appeal in a transition pension could be. If a fund has capital gains tax-swollen investments that it is keen to sell, a transition pension can result in some quite reasonable tax savings. Say a fund has \$300,000 in profits, the potential capital gains tax

savings will be around \$30,000.

Where a fund has assets that are supporting both pension accounts and a savings account, a tax-exempt proportion must be calculated, this will apply to the total investment income of the fund.

Crump says all pension income payments that are made from super funds have two components: a tax-free component generally sourced from after-tax contributions, and a taxable component from concessional tax contributions and investment returns.

These components apply to income payments to the member or to their beneficiaries on the member's death. The proportion of payments that are tax free is fixed on commencing a pension and for those under 60, the tax is only levied on the taxable component.

The basic attraction of transition pensions for those who are working is the idea of substituting taxed salary with concessional tax or tax-free income from super.

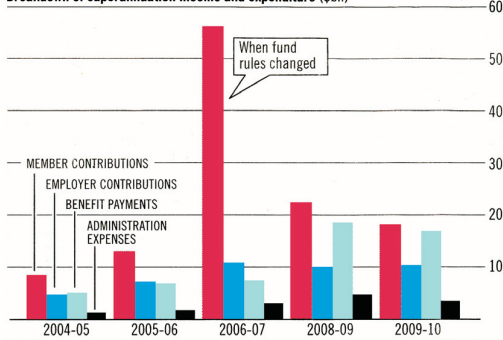
Crump says it is possible for a DIY fund member to have multiple pensions but only one accumulation account in their fund.

Special taxation treatment applies to pension accounts and the resulting payments, on the death of the pensioner,opping them and taking them back to the savings phase to blend them with the extra savings.



## Growth industry

Breakdown of superannuation income and expenditure (\$bn)



SOURCE: ATO