

# The pre-retirement years



*We see creating and looking after your wealth as a lifelong commitment. That's why we offer regular financial advice and guidance throughout the different stages in your life. Together, we can build the financial wealth that lets you enjoy the truly important things in your life.*

## **Financial priorities: Super, super, super**

### **Life motto: What mid-life crisis?**

During pre-retirement years, superannuation 'suddenly' becomes a major focus – retirement is just around the corner! Money that once went into a mortgage now goes into wealth accumulation as we start thinking about the lifestyle we want in retirement.

For some, this stage of life may start at 45 or 50, while for others the pre-retirement years may start at 55, 60, or even later, depending on when they plan to retire.

**Case study:** Andrew and Joan Stanton

**Ages:** Andrew, 55 years old; Joan, 52 years old

**Occupations:** Andrew, scientist; Joan, voluntary work

**Children:** Janet, 30 years old; David, 28 years old; Felicity, 24 years old

**Salary:** Andrew, \$90,000 a year

### **Assets:**

Home \$700,000

Managed fund \$75,000

Super (Andrew) \$300,000

Super (Joan) \$50,000

Cash Management Account \$15,000

**Financial goals:** Accumulate wealth for retirement and provide for our children

*'I want to retire in about five years' time and we want to enjoy our retirement. It's also important to us that we set up our children financially.'*

**Investment Risk Profile:** Andrew and Joan are both balanced investors

### **Recommendations/strategies from wealth adviser**

There are two questions Andrew and Joan need to think about in terms of retirement preparation:

- How much money do they need to fund their desired lifestyle?
- Will they outlive their money?

Three factors affect these questions – life expectancy, health in retirement and inflation. While it is impossible to know to what age Joan and Andrew will live we know that life expectancies are increasing. For example in 1961 a 65 year old Australian man could expect to live on average to age 76 and a woman to age 81.

### **What is wealth advice?**

Wealth advice is support and guidance on the best way to manage all your finances. Whether it's adjusting your debts to minimise repayments, saving for a home or a holiday, investing money, planning for your retirement, maximising pension entitlements or ensuring your family are protected if something happens to you, the right advice from the right people will help you achieve your goals faster and more effectively.

But now, a 65 year old Australian man can expect to live until around 83 and a female until around 86.

This increased life expectancy also means that inflation (the rising cost of living) can have a greater impact on retirement savings. An item that cost \$100 in 1972 would cost around \$755 today.

Life expectancy and cost of living increases also directly impact health costs in retirement. It may not be possible to predict what health factors will affect you as you age; however you need to consider the effect of the rising cost of health care and possible need for aged care for one or both as you age.

### Have they got enough?

Andrew and Joan's current strategy is contributing only super guarantee contributions for Andrew. They will have accumulated \$536,703 by the time Andrew turns 60. This may meet their need for \$40,000 p.a. in today's dollars at retirement, with little capacity to fund health and aged care costs without using their home, and with the prospect of their home being the only asset available for their children.

Andrew and Joan now have the opportunity to access Andrew's super in the form of an income stream, while Andrew is still working. This will allow Andrew to salary sacrifice more money into superannuation (which his employer allows), reduce his salary income and at the same time start a transition to retirement (TTR) pension.

Andrew and Joan can structure their income more tax effectively, continue to meet their income needs and contribute more to super via salary sacrifice and increase their wealth in retirement.

Let's look at how Andrew and Joan can implement their transition to retirement.

Andrew and Joan require an annual after tax income of \$40,000 to meet their lifestyle expenses.

By implementing a Transition to Retirement pension with the total superannuation balance of \$300,000 and drawing the maximum allowable pension income of 10% (\$30,000), Andrew can commence a salary sacrifice arrangement sacrificing \$65,562 in the first year to superannuation.

Thus, in the first year Andrew's income and tax position will be:

Salary	\$12,868
Account based pension (TTR)	\$30,000
Assessable income	\$42,868
<b>Tax assessed</b>	<b>\$ 7,460</b>
<i>Less</i>	
Tax offsets*	\$5,235
<i>Plus</i>	
Medicare Levy	\$643
<b>Tax payable</b>	<b>\$2,868</b>
<b>Income after tax</b>	<b>\$40,000</b>

\* Includes pension rebate, and other tax offsets

Over the next five years Andrew continues to salary sacrifice ensuring Andrew and Joan have \$40,000 p.a. in today's dollars to live, and reinvest the income from their managed fund investments.

When Andrew turns 60 and is ready to retire he has accumulated \$712,247 in his superannuation accumulation and pension accounts.

Joan sells the managed funds in her name and makes a \$110,000 contribution to super. She elects to make the contribution as a non concessional contribution. No tax deduction can be claimed; however this increases the tax exempt component of Joan's superannuation account which has estate planning benefits. When selling the managed funds Joan can use the 50% capital gains tax discount and will pay only 15% marginal tax rate.

Andrew and Joan commence account based pensions. As Andrew is now 60 he pays no tax on his pension, and does not have to include the pension in his tax return.

Until she turns 60 Joan is liable for tax, but will pay no tax as she receives a rebate on the account based pension.

Andrew and Joan draw pensions totalling \$47,640 p.a. giving them their desired \$40,000 p.a. in today's dollars.

As balanced investors, assuming long term average total returns of 8.3% p.a. Joan and Andrew can expect their funds will meet their income needs and provide capital to help them fund health and/or aged care costs and towards their estate. They may draw lump sums from their pension, and there is no upper limit to the level of regular pension payment they draw. In future they may also qualify for Centrelink benefits\*.

\* Assumes tax rates and legislation remains unchanged

This outcome can be achieved because superannuation (including pensions) enjoy generous taxation concessions compared to other income such as salaried income.

It's part of the government drive to encourage people to stay in the workforce longer and accumulate wealth for a self-funded independent retirement.

This is not a strategy for everybody; it's important to get the detail right so seeking professional financial planning advice is recommended.

### Wealth Protection

Although Andrew and Joan have paid off their mortgage and have adult children they can consider risk insurance to:

- Protect Andrew's ongoing ability to work until retirement. Income protection insurance is designed

to protect up to 75% of a person's salary if they are unable to work due to an accident or illness. As a non smoker aged 55, white collar worker Andrew would pay approximately \$3,600 p.a. in premiums in the first year (based on a 30 day waiting period). The premium is tax deductible and, if Andrew were to claim, any income he receives would be taxable.

- Provide for an additional lump sum to be available to Joan if Andrew died before he retires. Andrew can take the cover outside of superannuation, when the premium is not tax deductible, and the benefit is tax free to Joan as nominated beneficiary. Andrew may also have the choice of using part of his superannuation contribution to pay the premium, when the premium is effectively tax deductible. Any benefit paid is then tax free to Joan as his dependant; however, if Andrew outlives Joan part of the benefit will be taxable when paid to his legal personal representative. Andrew's adviser can help him assess the ownership which is most appropriate for his situation.

## Estate Planning

Andrew and Joan want to provide for their children. Their estate includes their home and other smaller assets such as their car, household furniture etc.

When setting up their wills the factors they should consider include:

- Ensure their wills and enduring powers of attorney are current and valid.
- Make binding nominations for their superannuation in favour of each other.
- Establish testamentary trusts in their wills, the effect of which can:
  - protect their assets in the event that the surviving spouse remarries
  - protect their assets from their children's spouses in the event of divorce
  - protect their assets from their children's creditors if they become bankrupt
  - stream income to children if they believe access to capital should be controlled
  - provide income and/or capital directly for the benefit of grandchildren
- Superannuation death benefits are tax free when paid to dependants. Andrew and Joan are dependants of each other, but their children are over age 18 and do not qualify as tax dependants. Tax may be levied on superannuation death benefits paid to non dependants, depending on the components of the death benefit.

Where superannuation is paid to the legal personal representative the will should provide direction for the executor .

- Estate equalisation – many assets are not covered by a person's will and can cause complications where a person wishes to divide their assets between several beneficiaries on their death. Assets outside the estate include jointly held assets, superannuation and life insurance outside superannuation. An estate equalisation clause within a will can require an executor to take into account who has inherited non estate assets when apportioning estate assets between beneficiaries.

During their retirement Andrew and Joan should work with their adviser to manage the proportion of assets they maintain inside and outside superannuation, so that the impact of superannuation death benefits tax is managed effectively with regard to their situation over time.

Andrew and Joan have the opportunity to manage their income very effectively as they approach retirement, increase their superannuation savings, establish retirement income to provide for their desired lifestyle needs and potential health and aged care costs, and leave an estate for their children.

## Looking for advice?

No matter what stage of life you're in, a wealth adviser can analyse your unique situation and help you make the most out of your finances. For more information on making the most out of your retirement income and estate planning, or to make an initial no-cost, no-obligation consultation, please contact: