Apogee FP
HIGH LEVEL FINANCIAL ADVICE

Guide to…

Financial Planning for Retirement

In today's uncertain climate, it is becoming increasingly difficult to generate reliable income and sound investment returns. This paper aims to explain the rules governing retirement and the most effective strategies for making the rules work in your favour.

A balanced approach to investing

A sensible approach to investing for retirement means balancing income requirements with capital accumulation, while recognising the need for an appropriate level of security. It is important to measure income in real terms, which means taking inflation into account. Nominal performance, which is usually quoted to investors, can give a distorted picture of goal achievement and may lead to poor investment decisions.

The importance of financial planning

From a financial perspective, the two key elements of planning for retirement are:

- Deciding the appropriate spending level, and
- Maximising investment efficiency.

Retirees with a reasonable amount of capital should aim to achieve a long term total after tax return of around 2% to 3% pa above inflation. Therefore, if inflation is expected to be around 4% pa over the longer term, investors should seek an after tax return of 6% to 7% pa compound. For example, it is possible for a married retired couple with around $500,000 invested at a modest 2% to 3% above inflation, to generate $35,000 secure income per annum, indexed to inflation and negligible tax liability.

Financial planning objectives

Objectives that should be considered when developing a financial plan include:

- **Lifestyle:** What annual income is needed during retirement to meet lifestyle needs?
- **Security and return:** What is the appropriate trade off between investment security and investment performance?
- **Liquidity:** How important is it that investments can be cashed quickly?
- **Management:** How involved do you want to be with the daily management of investments?

Spending capacity

How much a person can afford to spend will depend on a number of factors:

- Age and the state of their health,
- The capital they have available to invest, and
- How much they wish to leave to beneficiaries.

There may be a large variation between affordable expenditure and desired expenditure, but in most cases a strategy can be developed to help bridge the gap.

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Financial planning strategies

There are three golden rules to remember when developing a financial planning strategy:

Adequate income

Ensure that there is adequate income to meet all living costs, including a buffer of 5% to 10% above your initial estimate. It is wise to plan annual cash flow in detail; it should cover living costs and special expenditures for at least the next five years.

Most of the income should come from very secure sources such as fixed interest investments and annuities or pensions.

Asset allocation

Any long-term portfolio should have an asset allocation relevant to the principle of achieving acceptable returns with acceptable inflation through diversification. An appropriate portfolio may include investments in each of the major sectors of fixed interest, equities (shares) and property.

Minimise taxation and/or maximise Social Security benefits

The main sources of a tax effective income stream are share-based investments through dividend imputation, property-based investments through depreciation allowances and annuities and allocated pensions. With a well-constructed investment strategy most retirees will fall into the lower tax brackets.

For example:

Dividend income	$7,000
Imputation credit at 30%	$3,000
Assessable income from franked shares	$10,000
Tax on $10,000 at (assume 15% tax rate)	$1,500
Less Franking Rebate used	$1,500
Tax payable	$0
Imputation credit available	$3,000
Less franking rebate used	$1,500
Excess tax credit to be offset against other income or refunded if exceeds total tax liability	$1,500
Effective net income from franked shares *	$8,500
* At a 15% tax rate, a tax credit of $1,500 means that $8,500 of income is received	

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Reasonable Benefit Limits

A Reasonable Benefit Limit (RBL) is the maximum amount of concessionally taxed benefits a person can receive from the superannuation/rollover system during his or her lifetime.

For 2005/06 , the standard RBL has been set at $648,946 where a lump sum is taken and $1,297,886 where at least half the benefit is in the form of a complying pension or annuity.

Most superannuation benefits (and accrued earnings) rolled over after 15 February 1990 are subject to the RBL.

Undeducted contributions and certain other amounts are exempt but not their earnings. Superannuation benefits taken in cash also count towards the RBL, with the cash amount indexed forward to the time all remaining benefits are taken, at approximately the rate of wage inflation.

Any amount invested in an annuity or allocated pension is counted against the RBL at the time of purchase. Withdrawals from superannuation and rollover funds, which exceed the RBL, are subject to excess benefits tax at 39.5% on the taxed post 30 June 1983 component and 48.5% on the balance (including Medicare Levy).

Rollover strategies and ways to minimise lump sum tax

Many people receive a superannuation lump sum called an Eligible Termination Payment (ETP) when they retire. The most important decision in the short term is whether or not to rollover the ETP. There are many factors that will influence the decision including contributions and earnings tax, Reasonable Benefit Limits (RBL) and excess benefits tax.

Rollover funds include approved deposit funds (ADFs), deferred annuities (DAs), immediate annuities, allocated pensions, term allocated pensions and superannuation funds. These funds offer ETP investors two major advantages - deferral of lump sum tax and a tax shelter for investment earnings. While immediate annuities and allocated pensions do not pay tax on fund earnings, ADFs, DAs and superannuation funds pay tax on earnings at a maximum 15% and often at a much lower rate after adjustment for imputation credits.

Although rolling over a lump sum has many benefits, it may be more appropriate, especially for those over 55, to withdraw at least part of the ETP to invest outside the rollover system.

The appropriate rollover strategy depends on variables including age, family situation, the amount of the ETP, the person's RBL situation, length of service, future employment and other investments held. There are a number of initiatives that can minimise withdrawal taxes on an ETP such as:

- Stay in a rollover fund, at least until age 55, when lump sum tax rates fall significantly.
- Merge the ETP funds so the longest eligible service period will apply. This is usually beneficial especially where there is more than one ETP.
- Consider using suitable immediate annuities and allocated pensions for a secure flow of income and to delay lump sum tax.
- Retire early in the financial year to reduce the marginal tax rate. This is because salary earned in the current financial year will be added to taxable income and could result in a higher overall marginal rate of tax on other taxable income received in the year, such as ETPs.
- Check the RBL situation and pattern of withdrawals from rollovers regularly.

Choosing the rollover funds that best meet individual needs is important. All rollover funds are permitted to invest in any combination of fixed interest, shares and/or property so it is important to select funds that will provide an adequate level of diversification. Disproportionate weighting to a particular sector could increase the risk profile of an investment portfolio and endanger the security of their retirement capital.

The taxation of benefits

Component	Comment	Tax on withdrawal - under age 55 (Including Medicare levy)	Tax on withdrawal - 55 and over (Including Medicare levy)
Concessional	Received prior to 1/7/94 for some cases of invalidity or redundancy	5% taxed at person's marginal tax rates plus the Medicare Levy	5% taxed at person's marginal tax rates plus the Medicare Levy
Pre July 1983	Portion of ETP relating to service prior to 1/7/83	5% taxed at person's marginal tax rates plus the Medicare Levy	5% taxed at person's marginal tax rates plus the Medicare Levy
Post June 1983 – Taxed element	Portion relating to post June 83 service. Paid from a source that has paid contributions tax	21.5%	First $129,751 at 0% Thereafter at 16.5%
Post June 1983 – Untaxed element	Portion relating to post June 83 service. Paid from a source that has not paid contributions tax	31.5%	First $129,751 at 16.5% Thereafter at 31.5%
Post June 1994 – Invalidity	Amounts paid under invalidity after June 1994	Nil	Nil
Undeducted	Benefits from personal or spouse contributions since June 1983 for which no tax deductions have been claimed	Nil	Nil
CGT Exempt	Benefits relating to the small business CGT concessions	Nil	Nil
Excessive	Amounts over your RBL	39.5% on the 30 June 1983 component and 48.5% the balance	39.5% on the 30June 1983 component and 48.5% on the balance

Immediate annuities and allocated pensions

Immediate annuities and allocated pensions can be attractive investments for generating income in retirement. Immediate annuities are provided by insurance companies using either ETP or non-ETP money. In return a person can receive a guaranteed income for a set number of years or the rest of their life.

An allocated pension is a pension paid to a person from their individual 'account' in a super fund. Allocated pensions can only be purchased with ETP money and the payments you receive are not guaranteed. However, allocated pensions have the advantage of being far more flexible than immediate annuities both in terms of the regular payments you receive and in the choice of underlying investments available.

A person can choose the level of payments they want from an allocated pension, within broad minimum and maximum limits, which can be varied, as needs change. Allocated pensions also provide great flexibility in investment patterns. The money can be placed in a wide range of assets

according to your needs. There is no earnings tax so those assets can continue to grow during retirement in a tax-free environment. However, choosing an allocated pension involves taking investment risk, so making the correct choice of investments is very important.

The taxation treatment of allocated pensions and immediate annuity income is quite generous. Part of the income payment may be tax free because it is regarded as a return of a person's own capital. A portion of the income may also attract a 15% tax offset.

In addition, by rolling over to an immediate annuity or allocated pension, ETP taxes are deferred or avoided completely.

Centrelink treats both immediate annuities and allocated pensions very favourably. While the purchase price of an immediate annuity or allocated pension is assessed under the assets test, it is possible to generate quite high levels of income from these investments and have a large portion of it not counted under the income test, which may help to maximise government pension entitlements.

For self-funded retirees, a blend of allocated pension and immediate annuity income can provide both certainty and flexibility for your retirement needs.

Complying annuities and pensions

Both these types of investments work in much the same way in that you invest a lump sum of money and you receive a series of regular payments for a set period of time, or for a lifetime. The main distinction between complying pensions and annuities is that pensions can only be purchased using superannuation money and are paid by superannuation providers while annuities can be purchased using superannuation or non-superannuation money and are paid by life insurance companies.

They are called complying pensions or annuities because they comply with special requirements in the social security legislation and superannuation legislation and are less flexible than (for example) allocated pensions. However, they will have favourable social security means testing, they are partially (50%)exempt from the assets test and receive concessional treatment under the income test, and you may be able to access the higher Pension Reasonable Benefit Limit (RBL) to reduce excess benefits tax. Complying pensions and annuities can be for your lifetime or for a fixed term based on your statistical life expectancy.

Term allocated pensions pay regular payments annually until the end of the term that is selected. However these payments will fluctuate depending on the market performance of the investments selected by you.

The importance of financial advice

Start planning for retirement well in advance of finishing work and seek professional financial planning advice. Our office can help you become familiar with the strategic and investment options available and to make a considered decision about the best approach. Once this is accomplished, you can enjoy retirement, secure in the knowledge that your needs are well catered for.

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