WEALTH BITES 2023

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Understanding the three pillars of retirement income

While older Australians are reportedly among the wealthiest retirees in the world, much of their wealth is tied up in their family home. Australian retirees own more than one trillion dollars in untapped home equity[1]. This leaves many to worry about how they will find the money to pay for their day-to-day expenses when they stop working. However, many retirees do not have a full picture of their assets and ability to access their wealth, which is a major contributing factor.

The Association of Superannuation Funds of Australia estimates that the minimum cost of a comfortable retirement for a single person in Australia is $50,207 a year, while for couples, it's $70,806[2].

What are the three pillars of retirement income?

During the past two decades, Australians have relied on the so-called 'Three Pillars of Retirement Funding'. These include the age pension, funded by the Federal Government, compulsory superannuation and voluntary savings. However, a recent 'Household Capital: Your Life Choices' survey showed 85% of all retiree respondents are unaware of these three potential sources of income[3].

This is significant given that preparation for retirement should start at least ten years before your planned retirement date to optimise your financial situation.

Pillar 1 - The age pension

Most retirees understand the concept of the age pension:

- that it is asset-tested and income-tested;
- that once you qualify for it, it will likely be paid to you for life unless your circumstances change;
- that it is indexed for inflation; and
- has no risk associated with it.

It is a fantastic safety net for all Australians, providing them with a regular, if modest, income throughout their retirement.

Any other assets you hold or inherit through retirement can further boost this income. However, the more assets you own, the smaller your pension entitlements will become until you are not eligible for any age benefits. This is where it is crucial to start planning early.

Pillar 2 - Superannuation

For many Australians, the full potential of superannuation is yet to be seen, given that compulsory superannuation only really spread through the community some thirty years ago, and many older Australians still have relatively modest superannuation balances.

Superannuation, however, remains a central pillar of retirement planning, as once a private pension commences from your superannuation account, all the assets supporting that pension, in terms of capital gains and income,

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[1] https://treasury.gov.au/sites/default/files/2020-02/householdcapital030220.pdf
[2] https://www.superannuation.asn.au/resources/retirement-standard June 2023
[3] https://www.firstlinks.com.au/uniting-three-pillars-retirement-funding

become tax-free. The income paid from your super account is also generally tax-free after age 60. In certain situations, depending on the type of superannuation, the income paid may be subject to tax.

The biggest issue for retirees, however, is that strict rules surround when you can contribute to super and how much you can contribute when you do make these super contributions.

Most Australians are familiar with the superannuation contributions their employer makes on their behalf, and some understand what is involved with salary sacrificing and how this can be used to reduce their annual tax bill. Fewer, though, understand they can contribute up to an extra $110,000 annually to super with after-tax dollars. And if they downsize their family home, they can contribute up to $300,000 over and above their other contribution limits.

These rules are essential because, as many retirees are learning if in retirement their only assets are their home and their savings within super, then they may never need to lodge a tax return or pay tax again.
transition to retirement rules). How much you take will impact how long your pension lasts. If you need additional money in a particular year you can take out extra by increasing income or taking a lump sum commutation.

If you are age 60 or over and the pension is paid from a 'taxed' source, pension payments and commutations will also be received tax-free. If you are under age 60, tax may apply to pension payments and commutations, although a portion may be tax free and/or entitled to a 15% tax offset.

Pillar 3 - Voluntary savings

Understanding the rules and benefits of holding assets within super can be a big issue for retirees who hold assets outside of super, such as investment property or other savings, hoping to use these assets to help support themselves through retirement.

Without adequate planning in the years leading up to retirement, they may find they cannot squeeze these savings into superannuation, or at least not as quickly as they hoped, and they end up paying needless tax bills.

What does this mean?

As a result, it has never been more important to plan for your retirement as early as possible and obtain sound financial advice on how to structure your finances in retirement, as the penalties for getting it wrong can be significant.

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