

## Discussion Paper

### Financial planning for public servants – does it actually work?.

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#### Introduction

Late in 2013, I decided to embark on an education program, using real client case studies\* drawn from actual situations (the first client case study dating back to 1999/2000) as the basis for a series of Media Releases – and this has continued since. It now seems fair to ask “**Where are they ALL now?**” and “**did the strategies work?**”

The Media Release case studies have expanded over time and those which follow include the case studies of a small but representative sample of my numerous: Commonwealth Super Scheme (CSS) Public Sector Super (PSS) Super SA (Pension, Lump Sum and Triple S fund) and UniSuper Defined Benefit (DB) scheme clients and their personal case studies.

*\*All case studies are published with client permission, with the names changed to protect privacy. The original case study Media Release and associated newspaper articles are all available on our website [www.marinigroup.com.au](http://www.marinigroup.com.au)*

The education campaign began the concept of ‘54/11 Strategy opportunities’ for eligible members of the Commonwealth Super Scheme (CSS) and was my response to what I saw as the need for CSS members, having been a CSS member myself, to help my former colleagues to have a better understanding of their super benefits.

Generally, the ‘54/11’ opportunities apply to those who were employed by the Australian Public Service (APS) prior to 1990, when the CSS was closed to new members.

Whilst most CSS members are aware of the ‘54/11’ strategy, it has been my observation that very few fully understand the pros and cons of the various pension and lump-sum options which are available to them.

My mission, therefore, has been to encourage my APS clients to consider alternatives to the traditional option of taking their defined benefit superannuation in the form of a 100% pension benefit. Whilst the 100% pension option has the attraction of providing a constant lifetime benefit, the downside lies with the fact that a significant component of that pension is non-indexed. An alternative option involves cashing out (via a commutation) the non-indexed portion of the pension and investing it outside the defined benefit super environment.

## **Media Release 50 – ‘54/11’ - Public Servants Have Great Options**

**This release was written in August, 2013:**

An eligible (single) public servant receiving a 100% Defined benefit pension of say, \$70,000 pa would continue to receive that amount from the government each year, paid fortnightly. Only the ‘Basic’ pension (approximately \$50,000 pa of the \$70,000 pa) would be subject CPI increases. Based on an assumed CPI factor of 2.0% pa this means that in year 2 the gross annual pension payment would be only \$71,000.

Furthermore, prior to age 60, the entire defined benefit pension is fully taxable. Based on gross annual pension income of \$70,000 in year 1, the net annual pension income available (after payment of tax of approximately \$12,700) would be \$57,300.

Whilst this figure still represents a very respectable net retirement income, and better than most Australians may ever achieve – in fact, better than many APS employees will ever achieve on their CSS balances – it is this net income figure which lulls most to follow the CSS ‘100% defined benefit pension pied piper’.

It masks the MUCH better retirement benefit outcomes which can and SHOULD be achieved by not following the herd and reducing the risks by diversifying retirement investments wisely.

To demonstrate this point, the compilation of a number of ‘actual’ client case studies followed. The case studies, which involved a selection of my defined benefit super clients (including members of CSS, but also PSS, Super SA (Pension, Lump Sum and SSS Accumulation) and UniSuper have been used in a series of media releases which are now revisited.

## **Media Release 51 - 100% Lifetime Pension May Not Be the Best**

This release featured in a very well received article in **The Australian** – we called it Samantha's story, to protect her privacy.

In line with my recommended strategy, Samantha resigned from the Australian Public Service (APS) a month before she turned 55. The following day, she advised the Commonwealth Superannuation Scheme (CSS) that she had retired, triggering the '54/11' rules.

Samantha had been APS employee since leaving school at 17. Her annual net income as a level B staff member was \$53,488.

**Had she taken the 100% CSS defined benefit pension option, her estimated annual after-tax income would have been \$40,000 or approximately 75% of her 2013/14 net salary income.**

Based on my advice, Samantha chose to 'hedge her bets' by splitting her income between a 'part' Defined Benefit Pension and taking a lump sum (via a commutation of the remaining pension benefit).

After implementing a 'cash-out and re-contribution strategy' the proceeds of her lump-sum commutation were invested in a tax-free Account Based Pension (ABP) to supplement her CSS pension income.

As a result of our recommendations, which also included an annual Concessional Contribution strategy, **Samantha's total annual NET income in 2013/14 was a much higher \$53,040** – just short of her annual net salary of \$53,488 prior to 54/11 retirement, and around 32% higher than the 100% defined benefit pension option! Overall, an increase of more than \$13,000 per year on what it would have been had she just ticked the box and received the standard 100% pension benefit.

In addition, should she need it, Samantha now had access to a \$226,000 tax-free component in her Account Based Pension.

### **So, where is Samantha NOW?**

As at June 2017, Samantha's lump-sum commutation proceeds of \$226,000 invested in 100% tax-free ABP have grown to \$269,570 (approximately 19% more than her original investment) despite drawing pension income each year to provide the tax exempt ABP portion of her net income.

**Samantha's net income in 2016/17 was \$59,498\* (approximately 12% more than in August 2013) and she can take more tax-free ABP income or lump sums as required.**

Clearly this is a MUCH better outcome than the traditional option of a 100% defined benefit pension.

Finally, Samantha's retained taxable Defined benefit pension income is FULLY indexed and will only be marginally taxable when she turns 67. At 67, she could also be eligible for a small Centrelink part-pension – enough to pay her personal tax bill and give her access to discounts on medicines and rates etc.

And most importantly, ALL of Samantha's various pensions (CSS, ABP and later Age pension) will be FULLY indexed; and as a result, she will not become poorer as she gets older, like most of her former APS colleagues!

*\*This income also includes a tax-exempt Centrelink Carers Allowance of \$3,242 pa (Samantha currently cares for her mother and given her eligibility, the application for this benefit formed part of our advice).*

**NOTE: Because of this tax-exempt Carers Allowance, Samantha's NET contribution to the government's coffers is only \$1,712 pa. This is based on tax paid personally and via her super fund on her annual Concessional (Tax Deductible) Contributions less her tax-exempt Carers Allowance payment.**

## **Media Release 52 - Public Servants Can Get a Lot More Cash in Retirement**

Damian and Jill were both senior public servants. Damian was a Commonwealth Superannuation Scheme (CSS) member and Jill a member of Super SA. This is their retirement story.

Damian decided to retire in August 2012, and following considerable planning and many lengthy discussions between Damian, Jill and myself, Damian implemented a '54/11' CSS pension strategy.

He retained a gross annual CSS pension (having also taken the maximum possible CSS lump sum) was \$47,398.

At that time, Jill was still a senior state government public servant, and wanted to work for a few more years, though they both intended to take annual overseas holidays.

Her NET Super SA Lump Sum fund balance in 2013 was around \$1,000,000.

The strategies delivered an **interim outcome as follows:**

Damian immediately saved almost \$6,000 pa in personal tax on his CSS pension.

This tax saving for Damian was over and above a gross Account Based Pension (ABP) annual income of \$14,000 from his re-invested, retained CSS/AGEST lump-sum, and in addition to his retained 2012/13 gross annual CSS Defined Benefit Pension of \$47,398.

Jill, who has been a public servant for quite some time, would no longer risk breaching the untaxed cap available under her State Government super fund (which was \$1,315,000 in 2013/14). On my advice, she elected to 'contribution split' each year to a Super SA spouse account which we established for Damian.

In 2013, Damian and Jill had a combined annual net income of approximately \$63,000, comfortably higher than their stated need of \$60,000, despite substantial additional super contributions for each of them. **But that is far from the end of their story...**

In addition, they had the ability to increase their income very tax effectively, simply by increasing Damian's Account Based Pension income, if required.

With planning and careful restructuring, Damian and Jill were able to optimise their superannuation savings for their retirement and later would leave a significant legacy for their children and grandchildren.

Jill initially salary sacrificed approximately \$86,000 pa **more than she had been**, into her state government SSS (Southern State Super) fund, effectively boosting their combined super balances, despite Damian's Account Based Pension drawdown. Jill's annual personal tax bill initially reduced by approximately \$31,000, which was redirected to her super fund.

Jill's additional salary sacrifice contribution was possible due to the 'Constitutionally Protected' status of the fund. As a result of that status, it remains unaffected by the normal Concessional Contribution limits.

**The second part of the strategy has recently been put in place, as Jill joined her husband in retirement in September, 2017.**

Damian's retained CSS basic pension is now \$51,655 pa (fully indexed) and as he is now over age 60, he is eligible for a 10% CSS Tax Offset. This equates to an increase of \$5,166 in his NET annual CSS pension income.

As part of my recommendations, Damian also continues to make annual Concessional Contributions (CCs) to super to eliminate his personal tax entirely and continue to grow his super balances. As a

result, he pays NO personal tax, though he pays approximately \$1,800 pa in tax via his super fund on his annual tax-deductible CCs, and he still pays an annual Medicare Levy of \$793.

That's \$2,593 in tax and Medicare levy paid by Damian on his taxable CSS pension of \$51,655 pa for net annual CSS income of \$49,062.

As at September 2017 both Damian and Jill are just over 60 years of age, have between them \$1.981M in tax exempt Account Based Pensions.

As a result of my recommendation to annually 'contribution split' into Damian's Super SA SSS Spouse account, Jill did NOT exceed the 2017/18 \$1,445,000 Untaxed Plan Cap Threshold. This strategy saved Jill lump sum tax of approximately \$167,530, although when combined, their gross Super SA balances were well in excess of this threshold.

Importantly, due to the flexibility of the recommended strategies, neither Damian, nor Jill is affected by the 1 July 2017 retrospective rule change which caps the amount which can be held in a tax exempt ABP at \$1.6 million.

Based on their current account balances, their ABPs are required by legislation to pay them minimum tax exempt pension of \$79,240, providing a combined annual net retirement income of around \$129,000 – well in excess of their stated \$100,000 annual net income 'needs'. This amount also allows for their annual overseas holidays!

In addition, they can draw as much additional ABP income or lumps sums, tax free, as required.

In fact, Damian and Jill intend to assist both their children to purchase their own homes (when required) by accessing tax free lump-sums from these ABPs.

This 'actual' client case study demonstrates how, with good advice (and despite government meddling in the super system) EXCELLENT financial outcomes can and are still being achieved!

## **Media Release 53 - Super opportunity for Ex-Public Servants**

The story of John and Tatum is a favourite of mine. Like the others mentioned previously, it is entirely authentic – only their names have been changed to protect their privacy.

John joined the public service at age 17 and undertook his IT qualifications on a part-time basis. After 17 years of hard work, a restructure caused his job to be made redundant.

As John was and is a very diligent individual, he took the time to ensure that he was well informed about the Commonwealth Superannuation Scheme rules and the associated legislation. As a result, when he took his redundancy, he decided to make use of a similar opportunity being used by his colleagues under the 54/11 rules – by preserving his superannuation entitlements with the CSS.

He then set up his own business.

In the intervening period of self-employment, John set up a Self-Managed Super Fund (SMSF) which in 2013 was worth about \$139,000.

His partner Tatum had not been employed for any significant time in Australia, having migrated when she and John married later in life. As a result, she had no super of her own.

Twenty years later, at age 54, John's CSS benefit became available as:

- a) a full annual pension benefit of \$50,550 or;
- b) a 'part' pension of \$33,460 pa, plus a lump-sum commutation of approximately \$184,700.

The day after his 55<sup>th</sup> birthday, John advised the CSS that he was eligible for his previously preserved benefit entitlement. On the basis of my recommendations, John decided to take option b) – the standard indexed CSS pension plus the lump sum commutation.

We then implemented the following additional retirement income strategy:

- a tax-free account based pension in John's name, sourced from the couple's non-super Term Deposit funds
- a second (taxable) account based pension from the proceeds of his SMSF (which was wound up at that time) plus the lump-sum commutation of his CSS benefit which was preserved when he left the public service 20 years ago, and accumulated to a considerable amount.

(Detailed figures are included in the media release dated 21 August 2013 available via our website).

### **In August 2016, things are still looking good for John and Tatum:**

Since 2013, the couple have withdrawn significant funds, as planned, from their Tax-Free Account Based pension (ABP) account, to provide the additional capital required when they recently upgraded into their new home.

John's retained fully indexed CSS pension provides \$31,500 of their net annual income.

In addition, they still have more than \$550,000 remaining in their tax exempt Account Based Pensions, with the prescribed minimum annual payment of \$22,000 providing more than enough for their income needs.

With Tatum's casual employment income of approximately \$8,000 pa, their combined net annual income is \$61,500 (higher than their annual income needs of \$52,000) and they have FULL TAX FREE access to the \$550,000 via their ABPs for additional income or capital needs.

## **Media Release 57 - Public Servants Can Double-Dip after Redundancy**

Speaking as a former public servant, we can be a very conservative lot, and the thought of redundancy horrifies many. For those who face losing their jobs, however, there may well be an opportunity to get the last laugh by being able to 'double dip' under the Public Service Superannuation (PSS) scheme.

Over the last 20 years I have been able to guide my clients who are PSS members through a strategy which involves taking a lump sum (to pay off their house, go overseas on a holiday and /or make other lifestyle and recreational purchases) draw down the pension they require until age 65, and still be eligible for a significant Centrelink Age Pension.

This particular case study deals with my long-term clients who we will call 'Dick and Mary Van Dyke'.

The challenge they had given me (although Dick was already retired in 2014) was to help them to prepare for Mary's retirement.

I presented Dick and Mary with three PSS strategy options to consider. The detailed calculations (which are provided with Dick and Mary's permission) use their actual figures, and are available via the MFG website under: Media Release 57 (MR 57), 30 May 2014.

### **Option 1: 100% PSS pension**

Whilst the 100% pension option has the attraction of providing a constant lifetime benefit, this option actually provided less NET cash flow, less accessible lump-sums, less income stream diversification and would require Mary to always lodge tax returns. Should Dick survive Mary, his remaining PSS Reversionary pension would drop by approximately \$13,710 pa. This was, in my view, the least favourable option.

### **Option 2: 100% PSS lump sum**

This approach provided great capital with the potential for a residual value ultimately to be paid to their estate, but with too much market exposure. I rarely, if EVER, recommend this option.

### **Option 3: The recommended approach – part PSS pension and part lump sum**

This option produced the most favourable outcome for Mary and Dick, providing significantly more income than their net cash flow needs. The result was an annual cash flow of \$40,858 (equal to 58%) provided via Age Pension and PSS Pension benefits and total NET cashflows of approx \$70,446 pa.

In addition, it provided access to a significant capital sum (approximately \$537,293) which could be directed to Account Based Pension (ABP) funds.

By drawing the minimum Account Based Pension income, plus a combination of part Age Pension and part PSS Pension income, Mary and Dick will achieve significant income stream diversification and taxable income low enough (despite excellent gross cash flow) not to pay tax, or need to lodge a tax return ever again.

In late May 2017, Mary was offered a Redundancy payout, which she accepted. We implemented the recommended strategy (as per option 3) in July 2017.

The outcome has been MORE PSS pension and lump-sums than at the time of our original calculations/projections, as for the last three years, on my advice, Mary has been maximising her salary sacrifice contributions to superannuation.

Mary and Dick now have more than \$440,000 in Account Based Pension funds between them despite having recently allocated significant capital to:

- Home improvements;

- Teeth implants for Mary;
- Centrelink exempt Funeral Bonds (\$23,000 between them)
- Insurance Bonds for their grandchildren.

Their combined net annual income is now in fact \$74,467, made up of:

- \$31,055 gross from Mary's retained fully indexed 50% PSS pension
- \$19,412 in combined age pension; and
- Tax exempt ABP income (with also provides access to lump-sums or additional tax exempt ABP income as required).



## **Media Release 62 - An example of creating a 'Financial Magic Pudding'**

This particular case study is one which makes me very happy; it involves my long-standing friends and clients 'Tim' and 'Jane' and their situation clearly demonstrates the long-term benefits of "not keeping all your eggs in the one basket"!

### **In 2014 I wrote:**

Unlike many of their fellow retirees, Tim and Jane do not worry about buying a cup of coffee, the cost of going out for a meal, or how much petrol costs.

Tim noted recently that their retirement fund balances are about the same today as when he left work, and yet he and Jane have drawn down hundreds of thousands of dollars to live on since his retirement approximately 15 years ago, in late 1999!

Tim's un prompted statement that their lump sums had remained the same after all this time and after all the income they had drawn from them, was what prompted me to tell their story

When Tim 'took a package' and retired from his SA government role, his gross salary income was around \$50,000 p.a.

In 2014, 15 years later and in his mid-70s, Tim takes home the equivalent of twice that amount, thanks to some good financial planning advice. They are much better off than if he had taken a Super SA pension only.

**Today, retirement continues to be VERY comfortable** with Tim's retained Super SA pension and their part Age Pensions fully indexed each year.

Their Account Based and Term Allocated pensions remain valued at more than \$340,000, close to the same value invested 18 or so years ago.

This demonstrates why most people's fears of the lump sum being exhausted is just plain wrong! Tim and Jane have survived Y2K, the Tech Wreck, two Gulf Wars and the GCF, yet still have around the same account balances that they had when Tim cashed out (known as a Commutation) around 65% of his Super Sa pension on my advice and thus retained only 35% of the Super SA pension he could have retained!

Their Term Allocated Pension has also effectively ensured that they were not adversely affected by Centrelink's tougher Asset Test rules introduced on 1 January 2017.

They currently draw approximately \$26,000 annually from these funds to supplement Tim's annual Super SA pension of almost \$25,000, in addition to the receipt of around \$23,000 annually in combined Age pension benefits.

Tim & Jane have achieved a combined annual tax-exempt income of \$74,000 – and they love the fact that they have not needed to lodge tax returns since 2000.

## **Media Release 72 - Could it get any better?**

It could be argued that the subject of this media release has taken an adult lifetime to develop; it involves someone I have known since I left school and who is now a senior academic.

As a result of my advice to commute a significant portion of her UniSuper Defined Benefit Pension some years ago, my client will be one of the very few senior academics not to be hit with unexpected additional tax arising from the new Transfer Balance Cap rules (applying to pension benefits over \$1.6M or pension income in excess of \$100,000 pa) which came into effect as part of super rule changes on 1 July, 2017.

Over time, acting on my recommendations, she implemented a Transition to Retirement strategy, maximised salary sacrifice super contributions (up to \$100,000 pa when this was still possible) and split her super lump-sum funds between herself and her husband.

They currently have Account Based Pension (ABP) balances of approximately \$1 million and \$1.3 million respectively, each with tax free components of 100%.

After the part commutation of her UniSuper Defined Benefit Pension, my client retained a small UniSuper pension of \$20,000 pa. This pension has a Transfer Balance Cap value of \$320,000, which, combined with her current ABP of approximately \$1 million is below the \$1.6m cap, with no additional taxation issues.

As her husband has no other income stream he is similarly unaffected by the Transfer Balance Cap rules.

Based on a UniSuper DB pension of \$20,000 pa, plus minimum ABP income payments of \$50,000 and \$65,000 respectively, my client and her partner currently enjoy minimum tax free annual income of \$135,000 from their superannuation – placing them comfortably in the top 4% of retirees in the country in terms of income.

But, as they say in the ads: 'Wait, there's more!'

The couple also have a direct share portfolio and a geared rental property. As they are both now over age pension age, they pay no personal tax as their combined **taxable income** is less than the \$57,948 combined Seniors and Pensioners Tax Offset (SAPTO) threshold.

Any Account Based Pension income growth (over and above their **TAX EXEMPT** minimum pension payments) is also tax-free, as their ABPs have 100% tax free components. This also means that their children and grandchildren will inherit tax-free, or they can 'SKI' (Spend the Kids Inheritance) by taking more tax exempt ABP pension income and lump sums, as required.

In addition, my client still consults, earning approximately \$75,000 pa. On my advice, she continues to salary sacrifice into super the maximum possible each year (\$25,000 pa from 1 July 2017).

As a result of structuring their affairs over the last decade and a half, the family paid virtually no personal tax<sup>#</sup> on annual income of almost \$274,000<sup>^</sup> pa generated in 2016/17 – which takes them into the top 1% of income earners in retirement in Australia.

**#**Approximately \$5,250 was paid by the super fund on \$35,000 salary sacrificed to super. NIL Tax was paid on the tax exempt ABP and Retained UniSuper pensions. Thus, the taxable income of each member of this couple was less than \$28,974 (due to negative gearing losses on the rental property).

**^** Including estimated tax-free income/capital growth within the pension funds i.e. \$2.3 Million at 7% pa less 5% pa (or \$46,000 retained in their ABP's) taken as ABP income. (This NET of ALL ongoing fees including our annual advice fee, super fund admin fee and investment management fee)