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NEWSLETTER

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How do you set up your financial plan when retirement is approaching?

Dear Sir or Madam,

The older you get the more important becomes the question of how to set up a revenue plan and a wealth assessment. What needs to be considered for provisions, assets or taxes so you can realise your wishes and you can enjoy life to the full once you start reducing work or retire altogether.

Drawing retirement capital as a pension or as a lump sum?
This question includes both an economic and an individual aspect. The crucial factor with an economic assessment is the return that can be generated by investing the lump sum withdrawn. With the Swiss National Bank having set a negative interest rate and similar moves by the other central banks in Europe and the USA, this means that now and in the not-too-distant future, investments will yield as little as seeds in a desert. As a consequence, pension conversion rates are constantly being reduced and thus the retirement savings capital yields less money to be paid out as a pension. For example, for anyone who owns property with a mortgage on them, a lump sum withdrawal becomes an interesting option as debts can now be repaid to get an improved rate of return.

Should this option not be available, you need to consider what to do with this huge lump sum that you have withdrawn. If there are no lucrative options available on the bonds market, or if somebody has little experience with investing in shares, then a lump sum withdrawal could cause problems. When it comes to investments, banks and insurance companies are wooing customers. However, it is a fact that even they can generally only generate a modest financial return. Should you feel uncertain, or should handling money not your forte, then withdrawing your savings as a pension is certainly a viable solution.

Withdrawal as either a pension or as a lump also has individual aspects. The higher the life expectancy, the more attractive drawing a pension becomes. A practical solution to estimate your personal life expectancy is adding up the ages your grandparents and parents have all reached and then dividing the final number of years by the number of persons. Add a few years on top as life expectancy is generally on the rise. However, it could also be possible that you still have plans for and with the family; for example, you might wish to give away or bequeath asset provision funds. In such situations it would make sense to withdraw a lump sum, as this means that available assets are present. The pension remains a pension, and generally there is only a supplementary pension for the surviving spouse while children, future partners or distant relatives will end up empty-handed financially.

How can you save on taxes?
Crucial for any tax planning is whether the retirement savings capital is paid out as a pension or as a lump sum. Drawing a pension is subject to income tax each year. A lump sum withdrawal is subject to tax at the pension rate. This rate varies from canton to canton and can be between 5 and 15 %. Subsequently, the return from the capital investment is taxed as income and the capital as asset. Depending on whether other assets are present, this can lead to a substantial tax amount. Capital gains are tax free; however, the same applies for capital loss.

Another issue to consider in your tax planning is the fact that buying in to cover up any funding shortfalls during your years in work can be deducted from your taxable income. Thus you have the opportunity to reduce your tax burden before your retirement. However, such a buying-in is only possible until you are three years away from the day you want to take retirement. On the other hand, a gradual withdrawal of pension fund monies is not necessarily connected with a reduced progression. The tax administrations increasingly tend to accumulate each single partial withdrawal and present you with a consolidated tax calculation. In other words: partial withdrawal one and partial withdrawal two are summed up and will be taxed jointly (progressively).

Is early retirement worthwhile?
In general, early retirement has a significant influence on the amount of retirement capital available and thus, on pension. The Swiss pension system is constructed in such a way that with increasing age, the savings for retirement capital grow exponentially. In the years to follow you can generally expect an increased income and consequently, increased amounts of savings. However, should these cease, the loss (in savings) is substantial. An early retirement is only recommended in situations where sufficient other capital is available and if other individual reasons are present that would make an early exit from the workplace viable.

Not only is early retirement an option with an occupational pension plan, but also with government-supported OASI (Old-age and survivors' insurance). But even here, loss of capital is significant. With OASI, you also have the option to delay the pension and thus, for example with a delay of five years, draw an OASI pension increased by 31.5 %. Should you have excellent genes and your are not solely dependent on OASI then this decision might be worth taking.

With early retirement, payments into a occupational retirement plan are no longer possible, due to a lack of work-related earnings. On the other hand, the obligation to pay contributions to OASI continues even when you are without gainful employment. The contributions are calculated on assets and current pensions. Only once you have reached the age of 65 does the obligation to contribute end. Has only one spouse reached retirement age, then the spouse's pension will generally be halved. In this case, due to very particular methods of calculation, early retirement needs to be considered carefully and professional advice is necessary.

What to do with a detached house?
It makes sense to think about accommodation with approaching age. Two thirds of all detached houses in Switzerland are inhabited not by families with children but by either single persons or couples. As enjoyable as this situation may be, the size of a house or of a garden can also become a burden. On top of that, necessary renovation work can put an unexpected strain on your budget planning – and this is even more so as banks are increasingly reluctant to approve mortgages for elderly people. The sale of the house or a bequeathal of the property within the family has to be taken into consideration for your asset planning at an early stage. Moving into a modern apartment – freehold or rented – can also be a relief in such a situation.

With the sale of a house – similar to a lump sum withdrawal of pension capital – the issue arises as to how the money should be invested. One option is the purchase of an adequate freehold apartment, the other option is a financial investment. Should you opt for investing the money on the capital market, a magnitude of possibilities are available: bonds, shares, funds or derivatives, and so on. With profound knowledge of the capital market investment advice is highly recommended.

From a tax point of view, the same principle applies - that both capital gains and losses are tax free, whereas interest and dividends are subject to income tax, with assets also being subject to tax.

Kind regards
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