Retirement income streams

A Financial Planning Technical Guide

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Contents

If you like the idea of receiving regular income in retirement, then retirement income streams may be the answer for you. However, there are many kinds of retirement income streams to choose from. This guide is designed to help you understand how the main options work, their relative merits and special features.

The following information is current as at 1 July 2014.

Income stream overview

What is an income stream?

An income stream is a financial instrument designed to let you turn a lump sum of money including your super and non-super funds into a source of regular income. Income streams have become increasingly popular with retirees, because as well as providing a regular income, they can also provide tax advantages and a better social security outcome.

Income streams are generally available as either pensions or annuities. The main difference between a pension and an annuity is the provider:

- **Pensions** are generally provided by superannuation funds. They can generally only be purchased with accumulated superannuation monies
- **Annuities** are provided by life insurance offices, friendly societies or trade unions. They can generally be purchased with accumulated superannuation monies, or with non-superannuation (ordinary) monies.

Types of income streams

There are three main kinds of income stream available:

- **Account based.** Account based income streams can only be purchased with superannuation monies. Each year you are required to take a minimum payment which is based on your age at commencement and at each subsequent 1 July. No maximum income limit applies unless it is a Transition to Retirement (TTR) income stream where a maximum of 10% of the account balance applies. Your money is invested for you, and lasts as long as there is money left in your account.
- **Non-account based.** As the name suggests a non-account based income stream is one to which there is no account balance attributable to you These are generally fixed term and lifetime pensions and annuities.
  - Fixed term. As the name suggests, the term is fixed according to your life expectancy and the income level is also fixed at commencement
  - Lifetime. These income streams last as long as you do. As with the fixed term, the income level is pre-agreed. Unlike the others, the income is guaranteed for your lifetime – no matter what investment returns are generated and no matter whether you outlive your life expectancy.
- **Asset test exempt.** These income streams allow the recipient favourable social security treatment under the asset test. These were only available until 19 September 2007 and came in the form of lifetime, fixed term and market-linked income streams. Asset test exempt income streams may, subject to meeting certain conditions, be purchased from 20 September 2007 from the commutation of existing asset test exempt income streams.
- **Market linked.** Market linked income streams can only be purchased with superannuation monies. The term is fixed at commencement and the income level can vary from plus or minus 10% around the annual calculated amount. Public offer superannuation funds offered these types of income streams up to 19 September 2007. They may, subject to meeting certain conditions, still be purchased from public offer superannuation funds from the commutation of existing Market Linked pensions and complying fixed term pensions/annuities. It is also possible for a Self Managed Superannuation Fund to issue this type of income stream.

Each of these types of income stream have their relative merits and special features. These are set out for you on the following pages.

<table>
<tr><th></th><th>Market Linked Income Streams
(Limited availability after 20 September 2007)</th><th>Account Based Income Streams</th></tr>
<tr><td>What income do you receive?</td><td>Income is calculated by reference to your account balance at commencement and subsequently every 1 July, divided by a payment factor.</td><td>Income is subject to a minimum payment per year expressed as a percentage of your account balance based on your age at commencement date and each subsequent 1 July as follows:
<table>
<tr><th>Age</th><th>%</th></tr>
<tr><td>Under 65</td><td>4</td></tr>
<tr><td>65–74</td><td>5</td></tr>
<tr><td>75–79</td><td>6</td></tr>
<tr><td>80–84</td><td>7</td></tr>
</table>
<table>
<tr><th>Age</th><th>%</th></tr>
<tr><td>85–89</td><td>9</td></tr>
<tr><td>90–94</td><td>11</td></tr>
<tr><td>95 or more</td><td>14</td></tr>
</table>
[14] No maximum annual income limit applies unless a TTR income stream (10% of the account balance).</td></tr>
<tr><td>Can you withdraw money?</td><td>Not generally accessible.</td><td>Ability to make withdrawals at any time subject to fund rules with the exception of a TTR income stream.</td></tr>
<tr><td>How long do payments last?</td><td>Can choose from a term that lies between:
Your life expectancy at purchase
The life expectancy of a person five years younger at purchase
The number of years between your current age and 100.
If you have a spouse with a longer life expectancy who will continue to receive the pension on your death, the term can be based on the above rules using their life expectancy</td><td>Until the money in your account runs out.</td></tr>
<tr><td>Can you choose how the money is invested?</td><td>Generally have a number of choices about how your money is invested.</td><td>Generally have a number of choices about how your money is invested.</td></tr>
<tr><td>What happens if you die?</td><td>Income stream will continue to be paid to your reversionary beneficiary (if any), or will be paid to your other beneficiaries or your estate as a lump sum.</td><td>A tax dependent beneficiary may receive remaining balance as an income stream or lump sum. Alternatively, it can be paid to other beneficiaries or your estate as a lump sum.</td></tr>
</table>

<table>
<tr><th colspan="3">Non-Account Based Income Streams</th></tr>
<tr><th></th><th>Lifetime Pensions/Annuities</th><th>Fixed Term Pensions/Annuities</th></tr>
<tr><td>What income do you receive?</td><td>Income is fixed but may increase annually in line with a fixed percentage or CPI.</td><td>Income is fixed but may increase annually in line with a fixed percentage or CPI.</td></tr>
<tr><td>Can you withdraw money?</td><td>Not generally accessible.</td><td>Not generally accessible.</td></tr>
<tr><td>How long do payments last?</td><td>Until you die (or where you have a reversionary beneficiary who is a dependant for tax purposes – until you both die).</td><td>Can choose from any term.</td></tr>
<tr><td>Can you choose how the money is invested?</td><td>Not relevant as income is fixed.</td><td>Not relevant as income is fixed.</td></tr>
<tr><td>What happens if you die?</td><td>There are two options:
Where you have a reversionary beneficiary, they will continue to receive income payments until they die.
When you have a guaranteed period, if you die within the period, the residual value is paid to your beneficiaries or the estate.</td><td>The remaining income payments flow to the reversionary beneficiary for the remainder of the term or the residual value is paid to your beneficiaries or estate.</td></tr>
</table>

Transition to Retirement

If you have reached your preservation age, subject to the rules of your fund, you are able to draw on your super without having to retire permanently from the workforce.

Under these rules, if you are still working, you will have to receive your super as a particular type of pension. These pensions, known as "Transition to Retirement" (TTR) income streams, will generally not be "commutable". Broadly speaking, this means you will not be able to withdraw lump sum amounts from the income stream. They include Account Based pensions and Market Linked pensions. For an Account Based pension, a maximum income limit of 10% per annum of the account balance will apply.

If you select a TTR income stream, you will be allowed to take a lump sum once you meet a full condition of release such as retirement or reaching age 65. Alternatively, you can stop the pension and roll back your benefits to accumulation phase at any time.

Taxation of income streams

How is an income stream taxed?

From your preservation age to 59*

Not all income received from an income stream from a taxed superannuation fund is necessarily taxable for income tax purposes. The following table is a guide to how income streams are taxed.

Taxable Income	Income stream payment (assessable income) less tax free portion**.	=Taxable income
Tax Payable	You pay tax on taxable income at marginal tax rates, less a 15% tax offset for superannuation pensions. The tax offset is not available for income streams that are not from taxed superannuation funds.	= Net tax paid limited to zero where offset exceeds tax

** This is the portion of the pension payment that is not taxed.

Your preservation age is determined by your date of birth as follows:

Date of Birth	Preservation Age
Before 1 July 1960	55
1 July 1960 — 30 June 1961	56
1 July 1961 — 30 June 1962	57
1 July 1962 — 30 June 1963	58
1 July 1963 — 30 June 1964	59
On or after 1 July 1964	60

Age 60 and over

The income you receive from an income stream from a taxed superannuation fund (ie a pension) will be tax free and is not required to be included in your tax return.

Income streams and social security

Which income streams are asset or income test exempt?

The income and assets test are both used by Centrelink and the Department of Veterans' Affairs to determine eligibility for social security payments.

For social security purposes, income streams are divided into three assessment categories.

Income Stream	Income Test	Assets Test
Asset test exempt income stream – eligible lifetime, fixed term, Market Linked income streams.	Annual Payment - PP/RN	100% exempt if purchased before 20 September 2004. Market Linked income streams – 50% of ongoing account balance is exempt. Asset test exempt fixed term and lifetime income streams – 50% of the reduced value** of purchase price is exempt if purchased 20 September 2004 – 20 September 2007.
Account based income streams* and asset-tested lifetime and fixed term income streams with an initial term greater than 5 years or at least the life expectancy of the recipient if term is less than 5 years	Annual Payment - (PP-RCV-Commutations) / RN	Remaining account balance for account based income streams is assessed. Lifetime and fixed term income streams: • 100% RCV, purchase price • RCV < 100%, reduced value of purchase price.
Asset tested lifetime and fixed term income streams with an initial term of 5 years or less.	Deemed	Where: • 100% RCV, purchase price • RCV < 100%, reduced value of purchase price.
Non-purchased defined benefit pensions	Annual payment less tax free portion	100% exempt

*From 1 January 2015:

- New account based pensions will be deemed
- Existing account based pensions where the recipient is not receiving a Centrelink income support payment will be deemed.

** Calculation of reduced value PP [(PP - RCV) x (term elapsed/RN)]

Where:

- PP is the Purchase Price and means the full purchase price less any commuted amounts.
- RN means the Required Number and is the term at purchase for a market linked or fixed term income stream. It is your life expectancy for account based and lifetime income streams.
- RCV means the Residual Capital Value.

Eligibility for the Age Pension

Who is eligible for the Age Pension?

For some people the Age Pension will make up most of their retirement income. For others it works out to be a handy bonus. Some do not receive it at all. So, understanding your eligibility is a crucial part of retirement planning.

From 1 July 2017 the qualifying age for the Age Pension will increase from 65 to 65 ½ years and will then rise every 2 years reaching 67 by 1 July 2023.

The qualifying ages for the men and women are shown in the table below:

Born Between	Women eligible for Age Pension at	Men eligible for Age Pension at
1 July 1947 to 31 December 1948	64½	65
1 January 1949 to 30 June 1952	65	65
1 July 1952 to 31 December 1953	65½	65½
1 January 1954 to 30 June 1955	66	66
1 July 1955 to 31 December 1956	66½	66½
1 January 1957 and later	67	67

A 2014/2015 Budget measure is to continue the increase in the age pension age by 6 months every 2 years from 1 July 2025 until the qualification age reaches 70 by 1 July 2035. To date this measure has not been legislated.

The person claiming the Age Pension must be an Australian resident.

Generally, a person qualifies if they have always lived in Australia. A person who has lived overseas can also qualify if they either:

- Have lived here for at least 5 years continuously and have, in total, lived in Australia, on or off, for more than 10 years
- Have lived in a country with which Australia has an international Social Security Agreement that counts towards Australian residence
- Have a qualifying residence exemption (ie they are, or were, a refugee)
- Are a woman who was widowed here, and both she and her partner were Australian residents at the time, and she has lived in Australia for 104 weeks immediately before the claim
- Were receiving Widow B pension, Widow Allowance or Partner Allowance immediately before turning Age Pension age.

A person's Age Pension entitlement is calculated by Centrelink by applying the income or assets test. The test that produces the lowest entitlement will determine the amount of Age Pension a person will receive. The Centrelink rules provide specific definitions of assets and income and it is important that you have an understanding of these rules. You should discuss with your financial planner whether you may qualify for the Age Pension.

For more information on Centrelink payments, please call 132 300 or visit your nearest Centrelink office. For more information on Veterans' Affairs call the Department of Veterans' Affairs general enquiries on 133 254.

Payments

The Age Pension — As at 1 July 2014	
Single* (full rate)	$842.80** per fortnight
Couple (full rate)	$1,270.60 (combined) per fortnight

Source: Centrelink website

* Includes couples separated due to ill health.

** This payment includes the pension supplement plus the clean energy supplement

Asset test

The more assets you have, the less pension you will be entitled to. While the family home is normally not included in the assets test, non home-owners are entitled to a higher threshold because they have to pay rent in retirement.

As you can see, if you are single and a homeowner you may be able to receive a full pension if your other assets (such as cash and investments) are less than $202,000. For every $1,000 above this amount your pension payment is reduced by $1.50 per fortnight. When your assets reach $764,000 you will no longer qualify for any pension. The same principles apply to the other categories.

Assets Test – As at 1 July 2014		
Family situation	To receive full pension	To receive part pension[1]
Single	Up to $202,000	Less than $764,000
Partnered (combined)	Up to $286,500	Less than $1,134,000
Illness separated couple (combined)	Up to $286,000	Less than $1,410,500
One partner eligible (combined)	Up to $286,500	Less than $1,134,000

Source: Centrelink website

[1] Lower cutoff thresholds will apply to persons receiving the pension under transitional rules.

Assets Test — For Non-Home Owners — As at 1 July 2014		
Family situation	To receive full pension	To receive part pension*
Single	Up to $348,500	Less than $910,500
Partnered (combined)	Up to $433,000	Less than $1,280,500
Illness separated couple (combined)	Up to $433,000	Less than $1,557,000
One partner eligible (combined)	Up to $433,000	Less than $1,280,500

Source: Centrelink website

[1] Limits increase if Rent Assistance is paid with your pension.

Note: These details are based on 20 September 2009 changes.
If you were in receipt of a pension as at 20 September 2009, you may receive a higher pension under the transitional rules.

Income test

The more income you earn, the less pension you will be entitled to.

The maximum you can earn before you no longer qualify for a pension entitlement is $1,845.60 per fortnight for a single person and $2,825.20 per fortnight for a couple. Note that income includes earnings from salaries or wages, rent, interest, dividends and any money you are deemed to earn (see 'deeming' below). As you can see, a single person can earn up to $160.00 per fortnight ($284.00 for a couple) before they start to have their pension entitlements reduced.

Income Test – As at 20 March 2014		
Family situation	For full payment (per fortnight)[1]	For part payment (per fortnight)[2]
Single	Up to $160.00	Less than $1,845.60
Couple (combined)	Up to $284.00	Less than $2,825.20
Illness separated couple (combined)	Up to $284.00	Less than $3,655.20

Source: Centrelink website

[1]. Income over these amounts reduces the rate of Pension payable by 50 cents in the dollar.

[2]. Limits increase if Rent Assistance is paid with your Pension.

Note: These details are based on 20 September 2009 changes. If you were in receipt of a pension as at 20 September 2009 you may receive a higher pension under the transitional rules.

Deeming

Deeming rules discourage people from keeping their money in a low-interest bank account to increase their pension eligibility under the income test. Deeming assumes your capital from financial investments is earning a given rate of return (income) – regardless of what return those investments actually generate.

The current deeming rules are as follows:

- If you are single and receiving a pension or allowance, the first $48,000 of your financial investments are deemed to earn income at 2.0% pa. Any amounts over that are deemed to earn income at 3.5% pa.
- If you are part of a couple and at least one of you is getting a pension, the first $79,600 of your combined financial investments is deemed to earn income at 2.0% pa. Any amount over that is deemed to earn income at 3.5% pa.
- If you are part of a couple and neither receives a pension, the first $39,800 for each of you and your partner's financial investments is deemed to earn income at 2.0% pa. Any amount over that is deemed to earn income at 3.5% pa.
- Deeming rates are subject to change with interest rate movements.

Contact CoWealth Partners for further information on 02 8021 4889 or visit www.cowealth.com.au