Your super – booklet 3

Account-based pensions: Making your super go further

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Introduction

There are a number of ways to use your superannuation to fund your retirement income. One of the options available is an account-based pension which can provide you with a convenient, flexible and tax-effective income when you retire.

An account-based pension is a common way for retirees to receive their accumulated superannuation benefits in retirement. They can offer significant flexibility in investment choice and how you can receive your income.

This booklet will help you understand the main features of account-based pensions, including:

- how to invest in an account-based pension
- what levels of income you must receive
- how investment returns and payment levels can affect your balance
- the tax treatment of payments
- what happens to your account-based pension should you die
- alternatives to account-based pensions, including fixed payment income streams.

For many retirees, superannuation pension income is supplemented by a full or part-rate age pension. How your account-based pension will be treated under the social security rules is also examined.

An account-based pension is a common way for retirees to receive their accumulated superannuation benefits in retirement.

The other booklets in the *Your super* series are:

1. **GETTING THE BEST OUT OF YOUR SUPERANNUATION SAVINGS** which focuses on saving through super and some things to keep in mind while your super is accumulating.

2. **SUPERANNUATION WHEN LIFE CHANGES** which focuses on some important superannuation-related issues to consider whenever you experience changes in your circumstances, whether planned or unexpected.

4. **SUPER AND ESTATE PLANNING** which covers information about the treatment of superannuation on death and how you can use your super as an estate planning tool.

5. **SELF MANAGED SUPER FUNDS: FROM SET-UP TO WIND-UP** which focuses on the issues of establishing, running and winding up an SMSF, and what to consider when deciding whether an SMSF is right for you.

6. **SELF MANAGED SUPER FUNDS: A GUIDE TO SUPER BORROWING** which focuses on matters SMSF trustees should consider in establishing a super borrowing arrangement, as well as ongoing maintenance and wind-up issues.

This series of booklets provides information about *taxed superannuation funds*. A *taxed superannuation fund* pays tax on the assessable contributions and certain investment income of the fund. Most Australian superannuation funds are *taxed superannuation funds*. We have not included information about untaxed superannuation funds, such as certain government or public sector funds. Different arrangements apply to these funds which are beyond the scope of these booklets.

This booklet has been prepared without any knowledge of your personal circumstances. The information is general in nature and should not be relied upon as specific financial advice.

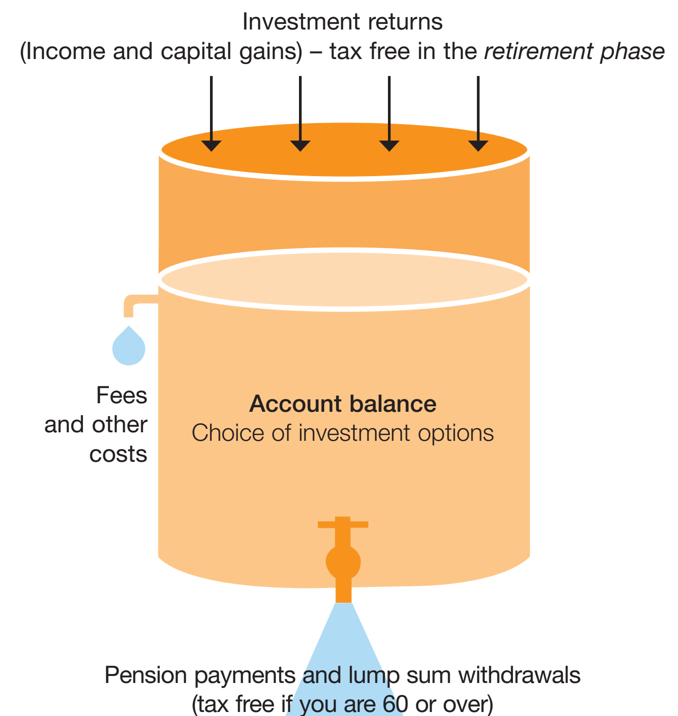
We strongly recommend that you seek the advice of a financial services professional, for example a financial planner, accountant/tax adviser or legal adviser. Throughout this booklet, the term 'financial adviser' is intended to include any one or more of these types of financial services professionals.

Note: Technical terms that are used throughout this booklet are shown in *italics* and are explained in the glossary at the end of the booklet.

What are account-based pensions?

An account-based pension is like a personal retirement income account operating in a superannuation fund. You will receive regular income payments, while at the same time your account will earn investment income.

Account-based pensions



An account-based pension allows you to consolidate your retirement savings in one place.

Here's how an account-based pension works

You will continue to receive pension payments as long as there's money left in your account. How long that will be depends on:

- the starting amount
- how you choose to invest it (and investment performance)
- the level of income you draw, and
- whether you take out any lump sum payments along the way.

There's no guarantee that it will last your lifetime, but tax advantages mean that you will get more mileage out of savings invested in an account-based pension than you would from many other types of investment arrangements.

Account-based pensions are tax-effective and flexible, especially if you are aged 60 or more, as your superannuation benefits (whether taken as a pension or lump sum) are completely tax free.

Account-based pensions have the following advantages:

Convenient

An account-based pension allows you to consolidate your retirement savings in one place. This means that you won't have to keep track of lots of individual investments for tax purposes.

What are account-based pensions?

Flexible

An account-based pension generally allows you to:

- choose the frequency of payments (for example monthly, quarterly or annually)
- choose the amount of your payments (subject to a minimum annual limit)
- withdraw lump sums whenever you need them
- select from a range of investment options, and
- specify who will receive either the residual balance or continue the pension after your death (depending on your fund's rules and who the beneficiary is).

You can adjust all of these to ensure your pension continues to suit your changing circumstances. However, there are some special restrictions if your pension is a transition to retirement (TTR) pension.

The planning possibilities are very flexible, and that's why many financial advisers recommend an account-based pension as the cornerstone of a retirement income plan.

Tax-effective

The investment earnings added to your pension account are generally tax free in the *retirement phase*. However, if you have a transition to retirement pension, investment earnings within the pension account are taxed at a maximum rate of 15 per cent until you have met a full condition of release.

Also, if you are aged 60 or more you won't pay any income tax on the payments you receive.

If you are aged between *preservation age* and 59, pension payments may be taxable, but often they'll include a *tax-free component.* You may also qualify for a 15 per cent tax offset on the *taxable component* of your payments.

The overall effect of these tax concessions is that you can receive quite a substantial income each financial year, even if you have not yet reached age 60, and still pay little or no tax.

… if you are aged 60 or more you won't pay any income tax on the payments you receive.

Starting an account-based pension

Starting an account-based pension is easy.

1 Accumulate money in your super fund

You can only start an account-based pension with money you hold in superannuation. This can include money that you have accumulated in your current fund through contributions and investment earnings, and amounts rolled over from other superannuation funds.

It is not compulsory for funds to offer account-based pensions but many do. You can check with your fund or speak with your adviser who will be able to find out whether your fund offers account-based pensions.

When building your superannuation, you need to be mindful of the contribution caps and, once you reach age 65, the restrictions and age limits that apply to most types of contributions. These rules are explained in *Your super – booklet 1: Getting the best out of your superannuation savings*.

2 Meet a condition of release

Before you can start to receive a pension with your preserved super benefits, you must have met a *condition of release*. The most common conditions of release are:

- reaching your *preservation age*
- permanently retiring after reaching *preservation age*
- reaching age 65, or
- permanent incapacity.

Your *preservation age* depends on when you were born.

If you were born …	… your preservation age is:
Before 1 July 1960	55 years
1 July 1960 to 30 June 1961	56 years
1 July 1961 to 30 June 1962	57 years
1 July 1962 to 30 June 1963	58 years
1 July 1963 to 30 June 1964	59 years
After 30 June 1964	60 years

Some conditions of release (such as reaching *preservation age*) have restrictions on the amount of, or form in which you can take your benefits, while others (such as reaching age 65) allow unrestricted access.

If you have met a full *condition of release*, you have unrestricted access to your superannuation benefits which means you can choose to receive a pension, lump sum or combination of both.

If you have reached you *preservation age* but have not yet retired, you may be able to use your accumulated superannuation benefits to commence a TTR pension. A TTR pension is similar to an account-based pension with restrictions that prevent you from drawing payments above a maximum limit (10 per cent of your account balance each financial year) and accessing your capital as a lump sum until you meet a full *condition of release*. Unlike a regular account-based pension (in the *retirement phase*), the income and capital gains on investments supporting a TTR pension are potentially taxable. TTR pensions are explained in more detail in *Your super – booklet 2: Superannuation when life changes*.

3 Rollover your super money into an account-based pension

Your accumulated super will be transferred into a pension account and you will begin to receive your payments. Note that from 1 July 2017 a limit applies to the amount that can be transferred into a pension account. This limit is explained further on page 8. You will maintain the flexibility to invest in a range of investment options that are offered by your fund.

In some more sophisticated master trusts and *self managed superannuation funds*, your superannuation investments do not need to be sold down and converted into cash before being transferred to a pension account. They can be transferred from your accumulation account into a new pension account without triggering a capital gains tax (CGT) liability. The advantage of this is that capital gains on your assets can be realised in the pension account where they will be tax free (compared to a maximum of 15 per cent tax on capital gains when realised in *accumulation phase*). For this reason, there can be advantages in choosing such a fund in the lead up to your retirement while you are still accumulating your super benefits. Your adviser will be able to let you know whether or not your fund offers this feature. You may also want to read *Your super – booklet 5: Self managed super funds: from set-up to wind-up*.

You will maintain the flexibility to invest in a range of investment options that are offered by your fund.

For more information about SMSFs read booklet 5.

The transfer balance cap is a lifetime limit set at $1.6 million in 2017/18.

Speak to your financial adviser for more information.

4 Limits on the amount in an account-based pension

From 1 July 2017, a limit (called the transfer balance cap) applies to the amount of your accumulated superannuation that can be transferred into a *retirement phase* pension account over the course of your lifetime. The transfer balance cap is a lifetime limit set at $1.6 million in 2017/18. It is indexed annually with the Consumer Price Index (CPI) rate and rounded down to the nearest $100,000. Penalties apply if this limit is exceeded.

What counts towards the transfer balance cap?

All your *retirement phase* pensions count towards your transfer balance cap, regardless of how many accounts you hold or how many times you transfer money into *retirement phase*. However, TTR pensions are not counted until you reach age 65 or notify your fund you have met another full condition of release.

The timing of when the pension is counted depends on whether it was started before or after 1 July 2017. If the pension started before 1 July 2017, the balance of the pension account on 30 June 2017 was counted towards the cap on 1 July 2017. If the pension has a commencement date of 1 July 2017 or later, the balance of the pension account when the pension commences is counted towards the cap.

If you make a lump sum withdrawal from your pension account or transfer funds back to the *accumulation phase*, the amount of your pension that was counted against your transfer balance cap will be reduced. Pension payments and investment earnings within the pension account do not impact the amount counted towards your transfer balance cap.

Special rules may apply if you have started a pension after making a personal injury contribution, or you have a complying pension or annuity, a defined benefit pension or a death benefit pension. Your financial adviser will be able to assist you in understanding the impact these pensions will have on your transfer balance cap.

The following example illustrates the transfer balance cap treatment of an account-based pension.

EXAMPLE 1: TRANSFER BALANCE CAP TREATMENT OF AN ACCOUNT-BASED PENSION

Emma, age 60 and retired, rolled over $600,000 into an account-based pension on 1 July 2017 and she draws pension payments of $2,000 per month. On 1 December 2017, Emma makes a lump sum withdrawal of $50,000 from her pension account to meet the cost of renovating her home.

Emma's super fund reports to the Australian Taxation Office that Emma has commenced an account-based pension and that she has made a lump sum withdrawal from her account. The transfer balance cap treatment of Emma's account-based pension is as follows:

- on 1 July 2017 when Emma's account-based pension commenced, she will have $600,000 added to her transfer balance account. She still has $1 million available cap space (this is the difference between the transfer balance cap and the starting balance of her pension)
- on 1 December 2017 when Emma makes a lump sum withdrawal from her account-based pension, her transfer balance account will be reduced by $50,000 to $550,000. This means she now has $1.05 million cap space available.

The timing of when the pension is counted depends on whether it was started before or after 1 July 2017.

Pension payment rules

… you don't have to take a full financial year's pension payment if your pension is only being paid for part of a financial year …

When you invest in an account-based pension, regulations require you to draw at least a minimum payment each financial year.

This minimum payment is calculated by multiplying a percentage factor (which depends on your age) by your account balance on the day you commence your pension, and then on each 1 July after that.

Your age on 1 July (or when you commence the pension in the first financial year)	Minimum payment percentage factor
Under 65 years	4%
65 – 74 years	5%
75 – 79 years	6%
80 – 84 years	7%
85 – 89 years	9%
90 – 94 years	11%
95 years or more	14%

If you commence a pension part way through the financial year, the minimum annual payment is calculated in proportion to the number of days remaining in the financial year (so you don't have to take a full financial year's pension payment if your pension is only being paid for part of a financial year). If you commence your pension on or after 1 June in a financial year, you are not required to take a minimum payment at all in that financial year.

There is no maximum limit, unless you are receiving a TTR pension. TTR pensions are subject to a maximum annual limit of 10 per cent of the account balance each financial year. The extra restrictions that apply to TTR pensions are explained in more detail in *Your super – booklet 2: Superannuation when life changes*.

For more information read booklet 2.

Your investment strategy and payment levels

Of course the higher the pension you choose to receive, the faster you're going to deplete your remaining balance, but that may be part of your plan. If, for example, you have another investment maturing in a few years, you may choose to take more out of your account-based pension now and then scale back the payments later. Alternatively, you may want to take smaller payments initially to take advantage of compounding returns so your pension may last for a longer period of time.

An account-based pension does not provide any guarantees to last your lifetime. But because of the tax advantages, retirement savings will typically last as long or longer if they are invested in an account-based pension compared to investing outside super.

Choosing the right investment mix for your account-based pension is very important. The investment options you select will depend on how comfortable you are with risk.

As a general rule, the bigger the potential investment return, the higher the investment risk. While you're young, you can generally afford to take some risk with your retirement investments, but as you get older you may wish to become more conservative in your approach. However, it is important not to be too conservative as even once you have retired, your retirement savings may need to last another 20 or 30 years or more.

It is important to select both your investment strategies and payment levels, taking account of how long you want your pension to last. You may consider things like social security entitlements (explained later in this booklet), other investments you hold and your general health.

The following example illustrates the effect of different investment earnings rates on how long an account-based pension can last.

The investment options you select will depend on how comfortable you are with risk.

EXAMPLE 2: AN ACCOUNT-BASED PENSION AT DIFFERENT EARNING RATES

Iva, age 57, has reached her *preservation age* and retired. She would like to commence an account-based pension on 1 July 2017, with an opening balance of $400,000. She would like to receive total pension payments of $23,000 in the first financial year (which is above the minimum required annual payment of $16,000). She also decides that she would like to increase her pension payments by the Consumer Price Index (CPI) rate each financial year to account for increases in the cost of living over time.

Based on the most recent Australian Life Tables published by the Australian Government Actuary[1], at the time she commences her pension her average life expectancy is a further 29.19 years, so she can be expected, on average, to live until around age 86.

The charts below show Iva's gross annual pension payments and account balance, assuming she earns investment returns of six per cent and eight per cent (net of fees) per year.

At an earnings rate of six per cent, Iva's pension account lasts until age 83.

Chart 1: Annual pension payments – 6% pa earnings rate

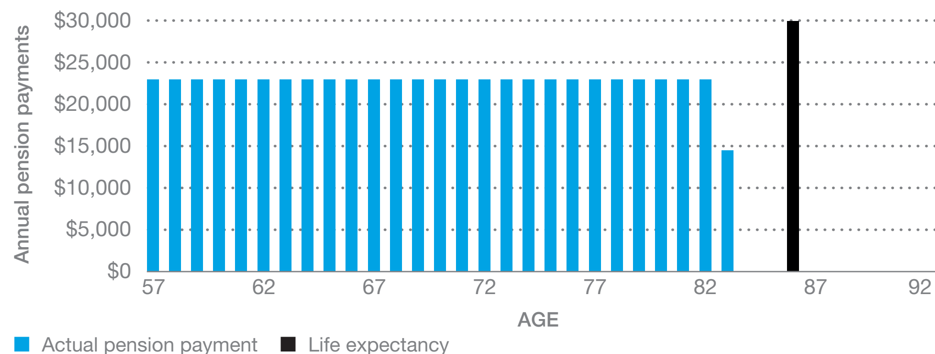
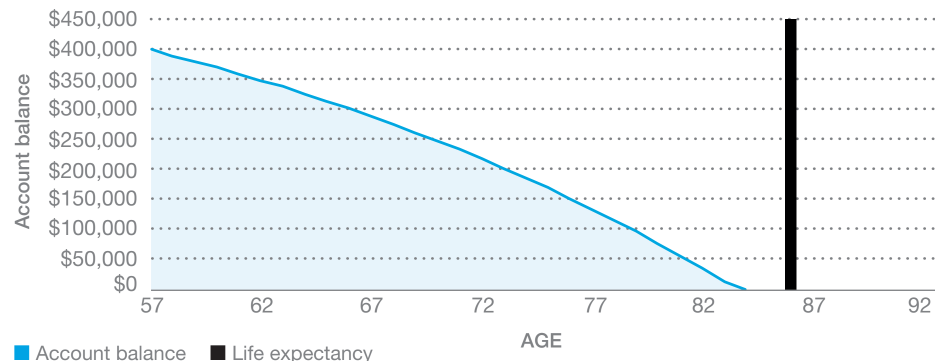


Chart 2: Account balance – 6% pa earnings rate



At an earnings rate of eight per cent, Iva's account lasts until over age 100.

Chart 3: Annual pension payments – 8% pa earnings rate

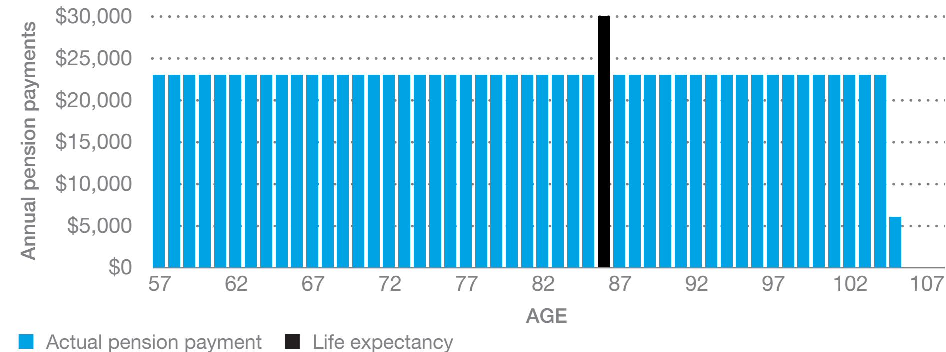
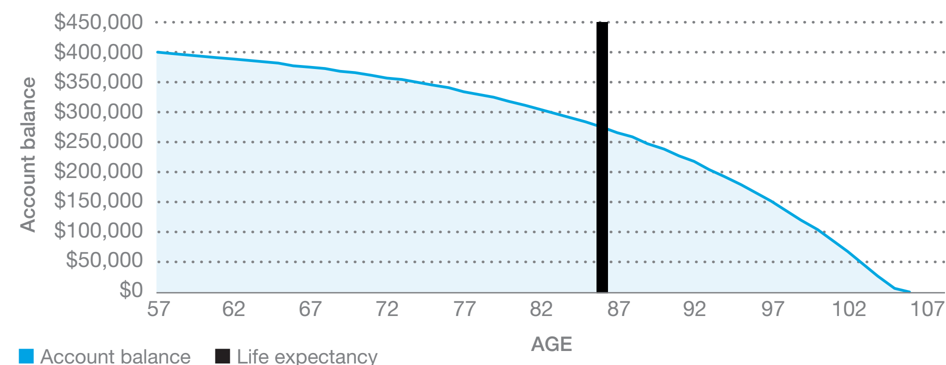


Chart 4: Account balance – 8% pa earnings rate



Assumptions

- All chart figures are in today's dollars (assuming the CPI increases at the rate of 2.5 per cent per annum).
- Pension payments are assumed to be made in the middle of each year.
- Earnings rates are net of fees.

You can see just how big an impact higher returns have on your account balance and the length of your pension.

At an earnings rate of six per cent, Iva's pension would be exhausted before reaching her average life expectancy. This may be partly because Iva would be drawing too much income from her pension. If she chose a lower annual payment level (keeping in mind that she is required to draw a minimum payment) her pension may last longer.

[1] Australian Life Tables 2010–2012, Australian Government Actuary. The table of life expectancy factors can be found in the appendix to this booklet.

You should review your needs with your financial adviser at least once each year …

Another important consideration when setting your annual payment level is whether you want your pension to provide for one or more of your dependants after your death (for example your *spouse*). The treatment of account-based pensions after death, and the options you may have available to pass on your benefits, are explained further on page 18 and also in *Your super – booklet 4: Super and estate planning*.

You should review your needs with your financial adviser at least once each year to make sure you remain on track and that your account-based pension remains suited to your circumstances.

For more information read booklet 4.

Tax arrangements

Tax treatment of investment income

While you receive pension payments, investment earnings will be paid into your pension account. One of the great attractions of *retirement phase* account-based pensions is that there's no tax on the investment earnings added to your account. This applies to both income and capital gains earned by the fund.

Tax treatment of pension payments

The tax treatment of payments to you out of your pension account depends on your age and the percentage of *taxable component* and *tax-free component* in your account.

Over age 60

If you are aged 60 or more, the full amount of each pension payment (the *tax-free component* and the *taxable component*) is paid to you tax free. Technically, it's called non-assessable non-exempt income. Non-assessable non-exempt income is income that is excluded from your assessable income.

A key advantage of non-assessable non-exempt income is that it is treated as if it was never received for tax purposes. For example, non-assessable non-exempt income is not taken into account in determining your eligibility for the Seniors and Pensioners Tax Offset and most other tax offsets. However, it is generally still assessed for social security purposes, for example under the age pension means test.

Under age 60

If you have not yet reached age 60 but have reached your *preservation age* (see page 6), the *tax-free component* of your payments will not be taxed, and the remainder (the *taxable component*) will be taxed at your marginal rate. However, you will receive a 15 per cent offset on the *taxable component* of your payments.

Age	Tax treatment of taxable component
Preservation age but less than 60	Marginal tax rates (plus Medicare levy) less 15% offset
Age 60 or more	Non-assessable non-exempt income

One of the great attractions of *retirement phase* account-based pensions is that there's no tax on the investment earnings …

Tax-free component

The *tax-free component* of the capital you use to commence your pension generally represents non-concessional contributions. Non-concessional contributions are contributions that are not taxed when received by your super fund. They generally consist of personal contributions for which a tax deduction is not claimed, contributions made for a *spouse* and certain contributions made on your behalf by the government (for example the government co-contribution).

Taxable component

The commencing balance of your pension less the *tax-free component* is the *taxable component*.

Proportioning of components

When you start an account-based pension, the percentage of *tax-free component* in your pension account is calculated only once and each future payment made from the pension (whether a regular pension payment or a lump sum) will include this same percentage of *tax-free component*.

EXAMPLE 3

Continuing the example of Iva, let's assume that her starting account balance of $400,000 included an $80,000 *tax-free component.* The percentage of *tax-free component* of any payment made from the pension will be worked out as follows:

Tax-free component percentage	=	$80,000 ÷ $400,000
	=	20%

Therefore, in the first financial year, the total assessable income from her pension (ie the *taxable component*) will be:

Assessable pension income	=	$23,000 – ($23,000 x 20%)
	=	$18,400

If we assume that Iva receives no other income, the gross tax payable will be $38. However, she will qualify for the following offsets.

Superannuation income stream offset of 15 per cent calculated as follows:

Income stream offset	=	$18,400 x 15%
	=	$2,760
Low Income Tax Offset	=	$445
Total offsets	=	$3,205

As a result of these offsets, even though Iva has not yet reached age 60, her tax liability is eliminated. At this level of income, Iva will also not pay Medicare levy. This means she will get to keep every cent of her pension income.

Tax treatment of lump sums

The tax treatment of lump sums (either from your super accumulation or pension account) can also depend on your age and the percentage of *tax-free component* in your account.

The tax treatment of lump sums can also depend on your age …

Over age 60

If you are aged 60 or more, the full amount of your lump sum is tax free.

Under age 60

If you have not yet reached 60, but have reached your *preservation age*, you may pay tax on the *taxable component* of your lump sum, depending on whether or not the *taxable component* of the payment exceeds the *low rate cap*.

Tax treatment of lump sums

Age	Taxable component*
Preservation age but less than 60	0% up to the low rate cap $200,000 (in 2017/18) Amounts above low rate cap 15% plus Medicare levy
Age 60 or more	Non-assessable non-exempt income

* If a lump sum withdrawal contains an element untaxed in the fund, the tax rates in the table may be higher. The circumstances when this may arise are beyond the scope of this booklet.

Low rate cap

The *low rate cap* is a limit on the amount of the *taxable component* of a superannuation lump sum that attracts a lower rate of tax (usually 0 per cent). It applies to lump sum benefits paid between *preservation age* and age 60 and is a lifetime limit. This means that the *taxable component* of any previous superannuation lump sum benefits that you have received since reaching your *preservation age* will generally reduce your *low rate cap* for a financial year. The *low rate cap* is indexed annually with Average Weekly Ordinary Time Earnings (AWOTE) and rounded down to the nearest $5,000.

What if you die before your account balance runs out?

Only certain dependent beneficiaries are eligible to receive your death benefits as a pension.

Your account-based pension can play an important part in your estate planning, and you'll need to think about what would happen if you were to die while there's still money in your account.

You will need to consider things like:

- **Who you want to leave your benefits to.**
  Generally, only your dependants as defined under superannuation law (known as SIS dependants) or your estate can receive your superannuation death benefits.
- **Will it be paid as a lump sum or a pension?**
  Only certain dependent beneficiaries are eligible to receive your death benefits as a pension.
- **How will your death benefits be taxed?**
  The tax arrangements for death benefits can depend on your age, whether benefits are paid as a lump sum or pension, your beneficiaries' ages and whether or not they are dependants for tax purposes (tax dependants) and the benefit's tax components.

The options available to you are subject to restrictions in the law and depend on your fund's rules.

Who can receive your benefits?

Under superannuation law, when you die, the trustee of your fund is generally required to pay your superannuation benefits as soon as practicable to either one or more of your SIS dependants, or to your legal personal representative (typically referred to as your estate). If paid to your estate, the proceeds from your superannuation death benefit will be distributed according to your will.

A SIS dependant, in relation to superannuation death benefits, includes:

- your *spouse* (including a de facto)
- your children (of any age)
- someone with whom you have an *interdependency relationship*, and
- someone who is a dependant of yours within the ordinary meaning of that term, such as a person who depends on you financially.

An *interdependency relationship* exists between two people if they have a close personal relationship, live together, one or each of them provides the other with financial support, and one or each of them provides the other with domestic support and personal care.

Many funds allow you to nominate one or more of your SIS dependants, or your legal personal representative to receive your remaining account balance on death via a death benefit nomination. A death benefit nomination can be binding or non-binding, depending on the rules of your fund.

Alternatively, at the time you commence your pension, your fund may allow you to specify a reversionary beneficiary who may continue to receive the pension after your death. In such an event, the pension does not stop, payments simply 'revert' to the other person. A reversionary beneficiary is usually a *spouse* but it could be another of your SIS dependants, provided they are eligible to receive a death benefit pension. When making a reversionary beneficiary nomination, it's important to consider whether the person you would like to nominate is eligible to receive your benefits as a pension.

A death benefit nomination can be binding or non-binding, depending on the rules of your fund.

Speak to your financial adviser for more information.

How can your benefits be paid?

There are some important restrictions that can prevent certain types of beneficiaries from receiving your death benefits as a pension.

A death benefit pension can only be paid to a beneficiary who is:

- any SIS dependant other than a child
- a child who is under 18
- a child under 25 who is financially dependent on you, or
- a child who is permanently disabled.[2]

Death benefit pensions generally count towards the recipient's transfer balance cap (see page 8). A death benefit paid to a beneficiary who does not meet the above criteria can only be paid as a lump sum. For example, if your death benefits are being paid to your estate, or an adult child who is not disabled or financially dependent, they must be paid as a lump sum.

A death benefit paid to a beneficiary who does not meet the above criteria can only be paid as a lump sum.

[2] Broadly, this is a disability that is permanent or likely to be permanent and results in the need for ongoing support and a substantially reduced capacity for communication, learning or mobility.

What if you die before your account balance runs out?

Tax treatment of death benefits

The tax treatment of your death benefits can depend on:

- whether your benefits are paid as a lump sum or a pension
- who receives your benefit, and
- the benefit's tax components.

Death benefits paid as a lump sum

If your benefits are paid as a lump sum to a tax dependant, they will be received tax free.

A tax dependant is:

- your *spouse* (including a de facto)
- your former *spouse* (if any)
- a child under the age of 18
- someone with whom you have an *interdependency relationship*
- someone who is a dependant of yours within the ordinary meaning of that term, such as a person who depends on you financially.

Also, if you die in the line of duty as either a member of the defence force or a police officer, beneficiaries of the death benefit who are not tax dependants will be treated as tax dependants.

A lump sum paid to a non-tax dependant may be subject to tax of up to 30 per cent plus Medicare levy on the *taxable component.*

If a lump sum is paid to your estate, the estate may pay tax depending on the size of the *taxable component* and whether the beneficiaries of the super death benefit proceeds are tax dependants or not.

Death benefit paid as a pension

If your death benefits are paid to a dependant as a pension, the tax treatment depends on your age at death or the age of your beneficiary.

If you die aged 60 or more, or if the beneficiary is aged 60 or more when they begin to receive a death benefit pension, it will be tax free.

If you die aged less than 60 and your beneficiary is also less than 60, the *taxable component* of the pension may be taxed at the beneficiary's marginal tax rate, but a 15 per cent offset will apply.

These arrangements are explained in further detail in *Your super – booklet 4: Super and estate planning*.

If your benefits are paid as a lump sum to a tax dependant, they will be received tax free.

Social security treatment of superannuation and account-based pensions

Age pension eligibility

The age pension is designed to provide Australians with a minimum level of income support in retirement. The maximum payment rates are shown in the table below.

Eligibility for the age pension can depend on a number of factors including whether you have reached *age pension age* and meet certain residency requirements.

Maximum basic rate of age pension

Family situation	Maximum age pension per fortnight	Total maximum payments per year
Single	$907.60	$23,597.60
Member of a couple (combined)	$1,368.20	$35,573.20

Rates above are effective as at 20 March 2018 and include the pension supplement and energy supplement. Pension payments (excluding the energy supplement of $14.10 per fortnight for a single person and $21.20 per fortnight combined for a couple) are indexed on 20 September and 20 March each year.

The age pension is designed to provide Australians with a minimum level of income support in retirement.

Age pension age

Age pension age is the age when you may qualify for the age pension. It is determined by your date of birth as shown in the table below.

If you were born …	… your age pension age is:
1 January 1949 to 30 June 1952	65 years
1 July 1952 to 31 December 1953	65.5 years
1 January 1954 to 30 June 1955	66 years
1 July 1955 to 31 December 1956	66.5 years
After 31 December 1956	67 years

Age pension age is gradually increasing by six months, every two years from 1 July 2017. *Age pension age* will be 67 by 1 July 2023.

The government has proposed further increases to the age pension age …

Means test

Eligibility for the age pension (as well as other social security benefits) also depends on whether you have income and assets below maximum levels. This is determined by applying two tests, collectively referred to as the means test:

- an income test and
- an assets test.

Your age pension entitlement is calculated under both tests, with the lesser result determining the amount of age pension that you will receive.

Once you reach age pension age, your accumulation phase super will be assessed …

Means test treatment of super

The treatment of superannuation investment balances under the means test can depend on whether they are held in *accumulation phase* or in a pension and also on your age.

Means testing of super in accumulation

If you hold superannuation investments in *accumulation phase* and are under *age pension age* your superannuation balances are exempt from assessment under the means test.

Once you reach *age pension age*, your *accumulation phase* super will be assessed under the assets test and deemed investment income on your super will count under the income test.

Age of member	Income test	Assets test
Below age pension age	Disregarded	Disregarded
Age pension age	Deemed	Assessed

Please note, salary sacrifice super contributions and certain other employer contributions are included in income for the income test in addition to increasing the value of super which is deemed for income test purposes.

Deemed income is the level of income that your financial assets are assumed to earn when assessing your eligibility for social security benefits, regardless of the income they actually earn.

Means testing of super pensions

If you invest your super in an income stream, it will generally be assessed under both the income and assets test.

The assets test free area depends on your family situation and whether or not you are a homeowner.

Assets test and pensions

Assessment of pension assets

Your pension account balance is included as an asset for the purpose of the assets test. The balance is revalued for social security purposes:

- every six months if you receive pension income payments more than once a year
- annually if you only receive your pension annually, and
- following any lump sum withdrawal during the year.

Centrelink generally assess account-based pension assets in February and August each year.

Assets test reduction

Under the assets test, your maximum basic rate of age pension (see page 22) is reduced by $3 per fortnight ($78 per year) for every $1,000 of assets above the assets test free area (single and couple combined).

Assets test free area

The assets test free area depends on your family situation and whether or not you are a homeowner. It is indexed annually in line with increases in the CPI. The assets test free areas and maximum asset levels that will allow you to qualify for a part-rate age pension applicable from 20 March 2018 are as follows:

Assets test thresholds for homeowners

Family situation	Assets test free area*	Maximum assets for part-pension**
Single	$253,750	$556,500
Couple (combined)	$380,500	$837,000

Assets test thresholds non-homeowners

Family situation	Assets test free area*	Maximum assets for part-pension**
Single	$456,750	$759,500
Couple (combined)	$583,500	$1,040,000

* These are the asset test free areas that apply from 1 July 2017. The assets test free areas are indexed on 1 July each year.

** These are the maximum asset limits for part-pensions that apply from 20 March 2018 and are subject to change due to indexation of both the asset test free areas (each 1 July) and maximum basic rates of age pension (each 20 March and 20 September).

Income test and pensions

Assessment of income from account-based pensions

The social security deeming rules apply to account-based pensions that commence on or after 1 January 2015 and to those holding an account-based pension at this date who are not in receipt of social security benefits (or who subsequently become ineligible for benefits). If you have an account-based pension that commenced prior to 1 January 2015 your account-based pension may continue to be assessed under the previous rules that applied before 1 January 2015. Speak to your adviser if you are unsure.

Social security rules at 1 July 2017 deem annual income on a financial investment to be 1.75 per cent of the first $50,200 for a single person (or the first $83,400 combined for a couple) plus 3.25 per cent of any investment balance over that amount. This deemed level of income is counted towards the social security income test, regardless of the level of income you actually draw from your pension.

Income test reduction

The income test reduces the maximum basic rate of age pension (for a single person) by 50 cents per fortnight for each $1 of assessed income above the free area. For a couple, the couple's rate of age pension is reduced by 25 cents each per $1 of income above the free area.

Income test free area

The income test free area depends on your family situation. The income test free areas and maximum income levels that will allow you to qualify for a part rate age pension applicable from 20 March 2018 are as follows:

Income test thresholds

Family situation	Income test free area* (per year)	Maximum income for part-pension** (per year)
Single	$4,368	$51,563.20
Couple (combined)	$7,800	$78,946.40

The social security deeming rules apply to account-based pensions that commence on or after 1 January 2015...

* The income test free areas apply from 1 July 2017. The free areas are indexed by CPI on 1 July each year.

** The maximum income limits are subject to change due to indexation of both the income test free areas and maximum basic rates of age pension. This means they change on 20 March, 1 July and 20 September each year.

EXAMPLE 4: SOCIAL SECURITY TREATMENT OF AN ACCOUNT-BASED PENSION COMMENCED AFTER 1 JANUARY 2015

Joseph turns 65 in March 2017. He rolls over $300,000 into an account-based pension on 1 April 2017 and chooses to draw a payment of $2,000 per month.

The social security treatment of his account-based pension is as follows (assuming he is in receipt of social security payments throughout the whole year):

Assets test

Assessed asset (initial assessment) = $300,000

Income test

The total value of the account-based pension will be included in Joseph and Carolyn's assessed financial assets and deemed.

If we assume Joseph and Carolyn have $50,000 of assessed financial assets and receive other assessed income of $3,000, their combined total assessed income will be:

Assessed income	=	$3,000
Deemed income (first financial year)	=	$83,400 x 1.75% + ($350,000 - $83,400) x 3.25%
	=	$1,459.50 + $8,664.50
	=	$10,124
Total assessed income	=	**$13,124**

Note: deeming rates used are current at 1 July 2017.

Account-based pensions: summing up and a brief look at the alternatives

Advantages of account-based pensions

Convenient

An account-based pension allows you to consolidate your investments in one place.

Flexible

With an account-based pension, you can:

- choose how often you want to receive payments
- choose the amount of your payments (subject to a minimum payment requirement)
- select how you would like to invest your pension capital
- nominate one or more of your dependants to receive your benefit after your death (depending on the rules of your provider), and
- make lump sum withdrawals from your pension whenever you need to.

Tax-effective

- The investment earnings added to your *retirement phase* pension account are tax free.
- If you are aged 60 or more, you do not pay any income tax on the payments you receive.
- Even if you haven't reached age 60, tax concessions mean that you can receive quite a substantial income each financial year and still pay little or no tax.

With an account-based pension, you can chose how often you want to receive payments …

Your pension will last only as long as there is money in your account.

Disadvantages of account-based pensions

The main disadvantage of an account-based pension is that there is no guarantee that your pension payments will continue throughout your lifetime. This is known as longevity risk. Your pension will last only as long as there is money in your account.

Longevity risk

To reduce longevity risk, it is helpful to gain a realistic estimate of how long your pension will have to last.

A 65 year old male is expected, on average, to live for another 19.22 years (age 84.22), but this means that approximately half of all 65 year old men will live longer than this.

It can be helpful to look at the longevity tables in Appendix B at the back of this booklet. For example, a 65 year old male has a nine per cent probability of living until age 95. Together with knowledge of your own health and family history, you can estimate whether it is reasonable that you will possibly be among the nine per cent living until age 95, or the two per cent living until age 100. From such information, you may decide that your pension really needs to last 35 years rather than 19.

What are the alternatives to account-based pensions?

In addition to, or instead of, an account-based pension you may choose to use your accumulated super benefits to purchase other types of income streams to fund your retirement income. These income streams generally do not have an account balance so payment levels are determined up front when you purchase the income stream.

Fixed payment pensions or annuities

Fixed payment pensions and annuities can be payable for either a fixed term, or for your lifetime. They generally benefit from the same tax concessions that apply to account-based pensions but they will not provide the same degree of flexibility. Fixed payment income streams are usually provided by life insurance companies.

Life pensions and annuities

A life pension or annuity can provide a regular stream of income payments which are generally determined by a contract with a life company at the time you purchase the income stream. Your payments may be indexed annually to keep pace with increases in the cost of living and you may also be able to specify a reversionary beneficiary who can continue to receive the income stream after you die.

While life pensions and annuities are guaranteed and can therefore provide you with greater certainty, one of the difficulties with them is that you are usually locked into a level of income that's determined at the time of commencement. You generally do not have ready access to your capital to make lump sum withdrawals. This is because the life insurance company locks in pension and annuity rates based on investment conditions, particularly interest rates, as well as mortality rate assessments at the time of purchase.

Despite these limitations, life pensions and annuities may be useful for people who want the security and certainty of knowing they will not outlive their pension.

Fixed term pensions and annuities

A fixed term pension or annuity can also provide greater certainty. You may choose from either a long or short-term pension or annuity and, subject to some restrictions, you may choose to either index your payments annually or lock in a residual capital value (which is the remaining balance that will be paid to you as a lump sum at the end of your term). Like account-based pensions, there is a minimum annual payment requirement, but this is calculated based on the purchase price as there is no account balance.

With a fixed term pension or annuity, like life pensions and annuities, you are generally locked into a level of income at rates which depend upon conditions at the time of purchase.

Fixed term pensions and annuities also have their limitations. They lack the flexibility of account-based pensions, while at the same time there is still the risk that you may outlive the term of your income stream. However, fixed term pensions or annuities can be suitable for people who want a regular and reliable income for a fixed period of time.

Account-based pensions: summing up and a brief look at the alternatives

Fixed payment income streams and investment risk

In buying a fixed payment income stream, the investment risk is passed from you to the life insurance company.

In so doing, subject to the capital strength of the life company, you may gain additional security. Importantly however, that security generally comes at a cost. For instance:

- some flexibility is lost (you may not be able to commute the income stream or penalties may apply)
- the life company will ordinarily ensure that it retains a margin from the actual asset returns over and above the income it pays to you, and
- the life company, not you, benefits from any upside achieved by the underlying assets.

You can have all the flexibility that an account-based pension offers (including access to capital and ability to vary your income payments) without taking on a high level of investment risk.

Hybrid products

Some income stream products are becoming available which offer a blend of market-linked investment returns (like account-based pensions) with some coverage of mortality risk (that is the risk of you outliving your income stream). The pros and cons of these products need to be weighed up carefully with the assistance of a financial adviser, taking account of expected performance, fees and the nature of the guarantees offered.

If you are concerned about taking on investment risk, an account-based pension can be invested in more conservative assets.

Pensions paid from defined benefit funds

Some public sector and corporate superannuation funds are defined benefit funds. In these funds, your final superannuation benefit is determined using a formula that is often based on final salary, years of service and a benefit accrual rate. Members of a defined benefit fund generally do not have an account balance and their entitlements do not depend on investment performance.

Because defined benefit pensions are paid from amounts that did not accumulate in the fund and earn investment income, generally no tax has been paid on contributions or earnings. For this reason, these pensions receive different tax treatment compared to pensions paid from *taxed superannuation funds*. They may also be assessed differently for social security purposes.

Speak to your financial adviser for more information.

Glossary

<table>
<tr><th>Term</th><th colspan="2">Definition</th></tr>
<tr><td>Accumulation phase</td><td colspan="2">A term used to describe the period when your superannuation benefits are accumulating in the fund. This is the period of time when you are likely to be working and contributing to your super.</td></tr>
<tr><td rowspan="8">Age pension age</td><td colspan="2">The age when a person may qualify for the age pension. Age pension age is determined by a person’s date of birth as shown in the table below.</td></tr>
<tr><th>Date of birth</th><th>Age pension age</th></tr>
<tr><td>1 January 1949 to 30 June 1952</td><td>65 years</td></tr>
<tr><td>1 July 1952 to 31 December 1953</td><td>65.5 years</td></tr>
<tr><td>1 January 1954 to 30 June 1955</td><td>66 years</td></tr>
<tr><td>1 July 1955 to 31 December 1956</td><td>66.5 years</td></tr>
<tr><td>1 January 1957 and later</td><td>67 years</td></tr>
<tr><td colspan="2">Age pension age is gradually increasing by six months, every two years from 1 July 2017. Age pension age will be 67 by 2023.</td></tr>
<tr><td>Condition of release</td><td colspan="2">A condition you must meet before you can access your preserved and restricted non-preserved superannuation benefits. The conditions of release are set out in superannuation legislation. Examples are retirement, reaching your preservation age, reaching age 65 and permanent incapacity. Some conditions of release have restrictions on the amount of or form in which you can take your benefits, while others (such as retirement) allow unrestricted access.</td></tr>
<tr><td>Interdependency relationship</td><td colspan="2">Two persons (whether or not related by family) have an interdependency relationship if:
a) they have a close personal relationship
b) they live together
c) one or each of them provides the other with financial support
d) one or each of them provides the other with domestic support and personal care.

If two persons (whether or not related by family) satisfy the requirement of item a above; but they do not satisfy the other requirements of an interdependency relationship above; and the reason they do not satisfy the other requirements is that either or both suffer from a physical, intellectual or psychiatric disability, they have an interdependency relationship.</td></tr>
</table>

Term	Definition
Low rate cap	A limit on the amount of the taxable component of a superannuation lump sum that attracts a lower rate of tax (usually 0 per cent). The low rate cap applies to lump sum benefits paid between preservation age and age 60 and is a lifetime limit. This means that the taxable component of any previous superannuation lump sum benefits that you have received since reaching your preservation age will generally reduce your low rate cap for an income year. The low rate cap is $200,000 in 2017/18 and is indexed annually with Average Weekly Ordinary Time Earnings (AWOTE) and rounded down to the nearest $5,000.
Preservation age	Generally the age when you can access your superannuation benefits after you retire. Your preservation age depends on when you were born.
Retirement phase	A term used to describe the period where you are receiving an income stream from your superannuation benefits and you have met a condition of release that allows unrestricted access to your preserved and restricted non-preserved benefits. For example, if you are retired and you have an account-based pension, the pension will be in the retirement phase. Investment earnings on income streams in the retirement phase are tax free.

If you were born…	Your preservation age is…
Before 1 July 1960	55 years
1 July 1960 to 30 June 1961	56 years
1 July 1961 to 30 June 1962	57 years
1 July 1962 to 30 June 1963	58 years
1 July 1963 to 30 June 1964	59 years
After 30 June 1964	60 years

Glossary

Term	Definition
Self managed superannuation fund (SMSF)	A fund that, in general terms, meets the following requirements: • it has less than five members • each member of the fund is a trustee and each trustee is a fund member • if the trustee of the fund is a body corporate each director of the body corporate is a member of the fund • no member of the fund is an employee of another member of the fund, unless they are related, and • no trustee of the fund receives any remuneration for their services as trustee.
Spouse	For superannuation and tax law purposes includes: • another person to whom the person is legally married • another person (whether of the same or different sex) with whom the person lives on a genuine domestic basis in a relationship as a couple, and • another person with whom the person has a certain type of registered relationship under certain State and Territory laws. The ACT, NSW, QLD, SA, TAS, and VIC have laws enabling the registration of opposite and same-sex couple relationships.
Taxable component	The value of your superannuation entitlement (or benefit) less the tax-free component of your entitlement (or benefit).
Tax-free component	The component of your superannuation entitlement (or benefit) that represents contributions that were not taxed when received by the fund (generally non-concessional contributions).
Taxed superannuation fund	A fund that pays tax on assessable contributions and investment income while your benefits are accumulating.

Appendix A: Life expectancy factors

Age	Male	Female
0	80.06	84.31
1	79.39	83.60
2	78.42	82.62
3	77.44	81.63
4	76.45	80.64
5	75.46	79.65
6	74.46	78.66
7	73.47	77.66
8	72.48	76.67
9	71.49	75.68
10	70.49	74.68
11	69.50	73.69
12	68.51	72.69
13	67.51	71.70
14	66.52	70.70
15	65.53	69.71
16	64.55	68.72
17	63.56	67.74
18	62.59	66.76
19	61.63	65.77
20	60.67	64.79
21	59.70	63.81
22	58.74	62.82
23	57.78	61.84
24	56.81	60.86
25	55.85	59.87
26	54.89	58.89
27	53.92	57.90
28	52.96	56.92
29	52.00	55.94
30	51.04	54.96
31	50.08	53.98
32	49.13	53.00
33	48.17	52.02
34	47.22	51.04
35	46.26	50.06
36	45.31	49.09
37	44.36	48.12
38	43.41	47.14
39	42.46	46.18
40	41.51	45.21
41	40.57	44.24
42	39.62	43.28
43	38.68	42.32
44	37.75	41.36
45	36.81	40.41
46	35.88	39.45
47	34.95	38.50
48	34.03	37.56
49	33.11	36.61
50	32.20	35.67
51	31.29	34.74
52	30.38	33.80
53	29.49	32.87
54	28.59	31.95
55	27.71	31.02
56	26.83	30.10
57	25.95	29.19
58	25.09	28.28
59	24.22	27.37
60	23.37	26.47
61	22.52	25.57
62	21.68	24.68
63	20.85	23.80
64	20.03	22.92
65	19.22	22.05
66	18.41	21.18
67	17.62	20.33
68	16.84	19.48
69	16.07	18.64
70	15.31	17.80
71	14.56	16.98
72	13.83	16.18
73	13.11	15.38
74	12.40	14.60
75	11.72	13.83
76	11.05	13.08
77	10.41	12.33
78	9.78	11.61
79	9.18	10.90
80	8.60	10.21
81	8.04	9.55
82	7.51	8.90
83	7.00	8.29
84	6.52	7.70
85	6.06	7.14
86	5.64	6.61
87	5.24	6.11
88	4.87	5.65
89	4.52	5.22
90	4.21	4.82
91	3.92	4.45
92	3.66	4.12
93	3.44	3.82
94	3.24	3.55
95	3.06	3.32
96	2.91	3.11
97	2.78	2.93
98	2.67	2.77
99	2.57	2.62
100	2.46	2.50

Australian Life Tables 2010–2012, Australian Government Actuary.

Appendix B: Longevity tables

Probability of survival for females

	Future age					
Current age	75	80	85	90	95	100
55	87%	77%	61%	39%	16%	4%
60	88%	78%	62%	39%	16%	4%
65	90%	80%	64%	40%	16%	4%
70	94%	83%	66%	42%	17%	4%
75	100%	89%	71%	45%	18%	4%
80	n/a	100%	80%	50%	21%	5%

Probability of survival for males

	Future age					
Current age	75	80	85	90	95	100
55	79%	65%	46%	25%	8%	2%
60	81%	67%	48%	25%	8%	2%
65	84%	70%	49%	26%	9%	2%
70	90%	75%	53%	28%	9%	2%
75	100%	83%	59%	31%	10%	2%
80	n/a	100%	71%	38%	13%	3%

Probabilities based on the Australian life tables 2010-2012, these tables are issued by the Australian Government Actuary.

If you have any questions or require more information, we recommend you speak to your financial adviser or contact Macquarie on 1800 806 310, email macquarie.com.au/personal or write to us at PO Box 192, Australia Square NSW 1215.

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