ACCURIUM

Deeming of account-based income streams

October 2014

Account-based income streams purchased from 1 January 2015 will be deemed under social security and Department of Veterans' Affairs (DVA) laws as a result of measures originally introduced by the previous Government last year. This will have implications for retirement planning strategies going forward as social security and DVA benefits often form a key component of a retiree's cash flow. It also provides a great opportunity to engage with your pre-retiree and retiree clients to review their situation.

In this article we look at the new rules in detail, which clients are likely to be impacted, and strategies to consider between now and January 2015 and beyond.

The changes provide a great opportunity to engage with your clients.

What's changing?

From 1 January 2015, new account-based income streams will be subject to deeming rules under the Income Test for Centrelink and DVA. This is opposed to the current rules where only annual income in excess of a deduction amount is assessed.

The previous Government stated that the intent of this change was to improve the fairness of the Age Pension Income Test by aligning the treatment of account-based income streams with other similar financial investments such as shares, term deposits and bank accounts currently subject to deeming.

The new rules will apply to account-based income streams such as account-based pensions (ABPs) and account-based annuities. Non-account-based annuities such as lifetime annuities and fixed term annuities with a term of greater than five years (unless life expectancy is less than five years) will continue to be assessed under the existing rules where income received minus the deduction amount is assessed. Short-term annuities (term of five years or less) will continue to be deemed as they are currently.

Note: The Guide to Social Security Law has been updated to reflect the new deeming rules from 1 January 2015. Section 4.9.3.3 outlines the Income Test treatment of income streams and states 'From 1 January 2015, asset-tested income streams (long-term) that are account based are assessed under the deeming income test. This includes account-based pensions and account-based annuities.

Annuities which are not account based, including defined benefit pensions in the SMSF, are not included in the deeming provisions and will continue to be assessed under the return of capital rules (i.e. gross annual income less deduction amount).'

Account-based income streams currently receive a deduction amount (formally known as the deductible amount). The deduction amount generally represents what is considered a return of the member's capital and does not count towards the Income Test. If annual payments received are less than the deduction amount then no income is assessed.

Did you know!!

The changes provide a great opportunity to engage with your clients.

Did you know!!

Non account-based annuities such as defined benefit pensions will not be assessed under the deeming rules.

The deduction amount is calculated by dividing the purchase price less commutations (if any) by the member's relevant number, which is the pensioner's life expectancy at the pension commencement date (or that of their spouse if they are a reversionary beneficiary with a longer life expectancy).

Table 1: Deeming rates for single and coupled pensioners

Single	Rate	Couple
First $48,000	2%	First $79,600
Over $48,000	3.5%	Over $79,600

Deeming rates are set by the Minister for the Department of Social Services and are continually monitored to ensure that they are appropriate and reflect returns across a range of investment choices available in the market. The current rates are at historical lows. Between 20 March 2010 and 19 March 2013 deeming rates were 3% and 4.5%, and they reached as high as 5% and 7% in July 1996.

Grandfathering provisions

There are grandfathering provisions in place to ensure that a person with an account-based income stream already in place and on an income support payment[1] immediately before 1 January 2015 will not be adversely impacted by these changes. The account-based income stream will continue to be assessed under the existing rules (using a deduction calculation).

This treatment will continue to apply into the future as long as beyond 1 January 2015 the person continually receives an income support payment and retains the grandfathered account-based income stream.

Grandfathering provisions will also apply to an account-based income stream that commenced pre 1 January 2015 and automatically reverts to a reversionary beneficiary in receipt of an income support payment at the time of reversion. There can be no trustee discretion around payment of the reversionary pension (in other words automatic reversion) and the reversionary beneficiary must continue to receive an income support payment otherwise the deeming rules will start to apply.

It is important to understand the common scenarios in which the grandfathering provisions will or will not apply. These include:

- Rolling over an existing pension interest into the SMSF after 1 January 2015. This measure may discourage people from commencing a new pension interest in the SMSF if they believe they will be worse off under the deeming rules, thereby locking them into their existing products.
- A person ceasing to receive an income support payment after 1 January 2015. Careful monitoring of a client's income and assets will be needed to ensure they do not unknowingly breach the means test.
- Commencing an account-based pension prior to 1 January 2015 but not receiving an income support payment by that time. This may be as a result of not reaching Age Pension age or having too much income or assets to qualify for an income support payment.

1 Income support payments include the Age and Service Pension, Disability Support Pension, Carer Payment and Newstart Allowance.

- Receiving an income support payment by 1 January 2015 but not commencing an account-based income stream before this date. This may lead to some retirees commencing an account-based pension earlier than originally planned if they are better off under existing rules.
- Rolling an account-based pension back to accumulation phase to amalgamate additional superannuation benefits to then commence a new pension.
- Having a death benefit paid as pension to a beneficiary who is not a reversionary beneficiary (i.e. in cases where the trustee has discretion over how to pay the death benefit).

How are retirees affected by this change?

The impact of the new rules on retirees will vary as it is dependent on their overall income and assets. Retirees with fewer assets will most likely be affected, particularly when they have little other than financial assets, as a result of the way the Income and Assets Tests work. Table 2 below highlights at which range of assets the Income Test applies as a result of deeming, assuming no other assets or income apart from financial assets.

Did you know!!

Retirees with fewer assets will most likely be affected by the new deeming rules.

Table 2: Assets range where the Income Test applies under current deeming rules (from 1 July 2014)

Clients are:	Assets range
Single, homeowner	$139,430 – $253,000
Single, non-homeowner	$139,430 – $519,000
Couple, homeowner	$245,100 – $320,500
Couple, non-homeowner	$245,100 – $586,500

From 1 July 2014

For single clients, the Income Test applies when financial assets reach $139,430 and for couples $245,100. As asset levels increase, the Assets Test will eventually take over. Table 2 highlights how deeming impacts non-homeowners with a wider range of assets as a result of the higher Assets Test thresholds.

Other retirees likely to be most impacted are those who:

- receive other income such as overseas pensions, taxable defined benefit pensions and employment/self-employment income that are assessed for the Income Test.
- draw down account-based pension income well above the deduction amount and are therefore affected by the Income Test.

Case study 1

Eloise (age 65) is a single client who owns her home, has $5,000 in personal assets and $200,000 in an account-based pension, drawing income of $10,000 (deduction amount of $9,250). Under current rules, she is eligible for a part Age Pension of $21,796 per annum as a result of the Assets Test. However, if her account-based pension is deemed as a financial asset, her Age Pension would reduce to $20,853, which is a reduction of $943 per annum.

Let's instead assume deeming rates were at 3% and 4.5%. Eloise's Age Pension would reduce by $1,943 per annum to $19,853. This highlights the significance of deeming rates, particularly for clients who do not have a significant level of assets.

Case study 2

Joe and Susan (both 65 and own their home) have $20,000 in personal assets, $120,000 in an account-based pension for Susan drawing income of $6,000 (with a deduction amount of $5,550) and Joe has a taxable Government pension of $35,000 per annum. They currently receive a part Age Pension of $19,003 under the Income Test. If Susan's account based pension was caught under the deeming rules, their Age Pension would reduce by $1,279 to $17,724.

It is important to remember that clients who are or will be assessed under the Assets Test may not be affected by this measure for years to come.

Further implications

As a result of the new deeming rules, self–funded retirees in residential aged care at 1 January 2015 who are in receipt of an account-based pension may see their aged care fees go up. A resident's account-based pension cannot meet the grandfathering provisions if they are not in receipt of an income support payment as at 1 January 2015. This may impact on aged care income-tested and means-tested care fee calculations as the aged care rules use the same Income Test as Centrelink and DVA.

Additionally, some measures announced in this year's Federal Budget may also have significant implications for retirees and future strategies if the relevant legislation is passed. Therefore, it is worth keeping these in mind when talking to clients.

- The Government proposes to include tax-free superannuation pensions in the income test used to determine eligibility for the Commonwealth Seniors Health Card (CSHC) from January 2015. Importantly, it is not the actual amount received that will be included, but rather a deemed amount determined using the same rules as those that apply for Age Pension purposes. Self-funded retirees in receipt of the card as of 1 January 2015 are proposed to have their account-based pensions grandfathered under the existing rules.
- From 20 September 2017, the Government proposes to reset the deeming thresholds to $30,000 for singles and $50,000 for couples. The reduction in the deeming thresholds will likely result in the Income Test applying at lower asset levels as highlighted in Table 3 which looks at the potential impact based on current Age Pension rates and thresholds assuming no other assets or income apart from financial assets. Table 3 below compares deeming at current thresholds versus proposed thresholds at September 2017.

Table 3: Comparison of current and proposed deeming thresholds

Clients are:	Assets range where the income test applies under current deeming rules (from 1 July 2014)	Assets range where the income test applies under deeming rules from 1 September 2017 assuming current Age Pension
Single, homeowner	$139,430 – $253,000	$131,720 – $259,500
Single, non-homeowner	$139,430 – $519,000	$131,720 – $525,000
Couple, homeowner	$245,100 – $320,500	$232,410 – $331,000
Couple, non-homeowner	$245,100 – $586,500	$232,410 – $596,500

Did you know!!

Self-funded retirees in residential aged care at 1 January 2015 who are in receipt of an account-based pension may see their aged care fees go up.

Opportunities to add value between now and 31 December 2014

The upcoming changes open up opportunities in the lead up to 1 January 2015, as clients will wish to understand whether they are better off under the existing rules or deeming. It is also a good time to discuss with your client's whether their retirement plan continues to provide the best outcome in light of their needs and objectives.

1. Make the most of the grandfathering provisions

Depending on their personal circumstance, there are a number of steps that may be taken to help clients take advantage of the grandfathering provisions and continue to be assessed under the current rules:

- Commence an account-based pension for clients that are receiving or eligible for an income support payment before 1 January 2015.
- Determine whether clients (currently self-funded) may be eligible for at least a dollar of Age Pension or other income support payment before 1 January 2015. If so, ensure they apply and start an account-based pension before this date.
- Consider restarting account-based income streams where account balances have risen significantly since the commencement of the pension to lock in a higher deduction amount.
- Refresh existing account-based pensions (roll an existing pension back to accumulation and recommence a new pension) to help maximise superannuation benefits in the tax-free pension phase and to lock-in the tax components for estate planning purposes.
- For eligible clients, consider re-contribution strategies to maximise the tax-free components of their account-based pensions. Advisers should be mindful of the likely beneficiaries and the reduction in any anti-detriment entitlements to beneficiaries as a consequence of this strategy.
- Clients who are in the process of, or want to, wind down their SMSF and transfer their account-based pensions to a retail provider should be mindful that this will result in the new pension being assessed under the deeming rules.
- Consider adding a reversionary beneficiary where appropriate, to extend grandfathering status after the death of the primary beneficiary. Note that this generally involves a recommencement of the account-based pension and potentially a lower deductible amount applied going forward.
- Review account-based pensions and consider the benefits of consolidation. In doing so, you should be mindful of any purpose multiple account-based pensions serve, such as separation of tax-free and taxable components for control or estate planning, and ensure these objectives are no longer effective for the client before consolidating accounts.
- Review whether self-funded retiree clients not currently eligible for the CSHC can qualify by 1 January 2015 if they are in receipt of an account-based pension (or are in a position to commence one before that date).

Clients not receiving an eligible income support payment prior to 1 January 2015 can never take advantage of the grandfathering provisions regardless of when their account-based pension commenced.

Did you know!!

It is important to make the most of the grandfathering provisions.

Did you know!!

This is also a good time for your client's to review their objectives and cash flow requirements in the SMSF investment strategy.

2. **Review the SMSF investment strategy as the member's objectives and cash flow requirements may have changed**

   This is also a good time for your clients to review whether their overall retirement strategy continues to best meet their needs. Your client's situation may have changed or there may be alternative strategies that may further enhance their position.

Strategies post 1 January 2015

The upcoming changes will open up opportunities to discuss with existing retirees if and when to commence a new pension or reboot account-based pension products such that they move to new rules when appropriate for their circumstances. There may be a time when the deeming rules are more favourable for the client, such as when they draw considerable amounts from their pension, or as their assets are used up over retirement.

The changes may also lead to more careful management of income streams protected under the grandfathering provisions. It is likely that there will be more consideration given to whether it is necessary to amalgamate super and pension accounts. Ironically, for some clients, this may reduce one of the key benefits of account-based pensions – flexibility.

Account-based pensions will continue to play an important role in retirees portfolios. However, more alternative strategies, may be considered from 1 January 2015 for those affected by the Income Test looking to increase Centrelink/ DVA payments.

These include:

- Lifetime annuities and fixed term annuities with a term greater than five years (or life expectancy). Long-term (non-account-based) annuities, including any defined benefit pensions held in the SMSF, will continue to be assessed under the current deduction rules.
- Investment bond in a family trust structure. Centrelink and DVA assess the actual income in a trust and therefore if the investment bond is the only asset and no withdrawals are made, no income is assessed.
- Leaving funds invested in financial assets outside of superannuation as they will be assessed the same way. Clients concerned about legislative risk regarding superannuation may feel more comfortable leaving some of their retirement funds in term deposits, direct shares and managed funds.

It will be important to consider these strategies in light of what is in the best interest of the client taking into account their whole situation and not solely the Age Pension.

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