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POOLED LIFETIME INCOME STREAMS

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FPA Dimension
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Financial planning

INCLUDES:

- Pooled Lifetime Income Stream
- Proposed means testing
- Proposed assets test
- Declining capital access schedule

While changes to the tax and superannuation rules enabling a range of new and innovative lifetime income streams to be offered from 1 July 2017 were made some time ago, the final social security means testing position was only announced in the 2018 Federal Budget.

And, if legislated, this proposed new means testing will apply to pooled lifetime income streams commencing from 1 July 2019.

Importantly though, existing lifetime income streams commenced before 1 July 2019 will retain the current means tests beyond that date.

In this article, we outline the proposed changes, briefly compare them to the current rules, and offer some potential advice opportunities and considerations (once legislated) for determining whether it is beneficial for a client to commence a pooled lifetime income stream either before or after 1 July 2019.

WHAT IS A POOLED LIFETIME INCOME STREAM?

A pooled lifetime income stream is effectively one that 'pools' together people's savings to provide lifetime payments and protect against longevity risk (i.e. an individual's risk of outliving their savings). This is achieved as a portion of a person's investment in the pool will go to support payments to other members upon that person's death.

Pooled lifetime income streams include:

- Lifetime superannuation pensions;
- Lifetime annuities (both superannuation and ordinary money); and
- Deferred lifetime annuities and Group self-annuitised products.

Note: Term-certain pensions and annuities are not pooled lifetime income streams, as there is no pooling of assets with these income streams and the obligation to provide income payments ceases at the end of the term selected.

PROPOSED MEANS TESTING FROM 1 JULY 2019

These proposals will **only** apply to pooled lifetime income streams commencing on or after 1 July 2019. (See Table 1.)

The proposals will **not** impact the following lifetime income streams:

- Lifetime income streams commenced prior to 1 July 2019. These will be grandfathered and retain the current means test rules.
- New or existing defined benefit lifetime income streams (regardless of start date). These will retain the current means test, with a maximum 10 per cent discount for income (subject to certain exclusions) and exemption from the assets test in most cases.

Example 1: Jim, 67, lifetime annuity

Jim, single and aged 67, has just retired on 1 June 2019. He owns his own home and has $250,000 in super. He has no other assets or income.

Let's compare the Age Pension payable if Jim uses his $250,000 to start a lifetime annuity on either 30 June 2019 (current rules) or 1 July 2019 (proposed rules). (See Table 2.)

Let's assume that:

- The annuity payment rate is 4.7 per cent per annum or $11,750 per annum, with no indexation;
- Current social security non-assessable portion (NAP) is $14,188 per annum, based on his purchase price of $250,000 divided by his life expectancy of 17.62 years; and
- Age Pension rates and thresholds are as at 1 July 2018.

In this example, more income will be counted under the proposed test than under the current test.

Table 1 - Means testing of pooled lifetime income streams

Current Income Test	Proposed Income Test from 1 July 2019
Pension/annuity payment less non-assessable portion (NAP*) is counted as income. ***NAP = (Purchase Price – Commutations) / Relevant number^**	• **Immediately paying lifetime income streams:** - 60 per cent of all payments from pooled lifetime income streams will be counted as income. • **Deferred lifetime annuities:** - No income counted in deferral phase. - 60 per cent of income payments counted once deferral phase ends and income payments commence.

^In the case of a lifetime income stream, the relevant number will be equal to the longest life expectancy at commencement.

Under the current rules, Jim's NAP will always be greater than the annuity payment, and hence nothing is counted under the income test. However, under the proposed rules, 60 per cent of annuity payments will be counted.

In this scenario, Jim would receive a higher amount of Age Pension for the first 13 years, if he commenced the annuity on 30 June 2019 under the current rules, compared to starting it one day later on 1 July 2019 under the proposed rules. From year 13, the indexation of the Centrelink income test threshold ensures that both options receive the same Age Pension thereafter.

Example 2: Beryl, 67, deferred lifetime annuity commencing at age 80

Beryl retires on 1 July 2019 at age 67. She owns her own home and has $400,000 in super (no other assets or income). She chooses to place $60,000 on that date into a deferred lifetime annuity, with payments to commence once she reaches age 80.

Whilst in deferral phase from age 60 to age 79, no income is counted from her investment in the deferred lifetime annuity for Age Pension purposes (though some amount will be counted under the assets test).

Upon turning age 80, this annuity will commence to pay an income, and thereafter, 60 per cent of annuity payments will be counted under the income test.

PROPOSED ASSETS TEST

The proposed assets test applied will depend on whether the pooled lifetime income stream complies with the SIS 'declining capital access schedule' (DCAS) requirements. (See Table 3.)

The DCAS requirements limit the proportion of the initial purchase price that may be returned as a surrender value (i.e. the lump sum available if a person commutes the product) or paid as a death benefit.

It is effectively a restriction on commutation and is based on a declining straight-line basis over the primary beneficiary's life expectancy (or an eligible reversionary beneficiary's life expectancy in certain circumstances).

The full purchase price may be paid as a commutation amount, if the income stream is commuted:

- within 14 days of commencing the income stream; or
- on the death of a beneficiary within the first half of the life expectancy period of the primary beneficiary.

Example 3: Wendy, 70, lifetime annuity, which meets declining capital access schedule

Wendy turns 70 on 1 August 2019 and purchases a lifetime annuity of $100,000.

Her annuity contract allows voluntary commutation:

- within 14 days of purchase – the full amount of the purchase price; or
- upon her death within her life expectancy (i.e. the first 17.8 years). In the case of death, the contract also allows the full amount of the purchase price to be payable within the first half of Wendy's life expectancy (i.e. the first 8.9 years) and complies with the restricted amount payable should death occur thereafter (with no amount payable should this occur after the end of her life expectancy).

This annuity complies with the DCAS, and hence:

- 60 per cent of the nominal purchase price (i.e. $60,000) is counted as an asset from age 70 to age 84; and
- 30 per cent of the nominal purchase price (i.e. $30,000) is counted thereafter.

If Wendy was aged 80 at the time of purchase:

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Table 2 - Analysis

	Current Income Test	Proposed Income Test
Annuity payment first year	$11,750	$11,750
Less NAP	($14,188)	N/A
Less proposed income test discount (40%)	N/A	($4,700)
Income counted	Nil	**$7,050**
Age Pension first year	**$23,598**	**$22,309**
Difference compared to current		**-$1,289**

Table 3 - Proposed Assets Test

Current Assets Test	Proposed Assets Test from 1 July 2019
Declining asset value counted based on: **Purchase price –** **Purchase Price less Residual Capital Value** / **Relevant number** X **Term elapsed**	**Complys with DCAS:** • 60 per cent of nominal purchase price counted to age 84 (or a minimum of 5 years), and 30 per cent of nominal purchase price thereafter for life. **Does not comply with DCAS:** **Greater of:** • 60 per cent of nominal purchase price counted to age 84 (or a minimum of 5 years), and 30 per cent of nominal purchase price thereafter for life; or • Surrender value if voluntarily commuted; or • Highest death benefit payable.

Table 4 - Analysis

	Current Assets Test	Proposed Assets Test
ABP, lifestyle and bank assets	$740,000	$740,000
Annuity purchase price	$120,000	$120,000
Less proposed asset discount (40%)	N/A	($48,000)
Assets counted first year	**$860,000**	**$812,000**
Age Pension first year (combined)	**Nil**	**$2,462**

- 60 per cent of the nominal purchase price is counted as an asset from age 80 to age 85, as there is a requirement to apply this percentage for a minimum of five years; and
- 30 per cent of the nominal purchase price is counted thereafter from age 86 for life.

Example 4: Mario, 70, lifetime annuity, which does not meet declining capital access schedule.

Mario turns 70 on 1 October 2019 and purchases a lifetime annuity of $200,000. The annuity contract allows voluntary commutation in the following circumstances:

- Within 14 days of the purchase – 100 per cent of purchase price;
- At any time up to the end of 15 years – with the maximum of 100 per cent of the purchase price available at the end of year 15; or
- Upon his death within his life expectancy (i.e. the first 15.31 years) – up to 100 per cent of the purchase price.

This annuity will **not** comply with the DCAS, as the amounts available on voluntary commutation outside the first 14 days and upon death exceed the maximum that may be payable under this requirement.

Accordingly, the amount counted under the assets test for his life expectancy period of 15.31 years is the full $200,000 payable upon death, as it is greater than the:

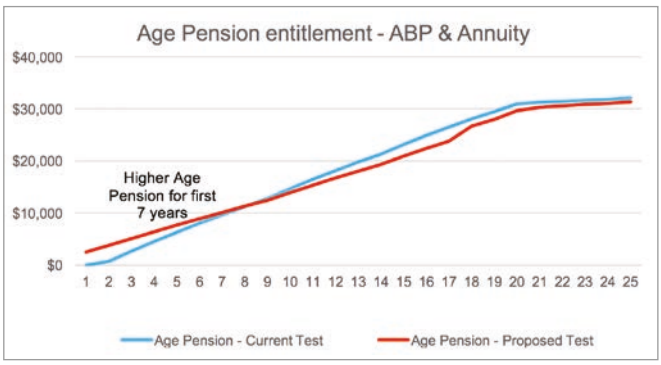
- surrender value from voluntary commutation; and
- 60 per cent of the nominal purchase price (to age 84 and 30 per cent thereafter).

Post-life expectancy, 30 per cent of the nominal purchase price is then counted as an asset.

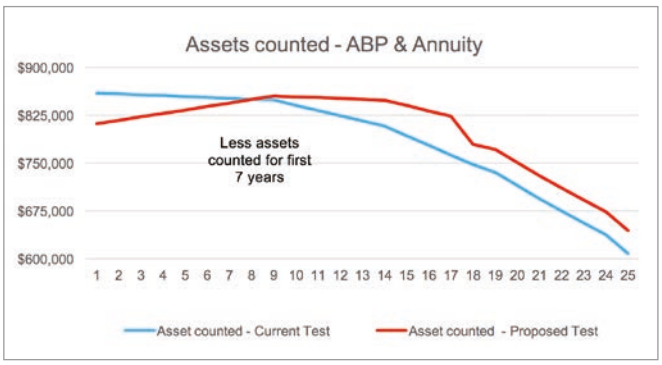
Example 5: Marco and Sharon, both aged 67

Marco and Sharon are both 67 years of age and have retired in June 2019. They own their own home and they have $780,000 in super between them, $50,000 in the bank and lifestyle assets of $30,000. With combined assets of $860,000, they are ineligible for the Age Pension in their first year of retirement.

Graph 1



Graph 2



QUESTIONS

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1 Which of the following statements about pooled lifetime income streams post-1 July 2019 is incorrect?

a. A deferred lifetime annuity is a pooled lifetime income stream.
b. Defined benefit lifetime income streams are excluded from the definition of pooled lifetime income streams.
c. A term-certain annuity is a pooled lifetime income stream.
d. Pooled lifetime income streams provide lifetime payments and protect against longevity risk.

2 Which of the following statements about the proposed means testing of pooled lifetime income streams is correct?

a. Will only apply to pooled lifetime income streams commencing on or after 1 July 2019.
b. Does not apply to lifetime income streams that commenced before 1 July 2019.
c. Does not apply to defined benefit lifetime income streams, regardless of commencement date.
d. All the above.

3 Leanne is 70 and uses $150,000 to buy a lifetime annuity on 1 July 2019. This annuity meets the declining capital access schedule requirements. What is the proposed means testing treatment for Age Pension purposes?

a. Income test: 60 per cent of annuity payments as income for life. Asset test: 60 per cent of nominal purchase price as an asset for life.
b. Income test: 60 per cent of annuity payments as income for life. Asset test: 60 per cent of nominal purchase price as an asset to age 84, and 30 per cent of nominal purchase price as an asset thereafter for life.
c. Income test: 60 per cent of annuity payments as income for life. Asset test: The greater of 60 per cent of purchase price, surrender value or amount payable upon death as an asset for life.
d. Income test: 60 per cent of annuity payments as income to age 84, and 30 per cent of annuity payments as income thereafter. Asset test: 60 per cent of nominal purchase price as an asset for life.

4 Which of the following statements about the proposed means testing of deferred lifetime annuities is incorrect?

a. Deemed income is counted during the deferral phase, and no asset value is counted until the deferral phase ends.
b. No income is counted in the deferral phase, and 60 per cent of annuity payments is counted as income for life once the deferral phase ends.
c. 60 per cent of nominal purchase price of the deferred lifetime annuity is counted as an asset to age 84 (or a minimum of five years), and 30 per cent of nominal purchase price is counted thereafter for life.
d. None of the above.

5 Income test sensitive clients will generally be better off if they commence a lifetime pension from 1 July 2019, compared to commencing a lifetime pension before 1 July 2019.

a. True.
b. False.

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Let's compare the Age Pension that may be payable if Marco uses $120,000 to buy a lifetime annuity on either 30 June 2019 (current rules) or 1 July 2019 (proposed rules), with $660,000 being used to start an account based pension (ABP). (See Table 4.) Let's assume that:

- The annuity payment rate is 4.7 per cent per annum or $5,640 per annum, with no indexation or reversion;
- The annuity complies with the declining capital access schedule;
- The ABP earning rate is 5.8 per cent per annum, and the minimum pension is drawn; and
- Age Pension rates and thresholds are as at 1 July 2018.

The assets test is the dominant test here, and of interest is the potential improvement in the Age Pension payable in the first year, if the annuity is commenced under the proposed rules from 1 July 2019.

It is no surprise that by commencing the annuity under the proposed rules, fewer assets are counted due to the 40 per cent assets test discount, and they go from being ineligible for the Age Pension (current rules) to receiving a small Age Pension of $2,462 in the first year under the proposed rules, plus access to the Pensioner Concession Card.

So, on a one year assessment, the proposed rules appear favourable. However, to fully appreciate the impact, one needs to consider more than just the first year. Graphs 1 and 2 consider the assets counted, and the Age Pension payable (discounted to today's dollars at 3.3 per cent per annum), over the first 25 years under both the current and proposed

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rules, to provide a more complete assessment of the impact of the proposed rules.

Marco and Sharon would receive a higher Age Pension under the proposed rules for the first seven years simply by starting the annuity on or after 1 July 2019, as fewer assets are counted in this period due to the 40 per cent discount.

However, from year eight and onwards, the Age Pension payable under the current rules then becomes higher compared to the proposed rules. This provides an interesting conundrum. Some clients may prefer to receive the higher amount initially and for the first seven years, on the basis that the laws may change again in the future, and therefore may wish to delay the commencement of the lifetime income stream until 1 July 2019. Other clients may prefer to lock in the current rules, which may provide a higher Age Pension down the track.

ADVICE OPPORTUNITIES

Once legislated, the following advice will assist in determining whether it may be beneficial to consider locking in the current means test rules by commencing a lifetime income stream before 1 July 2019, or to wait until after that date to apply the proposed rules.

Clients impacted by the income test

- Generally, more income will be counted under the proposed test than under the current rules.
- Consider other income counted before starting a lifetime income stream.
- For some clients, starting a lifetime income stream before 1 July 2019 will lock in the more favourable current income test.

Clients impacted by the assets test

- Generally, less assets will be counted for one to seven years under the proposed test than current rules, however, more will be counted after that.
- Immediate asset test discount of 40 per cent may assist clients whose assessable assets only slightly exceed the asset test cut out threshold to qualify for a small Age Pension entitlement and access to a Pensioner Concession Card.
- Defer the start of a lifetime income stream until after 1 July 2019 to benefit from an immediate 40 per cent asset test discount.

Note: Be wary with non-homeowner clients purchasing lifetime income streams after 1 July 2019. While these clients will receive the immediate asset test discount, subject to their other assessable assets and income, it could mean that the income test may become the dominant test. This may offset some of the benefits of investing into the lifetime income stream.

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