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NEW SOCIAL SECURITY RULES FOR LIFETIME INCOME STREAMS

Part one: Comparing the current assessment of lifetime income streams with the new rules that apply for lifetime income streams purchased on or after 1 July 2019

Kim Guest

New legislation passed parliament that changes the social security assessment of lifetime income streams including lifetime annuities.

Under the new rules, lifetime income streams purchased on or after 1 July 2019 will be assessed under new income and assets test rules. Grandfathering applies to lifetime income streams purchased prior to this date.

Whether a client is better off purchasing a lifetime income stream before or after 1 July 2019 is a complex question.

Many clients who purchase an income stream on or after 1 July 2019 will receive a higher rate of age pension in the initial years but a lower rate of age pension in later years when compared to the current rules. Whether they prefer an upfront or postponed benefit will depend on the client's circumstances.

This paper is the first part in a two-part series. In part one, we compare the current assessment of lifetime income streams with the new rules that apply for lifetime income streams purchased on or after 1 July 2019.

In part two (published next week), we discuss the more complex aspects of the new rules including the assessment of deferred income streams, reversionary income streams and annuities than contain life insurance.

Background

From 1 July 2017, the Government made the *Treasury Laws Amendment (2017 Measures No.1) Regulations 2017,* which amended the superannuation and taxation laws to introduce a new set of design rules for lifetime superannuation income streams. The new rules allow superannuation funds and life insurance companies to offer a new range of "innovative retirement income stream products" including

The quote

It is expected that a range of new types of lifetime income products will be developed that fit into this category including deferred lifetime annuities.

deferred annuities and group self-annuitised products. A key aim of these new products is to better manage longevity risk in retirement.

However since the introduction of the new rules there has been a limited number of innovative income stream products released in the marketplace. One reason for this delay has been uncertainty regarding the social security assessment of these new products.

This uncertainty has now been removed with the passing of *Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Act 2019* implementing a new means test assessment for lifetime income streams purchased on or after 1 July 2019.

However the new rules do not just apply to innovative retirement income streams, they apply to all lifetime income streams purchased on or after 1 July 2019 including immediate lifetime annuities.

What are lifetime income streams?

The new rules create a new category of income stream for social security purposes known as a lifetime income stream. To qualify as a lifetime income stream, once payments commence they must continue for the remainder of the primary or reversionary beneficiary's lifetime.

Currently, the most common type of income stream that meets this criterion is an immediate lifetime annuity purchased with superannuation or non-superannuation money.

However it is expected that a range of new types of lifetime income products will be developed that fit into this category including deferred lifetime annuities.

Lifetime income streams include:

- Immediate lifetime annuities (superannuation or non-superannuation)
- Deferred lifetime annuities (superannuation or non-superannuation)
- Group self-annuitised products
- Lifetime superannuation pensions

Lifetime income streams do not include:

- Account based pensions
- Defined benefit income streams
- Asset test exempt income streams
- Fixed term annuities

New rules

All lifetime income streams purchased on or after 1 July 2019 will be assessed under the new income and asset test rules. Grandfathering applies to lifetime income streams commenced prior to this date and they will continue to be assessed under the current means test treatment.

Under the new rules, lifetime income streams that comply with a 'capital access schedule' receive a reduced assessable value under the social security assets test. A capital access schedule limits the amount of capital that can be accessed as a voluntary commutation or death benefit. See 'capital access schedule' below for more information.

For lifetime income streams purchased on or after 1 July 2019 that comply with the capital access schedule, the social security assessment is:

Assessable assets:

- 60% of the purchase price[1] assessable until age 84[2] (or minimum five years[3]), then
- 30% of the purchase price assessable for the remainder of their life

Assessable income:

- 60% of annual payment

[1]For deferred income streams, amounts paid to purchase the income stream are indexed to the assessment date. See 'deferred income streams' for more information.

[2]Age 84 is based on the life expectancy of a 65 year old male at the assessment day using current life expectancy tables. This age is determined on the assessment day and may change where life expectancy tables are updated. Age 84 applies for all clients, regardless of their age or gender.

[3]The assessable asset value is 60% of the purchase price for at least five years from the assessment day. The assessment day is generally the date of purchase however the rules are more complex for deferred income streams. See 'deferred income streams' for more information.

The following table compares the social security assessment of lifetime income streams purchased before 1 July 2019 with the new rules that apply to lifetime income streams purchased on or after 1 July 2019.

	Purchased pre 1 July 2019	Purchased on or after 1 July 2019
Assets test	Purchase price assessed but depleted each year* Reaches nil at life expectancy	60% of purchase price assessed until age 84 (and minimum of 5 years) 30% of purchase price assessed for remainder of life
Income test	Annual payment less deductible amount	60% of annual payment

** The formula to calculate the assessable asset value is Purchase Price – [((Purchase Price –Residual Capital Value) / Relevant Number) × Term Elapsed]*

The following examples demonstrate the assets and income test assessment of lifetime income streams purchased on or after 1 July 2019:

Example - Assets test

Joan purchases a lifetime income stream at age 66 for $100,000.

Under the assets test, 60 per cent of the purchase price ($60,000) is assessable until age 84 (19 years), after which point 30 per cent ($30,000) is assessable.

Example – Assets test

Bert purchases a lifetime income stream at age 83 for $100,000.

Generally 60 per cent of the purchase price is assessable until age 84, however as Bert is age 83 this would only be one year and there is a requirement that 60 per cent is assessable for at least five years.

So in Bert's case, 60 per cent of the purchase price ($60,000) is assessable until age 88 (5 years), after which point 30 per cent ($30,000) is assessable.

Example - Income test

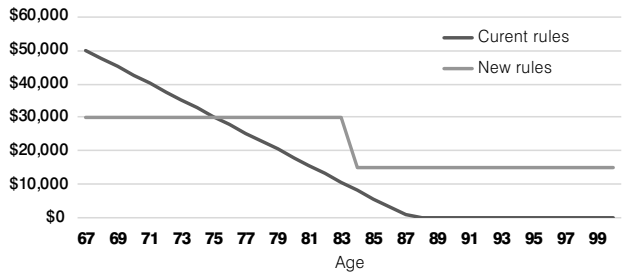
Tom receives an annual payment of $10,000 from a lifetime income stream.

60 per cent ($6,000) is assessed as income under the income test. As payments increase due to indexation, 60 per cent of the indexed payments will be assessable for the duration of the lifetime income stream.

Comparison of current and new rules

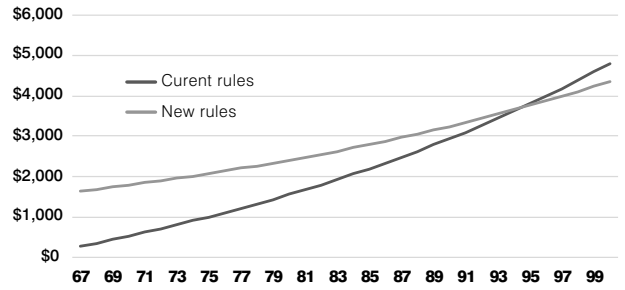
The following graphs compare the assets and income test assessment of a lifetime income stream purchased for $50,000 before or after 1 July 2019.

Figure 1. Annuity assessable asset value



Note: The crossover point where the current rules provide a lower assessable asset value than the new rules varies depending on the age and gender of the client

Figure 2. Annuity assessable income value (pa)



Assumptions for Figures 1 & 2:

- *Immediate lifetime annuity*
- *Purchase price $50,000*
- *Owner is a 67 year old female, life expectancy 20.33*
- *Annual payment $2,736 indexed at 3%pa*
- *Deductible amount $2,459*

Assets test

Figure 1 shows that under the assets test, where the lifetime income stream is purchased under the new rules, it has a lower assessable asset value for the first nine years when compared to a lifetime income stream purchased under the current rules (though the crossover point varies depending on the age and gender of the client). The lower asset value in early years is due to the upfront 40% asset test reduction.

However in this example, after nine years the lifetime income stream purchased under the current rules has a lower assessable asset value due to asset test depletion. The formula to calculate the assessable asset value under the current rules is:

> Purchase Price – [((Purchase Price – Residual Capital Value) / Relevant Number) × Term Elapsed]

For asset tested clients, this creates a conundrum. Should the client purchase an income stream under the new rules and receive an upfront benefit or should they purchase the income stream under the current rules to receive a postponed benefit?

Income test

Under the income test, the graph shows that the lifetime income stream purchased under the new rules has a higher amount of assessable income until age 94. This is because the assessment of 60% of the indexed annual payment is generally higher than annual payment minus deductible amount assessment under the current rules. The formula to calculate the assessable income value under the current rules is:

> Annual payment – [(Purchase Price – Commutations – Residual capital value)/Relevant number]

For this reason income tested clients, or clients that initially start off assets tested but become income tested in the future, may benefit from purchasing a lifetime income stream under the current rules before 1 July 2019.

Refer to the client scenarios section for more analysis.

> **FirstTech comment**
>
> It is interesting to note that the inclusion of a reversionary beneficiary does not impact the assessable assets or income of a lifetime income stream under the new rules.
>
> This differs from the current rules, where the inclusion of a reversionary beneficiary can reduce the depletion amount (under the assets test) or the deductible amount (under the income test) where the reversionary beneficiary has a longer life expectancy than the primary beneficiary at commencement.

Capital access schedule

When the government introduced "innovative retirement income stream products" into the superannuation and tax legislation, restrictions were placed on the amount that could be commuted from the income stream.

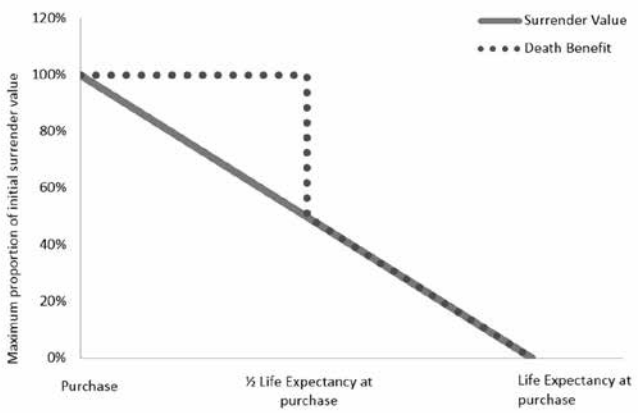
The graph below demonstrates the maximum amount that can be commuted either voluntarily or on death, known as the capital access schedule.

In summary, the maximum amount that can be commuted as a voluntary surrender value is a declining straight-line over the primary beneficiary's life expectancy (or reversionary beneficiary's life expectancy in certain circumstances).

On death, the maximum amount that can be commuted is 100% of the purchase price within the first half of the primary beneficiary's life expectancy, then after this date the declining straight line value applies. No amounts can be commuted from the income stream once they reach their life expectancy.

The capital access schedule is important for social security purposes as lifetime income streams that comply receive a reduced assessable asset value (i.e. 60% of the purchase price assessable until age 84 (or minimum five years), then 30% of the purchase price assessable for the remainder of their life).

Figure 3. Capital access schedule



Example

Ted purchased an immediate lifetime annuity with superannuation monies in July 2019 for $100,000. Under the annuity contract, no amount is commutable as a voluntary commutation.

On death, the amount payable is exactly the same as the capital access schedule, that is, 100% of the purchase price is payable within the first half of the primary beneficiary's life expectancy, then after this date the declining straight line value applies.

As the commutation amounts do not exceed the amounts permissible under the capital access schedule, the annuity receives a reduced assessable asset value, i.e. 60% of the purchase price assessable until age 84 (or minimum five years), then 30% of the purchase price assessable for the remainder of their life.

Under the income test, 60% of the annual payment is assessable.

FirstTech comment

The capital access schedule is the maximum commutation amount permitted under the legislation. However, individual products may provide a commutation amount that is significantly lower than this amount.

For example, some lifetime annuities may have a nil amount that can be commuted voluntarily.

What if they do not comply with the capital access schedule?

Lifetime income streams purchased on or after 1 July 2019 that do not comply with the capital access schedule, that is, allow a higher amount to be commuted than the schedule allows, are assessed differently under the assets test.

In this case, the assessable asset value of the lifetime income stream is the higher of:

- Current or future surrender value
- Current or future death benefit
- 60% of the purchase price assessable until age 84 (or minimum five years), then 30% of the purchase price assessable for the remainder of their life

Note: A legislative instrument is expected under section 1120AB(4) of the Social Security Act 1991 confirming this asset value assessment. At the time of writing this instrument has not been enacted

However under the income test, they are assessed in the same way as other lifetime income streams, that is, 60% of the annual payment is assessable.

Example

Deidre purchased an ordinary money, immediate lifetime annuity in July 2019 for $100,000.

Under the annuity contract, if Deidre dies in the first 15 years the death benefit value is 100% of the purchase price. In addition, she is able to voluntarily commute 100% of the purchase price at a 15 year window (i.e. 15 years after date of purchase).

As these commutation amounts exceed the amount permitted under the capital access schedule, the assessable asset value for social security purposes is the higher of:

- Current or future surrender value
- Current or future death benefit
- 60% of the purchase price assessable until age 84 (or minimum five years), then 30% of the purchase price assessable for the remainder of their life

In this case, the assessable asset value is $100,000 for the first 15 years. After 15 years, as the surrender value and death benefit value are nil, the asset value would be:

- 60% of the purchase price assessable until age 84 (or minimum five years), then 30% of the purchase price assessable for the remainder of their life

Under the income test, 60% of the annual payment is assessable.

Client scenarios

In the following client scenarios we model the long term social security and cashflow implications of purchasing a lifetime income stream, comparing:

- Current rules – purchasing pre 1 July 2019, and
- New rules - purchasing on or after 1 July 2019

Scenarios:

1. Couple – asset tested
2. Single – income tested

Note: the results of all scenarios are in future dollars.

Scenario 1 – Couple age pensioners, asset tested

Ben age 68 and Maria age 66 are a married couple receiving the age pension.

They are homeowners who are asset tested.

Maria invests $200,000 in a reversionary lifetime annuity, paying an annual payment of $10,279pa indexed at CPI.

They also have $20,000 in non-financial assets and $380,000 in financial investments subject to deeming.

In year one:

	Current rules (pre 1 July 2019 lifetime income stream)	New rules (post 1 July 2019 lifetime income stream)
Lifetime annuity assessable assets	$200,000	$120,000
Total assessable assets	**$600,000**	**$520,000**
Lifetime annuity assessable income	$836*	$6,167**
Total assessable income	**$11,911**	**$17,242**
Age pension	**$19,726pa**	**$25,966pa**

**Annual payment $10,279 – deductible amount $9,443*
***60% x $10,279*

In year one, purchasing a lifetime income stream under the new rules (post 1 July 2019) results in a higher rate of age pension. As they are asset tested, assessable assets under the new rules (60% of purchase price) results in less assessable assets than the current rules (100% of purchase price initially assessable, then depletes over time).

However it's important to look at the impact on their age pension entitlement over time. Figure 4 shows that the new rules result in a higher age pension for the first nine years of the projection. However after nine years, the current rules provide a higher rate of age pension for the next 20 years.

On a cumulative basis, the Figure 5 shows that the new rules provide additional age pension of approximately $30,000 by year nine, but then this benefit is reduced to almost nil by age 100.

Figure 4. Age pension results

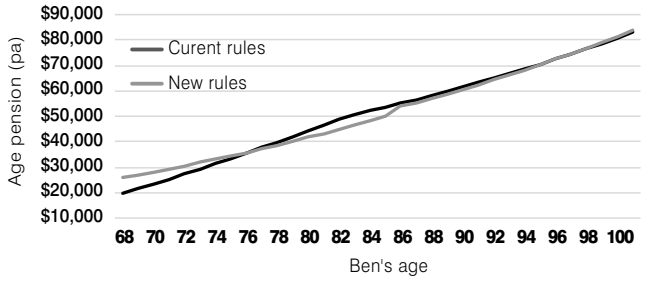
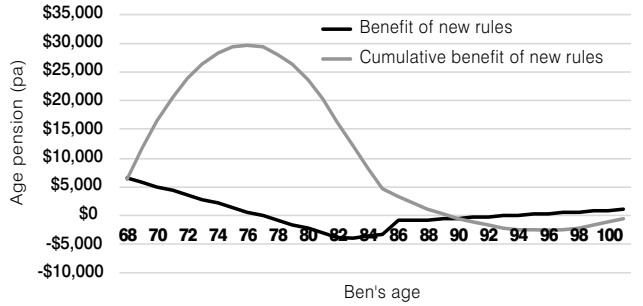


Figure 5. Difference in age pension



This scenario illustrates that asset tested clients may be better off purchasing a lifetime income stream under the new rules (post 1 July 2019) as they receive a higher upfront rate of age pension, however over the long term the value of this benefit reduces to nil by age 90 when compared to the current rules.

It's important to note when comparing these results that we have assumed that the client lives to age 100. If they were to pass away at an earlier age, for example at age 85, the new rules would provide a higher cumulative benefit.

Scenario 2 – Single age pensioner, income tested

Dorothy age 67, is a single age pensioner. She is a homeowner who is income tested.

She invests $100,000 in a lifetime annuity, paying an annual payment of $5,472pa indexed at CPI.

Dorothy also has $20,000 in non-financial assets and $120,000 in financial investments subject to deeming.

In year one:

	Current rules (pre 1 July 2019 lifetime income stream)	New rules (post 1 July 2019 lifetime income stream)
Lifetime annuity assessable assets	$100,000	$60,000
Total assessable assets	**$240,000**	**$200,000**
Lifetime annuity assessable income	$553*	$3,283**
Total assessable income	**$3,685**	**$6,415**
Age pension	**$24,081pa**	**$23,110pa**

**Annual payment $5,472 – deductible amount $4,919*
***60% x $5,472*

In year one, purchasing a lifetime income stream under the current rules (pre 1 July 2019) results in a higher rate of age pension. As Dorothy is income tested, assessable income under the current rules (annual payment – deductible amount) results in less assessable income than the new rules (60% of annual payment).

Figure 6 looks at Dorothy's age pension over time. Figure 7 shows that on a cumulative basis, Dorothy is approximately $20,000 worse off (in future dollars) under the new rules.

Figure 6. Age pension results

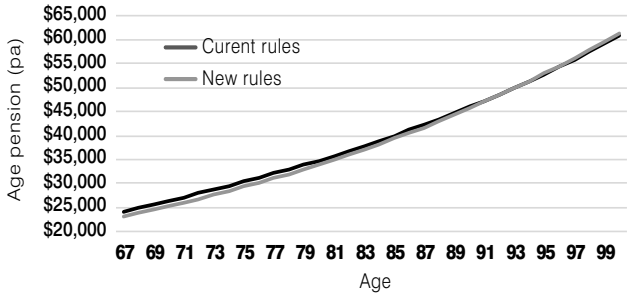
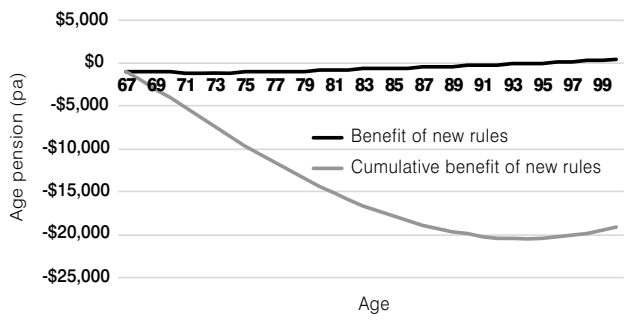


Figure 7. Difference in age pension



This scenario illustrates that income tested clients may be better off purchasing a lifetime income stream under the current rules (pre 1 July 2019).

Advice implications

Whether a client is better off purchasing a lifetime income stream before or after 1 July 2019 is a complex question.

Considerations include:

a) Whether the client is income or asset tested for social security purposes over their retirement
b) How much they value access to capital
c) Whether they are an aged care resident.

Income or asset tested

It is important to consider whether the client will be income or asset tested over the entire projection period, not just the first year. In many cases, the client's preference for upfront benefits will need to be compared to their preference for future benefits when determining whether to purchase a lifetime income stream before or after 1 July 2019.

- For asset tested clients
  - o Clients receive an immediate upfront benefit of a 40% discount if they purchase the lifetime income stream on or after 1 July 2019. However after a certain number of years (generally 7 to 12), there is a crossover point where pre 1 July 2019 income streams produce a higher amount of age pension.
  - o The question is whether the client prefers an upfront benefit or a postponed benefit. Factors such as life expectancy and the probability of future legislative changes need to be taken into account.
  - o Another important consideration is whether the client becomes income tested over time. In this case, purchasing the lifetime income stream pre 1 July 2019 may achieve a better result when the client later becomes income tested.
- For income test tested clients
  - o Purchasing a lifetime income stream pre 1 July 2019 generally results in a lower amount of assessable income than post 1 July 2019.
  - o In addition, consideration should be given to purchasing a superannuation deferred lifetime income stream, as generally no income is assessable during the deferral period (see section on deferred income streams below for more information).

Access to capital

Another important consideration is whether the client wants access to the capital in the lifetime income stream that exceeds the capital access schedule

- Some clients may have a strong preference for access to capital. For example, there are lifetime income streams currently on the market that allow a client to commute up to 100% of the purchase price at year 15.
- For these clients, there may be an advantage in purchasing the lifetime income stream pre 1 July 2019, as it will be assessed under the current rules which deplete the asset value to nil by life expectancy. In contrast, if they purchased a lifetime income stream that does not comply with the capital access schedule post 1 July 2019, the higher of the surrender value or death benefit (if greater than the standard assessment of either 60% or 30% of the purchase price depending on the client's age) would be an assessable asset.

Aged care residents

There are a number of special considerations if the client is an aged care resident. The new legislation significantly changes the income and assets test assessment of lifetime annuities that contain a life insurance component.

In many cases, purchasing these products before 1 July 2019 will result in lower assessable assets and income for both social security and aged care fee purposes.

See "investment-type life policies" in Part Two of this paper for more information. FS

Part two of this paper, published next week, will discuss the more complex aspects of the new rules including the assessment of deferred income streams, reversionary income streams and annuities than contain life insurance.