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Account-based pensions

1 July 2019 (updated annually)

You've spent your life accumulating your super and now you are nearing those retirement years you've been dreaming about. What happens now? How can you ensure that you are going to get the most out of your super?

One option that you can look into is an account-based pension (sometimes referred to as a super income stream). This will provide you with a regular and tax-effective income stream during your retirement.

What is an account-based pension?

You use the money you have accumulated in super to purchase an income stream, or account-based pension, that will pay you a regular income from your super. The income stream will usually be available once you've retired from work but in some circumstances, you may be able to access the money before you retire.

Every year you will need to withdraw a minimum pension payment, which will be calculated according to your age. There is no maximum payment amount limit, unless the pension was commenced as part of a transition to retirement pension.

Your account-based pension account can hold a range of investments – including shares, fixed interest, cash and managed investments – depending on the investments offered by your fund. However the maximum an individual can use to purchase an account-based pension is generally $1,600,000.

Benefits of choosing an account-based pension

Tax benefits

- The main benefit of choosing an account-based pension relates to the tax savings. An account-based pension can be more tax-effective than taking your super as a lump sum.
- The earnings from investments in your account are tax-free. These tax-free earnings remain in your account and increase the account balance.
- Also, lump sum and pension payments from your account-based pension are tax-free once you turn 60.

Prior to retirement

A transition to retirement pension is a more restrictive form of an account-based pension because lump sums cannot generally be received. So remember to set aside funds outside super to supplement income. However, a transition to retirement pension does not benefit from the same tax-free earnings as a full account-based pension.

Some of the benefits of a transition to retirement pension include:

- The proportion of the tax-free component of your account-based pension balance at commencement will be returned as tax-free pension payments if you are between preservation age and 59.
- If you have reached your preservation age but have not yet turned 60, the portion of your payment that is taxable will be assessed at your marginal rate, but you will also be entitled to a tax rebate of 15 per cent based on the taxable component of the payment.

What's your preservation age?

When were you born?	Your preservation age

Before 1 July 1960	55
1 July 1960 – 30 June 1961	56
1 July 1961 – 30 June 1962	57
1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
After 30 June 1964	60

Flexibility

- By investing in long-term growth assets, any returns you make should result in an increase in the value of your investment.
- If you are balancing your account-based pension income with other income sources, you are able to vary the amount of income you receive and the frequency and timing of each payment, depending on your changing needs. However, a specified minimum payment must be taken each year.

Centrelink

Centrelink uses deeming to assess income from financial investments. From 1 January 2015, the deeming rules are used to assess income from account-based pensions.

Deeming assumes that financial investments are earning a certain rate of income. The current deeming rates from 1 July 2019 are:

- 1.75 per cent on investments up to $51,800 for a single (up to $86,200 for a pensioner couple)
- 3.25 per cent on investments over $51,800 for a single (over $86,200 for a pensioner couple).

If you were receiving an income support payment on 31 December 2014 and had an account-based pension, this pension is grandfathered and is not assessed under the deeming rules.

However, if you choose to change an existing pension to a new pension, or purchase a new pension after 1 January 2015, the new pension will be assessed under the deeming rules. Any choices you make that do not involve changing to a new product (eg changing your investment strategy) will not affect grandfathering arrangements.

If you are an income support recipient with a grandfathered account-based pension and you cease to be paid an income support payment on or after 1 January 2015, the grandfathering provisions will cease to apply.

Estate planning

An account-based pension can run for your lifetime, as long as there is sufficient capital available, and can be transferred to your beneficiary (generally your spouse) after you die. Account-based pensions are a good way to secure an income stream for your spouse.

Case study

Joe

Joe, aged 65, has just retired and has $350,000 in super, all of which is classified as a taxable component. After meeting with his financial adviser, he decided to use his super to commence an account-based pension. Under the levels set by legislation, for the first year of the account-based pension, Joe must draw a minimum of $17,500.

Let's assume Joe wants to receive $30,000 pa as a pension. At marginal tax rates, $30,000 of income normally results in tax payable of $2,242 (excluding Medicare levy and tax offsets). However, as Joe is over 60, the pension is paid 100 per cent tax-free.

Belinda

Belinda is retired and 56 and has the same super balance as Joe. Her minimum payment requirement is $14,000. However, she wants $30,000 instead. Normally, the tax payable on this at marginal tax rates is $2,242. However, as Belinda has reached her preservation age (56), she receives a 15 per cent tax offset on the pension payment on the taxable component. This completely eliminates her tax liability. The Medicare levy may still apply.

Nominating a reversionary beneficiary

When you start an account-based pension, an important decision you need to make is how the remaining balance of your pension will be distributed upon your death (assuming, of course, that there is some money left).

With regard to your account-based pension, you can generally make the following nominations:

1. **Nominated beneficiary** – while you may provide direction to a super fund trustee, it does not guarantee that your death benefit will be paid to the person you have nominated and/or your estate.
2. **Reversionary beneficiary** – the nominated person (generally a spouse) will automatically continue to receive the pension after your death.
3. **Binding death benefit nomination** – you have certainty that your superannuation benefit will be paid to the beneficiary you nominate – there is no trustee discretion. Your beneficiary may then choose how they want to receive the benefit; either in the form of a pension, a lump sum or a combination of both. These nominations must be updated at least every three years.

Why choose a reversionary beneficiary

Under the nominated beneficiary option, the fund's trustee will always have ultimate discretion as to who will receive your super death benefits. A binding nomination option may not always be valid (eg if your circumstances change and you forget to revise your nomination). The reversionary beneficiary option, however, is the option that will provide greater certainty that your intended beneficiary (provided they are an eligible dependant at death) will receive an ongoing pension following your death.

Because of the restrictions on pension payments to child beneficiaries (ie benefits must be commuted and paid out when the child turns 25), many superannuation funds only permit a reversionary option to a spouse.

Advantages of a reversionary pension

- Generally, the pension is tax-free, or at least concessionally taxed, depending on the age of the deceased person as well as their beneficiaries at date of death.

Age of deceased/dependant	Tax component	Tax treatment
If either or both aged 60 or over	Tax-free	No tax payable
	Taxable - taxed element	No tax payable
If both under age 60	Tax-free	No tax payable
	Taxable - taxed element	Marginal tax rate, but 15% tax offset applies

- Earnings and capital gains on pension assets are tax-free (in the fund).

- A death benefit paid as a pension would retain funds in the super environment. By receiving a death benefit as a lump sum, some beneficiaries may not be able to contribute that money back into a superannuation fund due to certain restrictions imposed by law.
- There is no urgency to deal with death benefits at a time of grief as the pension automatically switches from the deceased to the reversionary beneficiary.
- Anyone who has an account-based pension has a transfer balance cap of $1.6 million dollars. A reversionary account-based pension is not counted towards their transfer balance cap until 12 months after the death of their spouse. This allows them time to decide what action to take and to accumulate tax free earnings for a year.

Disadvantages of a reversionary pension

- Funds are not readily available to pay off non-deductible debts; however your beneficiary may withdraw a lump sum from the pension, up to the full amount of the pension if necessary.
- The nomination is not usually able to be modified or removed without re-commencing the pension.

Things you should consider

Make sure you have the right strategy in place so that your investment has the potential to grow and you are not just drawing from your retirement savings.

You need to be aware that account-based pension payments are not guaranteed to last your lifetime. As they are linked to the market performance, if markets rise or fall, your pension payments may increase or decrease from one year to the next.

Your account-based pension payments will cease once the account balance is exhausted.

You should also keep in mind issues that may interrupt your retirement strategy, such as the possibility of redundancy or an unplanned early retirement.