

Advice Guide - Superannuation Income Streams

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How to read this document

Managing your finances to meet your day to day requirements as well as your long-term goals can be a complex task. There are all sorts of issues you need to consider such as taxation, legislation, protecting your wealth and assets, associated costs and the inherent risks of investment. When undertaking a financial plan it is important that you understand how these issues will impact on you and what you should expect over time.

This document contains general information about the benefits, costs and risks associated with certain product classes and strategies. It is designed for use in conjunction with a Statement of Advice that takes into account the circumstances and objectives of an individual. Before making a commitment to purchase or sell a financial product, you should ensure that you have obtained an individual Statement of Advice prepared by WARR HUNT Pty Ltd.

As legislation may change, you should ensure you have the most recent version of this document.

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For your ideal life

Superannuation Income Streams

When approaching retirement, an important consideration is how to invest your savings including superannuation so you are able to replace your wage with regular income throughout retirement.

When it comes to choosing how to structure your investments in retirement, it is important to invest in a tax effective way and maintain flexibility to cover any unforeseen changes in your circumstances.

Some of the options available to fund your retirement include:

- investing outside the superannuation environment (this may involve cashing out all or part of your superannuation benefits as a lump sum payment);
- using all or part of your retirement savings to buy a regular income stream such as an annuity or a superannuation pension, *or*
- a combination of both the above.

Investing outside superannuation

Depending on your requirements for income and access to capital, you may choose to invest outside the superannuation environment. You could choose to purchase investments such as property, managed funds or shares, or you could use your funds to pay off loans or to take a holiday.

As part of this strategy, you may also choose to withdraw your funds from superannuation.

Factors to be aware of

- Depending on your circumstances, you may be liable to pay lump sum tax on any amounts you withdraw.
- Generating income from investments held outside superannuation may not be the most tax effective option for you.
- If you make a lump sum withdrawal from superannuation to invest into non-superannuation investments, you may lose access to tax-free income/earnings or the tax offset generally associated with income streams commenced with superannuation benefits.
- If you make a lump sum withdrawal from superannuation to invest into non-superannuation investments, you may lose the opportunity to reinvest your funds into superannuation at a later date.
- Investing outside superannuation may impact on any current or future Centrelink benefits which you may be eligible for.

Superannuation - taxed and untaxed funds

Most superannuation funds are **taxed** funds, meaning earnings within the fund are taxed. This includes public offer funds, industry funds and self managed superannuation funds.

Some funds however are **untaxed** and different taxation rules apply for these, particularly when taking a benefit as a lump sum or an income stream. Examples of untaxed funds include the Commonwealth Superannuation Scheme (CSS and PSS). Specialist advice should be sought in relation to funds such as these.

What is a superannuation pension?

The main type of income stream available in today's market is a superannuation pension. A superannuation pension is a retirement income stream that can only be purchased with money held in superannuation.

With this type of investment, all earnings generated are reinvested back into the account. Regular income payments are paid until the account balance is exhausted. Furthermore, if you have met a full condition of release, any earnings generated or capital gains in the account are not subject to tax. This will be the case where you have reached age 65, or in the event that you notify the fund that you:

- Have reached your preservation age and permanently retired;
- Have ceased an employment arrangement after turning 60;
- Have been diagnosed as being terminally ill with a life expectancy of less than 24 months; or
- You become permanently disabled.

The amount that you can use to commence tax-free retirement phase pensions is limited by the transfer balance cap and may be subject to indexation. Penalties will apply for excess transfers. Superannuation savings above this amount can either:

- remain in the accumulation phase of superannuation where earnings are taxed at 15%, or
- cashed out of the superannuation system and earnings taxed at marginal tax rates.

Account Based Pensions

The benefit of a pension is income payments are tax free after the age of 60 or concessional tax between preservation age and 60.

You are able to choose the amount of income you receive subject to minimum payment percentages set by the Government. No maximum will apply with the exception of TRIS pensions – see below for more details. The minimum amount of your pension is the account balance multiplied by the percentage factor. You are able to choose the payment term i.e. monthly, quarterly, half-yearly or annually depending on the product offering.

Earnings including capital gains on assets supporting Account Based Pensions are tax exempt if you have met a full condition of release up to the transfer balance cap.

You are able to access your capital funds at any time and have the flexibility to make withdrawals in addition to your income payments.

You are generally able to choose from a number of different investment options from which your pension payments will be drawn. This gives you some control over how your money is invested.

Transition to Retirement Income Streams (TRIS)

You may be able to commence TRIS when you reach your preservation age (55-60 depending on your date of birth). You are able to choose the amount of income you receive subject to minimum and maximum payment percentages set by the Government. The maximum is 10%.

The minimum/maximum amount of your pension is the account balance multiplied by the percentage factor. You are able to choose the payment term i.e. monthly, quarterly, half-yearly or annually depending on the product offering.

Earnings on assets supporting TRIS pension accounts will be taxed at the superannuation fund tax rate of up to 15%. Once you meet a full condition of release your pension earnings will be tax free.

Taxation of superannuation pensions (this applies only to taxed funds)

Superannuation pension accounts may include both tax-free and taxable components. The proportion of each is based on the fixed percentage of these components at the commencement of the superannuation pension.

Each income payment (and commutation amount) from a superannuation pension will be deemed to include both taxable and tax free components and you cannot choose which component(s) to draw your pension from. This is known as the proportional drawdown regime.

Income payments for those aged 60 and over are entirely tax-free regardless of the underlying tax components. For those preservation age to 59, the tax free component of the income payment is free of Pay As You Go (PAYG) tax and the remainder (taxable portion) of the pension payment, is taxed at your marginal tax rate with a 15% tax offset.

Factors to be aware of

- The term of the pension is not guaranteed which means your money may not last throughout your retirement. The pension ends once the account balance has been fully paid to you.
- Your investment returns will fluctuate depending on economic and market conditions which means your investment can increase or decrease in value.
- Tax may be levied on any remaining pension balance on death (for example, if paid as a lump sum to a non-financially dependant beneficiary, such as an adult child).
- Payments from a death benefit income stream received by a tax dependant who is under age 60 will be subject to concessional rates of tax on the taxable component if the deceased was also aged under 60 at the time of death. If the deceased or beneficiary is over age 60, the income payments are tax-free.
- Generally, death benefits are also assessed against the transfer balance cap.

Estate Planning

There is no mortality risk which means if you die before the capital invested (plus any investment earnings) is exhausted, the balance will be paid out to your nominated beneficiary, your estate, or legal representative. If, upon death, the account balance is paid to a dependant such as a spouse or a child under 18 years of age, the lump sum will usually be paid tax-free. Should it be paid to a non-dependant, such as a child over 18 years of age, taxation may apply.

Annuities

Another method of providing an income stream in retirement is via an annuity. An annuity is an investment that pays a series of regular guaranteed income payments for either a fixed period of time or for life. They may be purchased with superannuation funds or non-superannuation monies.

- If superannuation funds are used, income payments receive the same tax treatment as superannuation pensions.
- If non superannuation monies are used, a tax-free amount for each payment will be calculated, representing your return of capital.

Key features of fixed term annuities

- You nominate the term of the annuity and the payment frequency.
- You have certainty your income will not run out during the annuity term. The payments are guaranteed over this period.
- The flexibility to choose whether your income payments will remain level or be indexed each year to keep pace with increases in prices due to

- You can choose whether you would like to have a portion of your capital returned to you as a lump sum at the end of the term and the amount of this lump sum.
- As it is not market linked, you are protected from adverse movements in investment markets. Instead, you lock in the applicable interest rate at the time the investment is made.

Key features of lifetime annuities

- It can revert to a spouse upon death of the original annuitant.
- You have certainty your income will not run out during your lifetime. The payments are guaranteed.
- You can elect to apply a 'guaranteed period'. This means that if you die during this period a lump sum may be payable to your estate or nominated beneficiary. In some cases, this may be less than you originally invested as it is influenced by a number of factors including prevailing interest rates at the time the lump sum is paid and the original terms of the annuity.
- You can determine the frequency of the income payments.
- You can choose whether your income payments remain level or are indexed each year to keep pace with increases in prices due to inflation.
- As it is not market linked, you are protected from adverse movements in investment markets. Instead, you lock in the applicable interest rate at the time the investment is made.
- Part of the income you receive may be tax free.

Factors to be aware of

- A lifetime annuity has nil residual capital value, meaning nothing is paid to your dependants or estate upon your death. The exceptions are if you have selected a reversionary annuitant or if a guaranteed income period has been selected and you pass away within this period. In this event, your beneficiaries or estate will only receive what would have been paid to you during the guaranteed period. Depending on how long you live, there could be an overall loss of capital.
- It is not investment linked so your capital will not grow and you cannot take advantage of favourable market movements.
- Annuities purchased with superannuation money will be counted against the transfer balance cap. The taxation of payments to you may be impacted if you have superannuation income streams that exceed the transfer balance cap and are unable to lower your superannuation income streams below the cap threshold.
- You are locked in to a specific rate of return for the rest of the term (or life). If interest rates rise, you are not able to take advantage of the higher potential return without incurring penalties.
- Once the annuity is established, the amount and frequency of the income payments cannot be altered.
- Your options are restricted if your circumstances change as generally speaking, you cannot withdraw a lump sum. Penalties apply to any withdrawals.
- The income of an annuity is assessed by the Centrelink and Department of Veteran's Affairs income test as follows:
 - subject to deeming rates where the term is five years or less, or
 - total income is reduced by a 'deductible amount' where the term is more than five years.
- NOTE: If your life expectancy is equal to or less than five years, the income assessment will be total income reduced by a 'deduction amount'.
- The investment amount of an annuity is assessed under the Centrelink and Department of Veteran's Affairs Assets Test. If you choose to receive all of the capital at the end of the selected term, the assessed asset value does not change. If you choose to have some of the capital returned as part of the regular payments, the asset value is recalculated every six to 12 months and reduced by the amount of capital returned up to that time.