Retirement Income – Annuities

An annuity is an investment that pays a series of regular guaranteed income payments for either a fixed period of time or for life. Subject to the terms of the particular annuity you purchase, the provider may offer a range of features and benefits across their suite of products. We have summarised some of the benefits that may be on offer below. Annuities can be purchased with either superannuation or non-superannuation money.

Key features of Fixed Term Annuities

- You nominate the term of the investment 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 inflation.
- 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.
- The income from your annuity may be paid directly to a beneficiary or your estate if you pass away before the end of the term.

Key features of Lifetime Annuities

- You may be able to elect for the annuity to continue to be paid to your spouse upon your death as the original annuitant.
- You have certainty your income will not run out during your lifetime. The payments are guaranteed.
- You may be able to elect to apply a 'guaranteed period'. Depending on the particular annuity, this may mean the income will continue to be paid for a guaranteed minimum period of time, even if you pass away during the guaranteed period. Alternatively a lump sum amount may be payable.
- 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.

How it works

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 money.

If superannuation funds are used, income payments receive the same tax treatment as superannuation pensions.

If non superannuation money is used, a tax free amount for each payment will be calculated, representing your return of capital. The amount above your return of capital is taxable income.

How are Annuities assessed for social security purposes?

Both lifetime annuities and 100% capital return annuities with terms of six years and above receive favourable treatment under the asset and income tests for Centrelink/Department of Veterans' Affairs

(DVA) income recipients and daily aged care fees. This treatment also applies if the term is less than six years but is equal to or greater than the life expectancy of the owner.

The income of an annuity is assessed by Centrelink/DVA's 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' that reflects a return of the purchase price where the term is more than five years.

The amount you invest into an annuity is assessed under Centrelink /DVA's 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.

<u>Complying annuities</u>

Certain annuities receive favourable assessment under the assets test and are generally known as 'complying annuities'. Some of the key features of complying annuities include:

the annuity is non-commutable meaning you are unable to make lump sum withdrawals
the term established when the annuity was purchased met the requirements of the legislation, and
limitation on the ability to have the annuity paid to a reversionary beneficiary.

If all the criteria in the legislation was satisfied, the exemption under the assets test would be:

100% if purchased prior to 20 September 2004, or
50% if purchased from 20 September 2004 but before 20 September 2007.

In limited situations, you may be able to commute a complying annuity but generally only to purchase another complying annuity. Care should be taken as the favourable assets test treatment may be lost if the new annuity does not have the appropriate characteristics.

If an annuity reverts to a beneficiary, it may be reassessed at that time against the criteria including the beneficiary's age. This may result in a loss of the favourable assets test treatment.

Benefits

Benefits of an annuity can include:

- **Security** - Your interest and capital payments are guaranteed, regardless of share market movements or interest rate fluctuations.
- **May be a variety of options for terms and payment frequency** - Before you purchase an annuity you can choose your investment term. Fixed term annuities are generally available for fixed terms of between one and 50 years. The investor selects the term most appropriate to them.
- **The term of a lifetime annuity is the rest of the investor's life** - income payments continue until you die. It can be as short as one year or even for your lifetime.
- **Payment frequency** - You can select how often you get paid - monthly, quarterly, half-yearly or annually.
- **Inflation protection** - With some annuities, you can elect to index your payments so they keep pace with inflation or at a fixed rate of indexation.
- **Tax effectiveness** - When an annuity is bought with money rolled over within the superannuation system by a person aged 60 or over, the regular payments are tax free. Favourable tax treatment applies for annuities purchased with superannuation money if the person has reached their preservation age but still under age 60.

- **Access to your money** - If you would like to cancel your annuity, in most cases you will receive a return of your investment but you may receive back less than you invested originally and less than you would have received had you held the annuity for its agreed term.

Risks, consequences and other important things to consider

These may include:

- 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.
- You are locked into 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 may apply to any withdrawals.
- Annuities purchased with superannuation money are counted against your transfer balance cap. The general transfer balance cap is $1.7 million for the current financial year and may be subject to indexation. Your personal transfer balance cap may be between $1.6 million and $1.7 million if you commenced a retirement phase income stream prior to 1 July 2021. Penalties apply if this cap is breached. The taxation of payments from these annuities may be impacted if the value of your annuity exceeds your transfer balance cap and you are unable to commute an amount to reduce the assessment against your transfer balance cap. The way in which an annuity is valued to determine the amount that will count towards the transfer balance cap will depend in part, on whether you purchased the annuity before or after 1 July 2017. These rules are complex.
- The income of an annuity is assessed by Centrelink /DVA 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 (if your life expectancy is equal to or less than five years, the income assessment is also the total income reduced by a 'deduction amount').
- The investment amount of an annuity is assessed under Centrelink /DVA 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.
- In limited situations, some annuities are considered 'complying' and may receive favourable treatment under the assets test for Centrelink /DVA. These complying annuities may have a 100% or 50% assets test exemption. Care should be taken as this treatment may be lost if able to commute to purchase a new complying annuity or upon payment to a reversionary beneficiary.

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conjunction with a Statement of Advice ('SOA'), any personal financial advice relevant to the financial planning concept/strategy referred to in this document will be contained in that SOA.
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