DISCLAIMER

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INTRODUCTION

The two chapters in this booklet – Retirement Planning and Aged Care Planning 2017-18 – are from Thomson Reuters’ Australian Financial Planning Handbook 2017-18.

Challenger is the author of these two key chapters and is pleased to provide them to you in this booklet.

As the chapters are extracts from the Thomson Reuters’ Australian Financial Planning Handbook 2017-18, the paragraph numbers and section references have not been altered for this booklet and appear as they are in the Handbook.

The Thomson Reuters’ Australian Financial Planning Handbook 2017-18 also includes expert and updated coverage of financial services compliance issues, including the Future of Financial Advice (FoFA) reforms, special chapters on Providing Advice and on Regulation and Licensing, superannuation changes (especially SMSFs), ASIC requirements, as well as other chapters on CGT for Investors, Estate Planning, Financial Planning for Small Business, and a special Developments to Watch chapter.

If you would like to purchase the Thomson Reuters’ Australian Financial Planning Handbook 2017-18 in its entirety, please contact the Thomson Reuters Customer Support team on 1800 074 333, or visit tax.thomsonreuters.com.au.
By Sean Howard, Technical Services Manager, Challenger Limited

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Chapter objectives and relevance for financial planners

The need to plan for retirement is widely acknowledged but many people fail to take action.

This chapter seeks to enable financial planners to project the level of savings required to satisfy a client’s lifestyle expectations and goals in retirement. A person could be in retirement for over a third of their life, hence the need to accumulate a significant amount of capital over their working life to fund a
comfortable lifestyle in retirement. Developing a retirement plan as early as possible enables a financial planner to establish a trusted relationship with a client. Building a lifelong relationship will deliver benefits to the client as they face key financial events (when trust is at a premium), and provide an adviser with an ongoing source of business.

Coverage is provided on how to develop a retirement plan with a client to enable them to implement achievable goals via some basic, but highly effective, long-term saving strategies. With some careful planning over the various life stages, a financial planner can set their clients on the road to achieving, or at least maximising, retirement lifestyle expectations. To achieve this objective, a financial planner needs a detailed understanding of the complex interaction of the ever-changing rules for superannuation, tax and social security.

After accumulating wealth over a working life, the next step involves managing the transition to the retirement income phase. This is an important time for both the client (and adviser) given the daunting responsibility of deploying a lifetime of savings to provide an income for potentially decades of retirement. This chapter sets out details on the retirement income options (e.g., account-based pensions) that are available to provide a replacement for employment income. The Age Pension is another important source of retirement income for many.

Finally, when implementing a retirement income strategy, a financial planner must keep in mind the intergenerational wealth transfer issues for any unused superannuation assets that will ultimately be transferred to the next generation (i.e., the adviser’s next client). This chapter maps out some basic estate planning strategies to consider when establishing a retirement income.

INTRODUCTION

Retirement planning – overview

Retirement planning essentially involves developing a strategy for an individual to accumulate enough wealth during her or his working life in order to satisfy lifestyle expectations and goals in retirement.

Increasingly, more people are aware of the need to save for retirement as they become conscious of the implications of an ageing population and longer life expectancy. Many would also like the opportunity to retire before age 65 or appreciate that the Age Pension and Pension Supplement alone ($23,096 for a single and $34,819 for a couple as at 1 July 2017) will not meet their retirement lifestyle expectations. In addition, the qualifying age for the Age Pension is progressively increasing from age 65 to 67 by July 2023 (and has been proposed to further increase to age 70 by 2035): see [14 425].

Generally, it is necessary to accumulate a significant amount of capital to fund a comfortable lifestyle in retirement. Therefore, developing a retirement plan as early as possible will enable a person to reconcile retirement with achievable goals available via some basic, but highly effective, long-term saving strategies. Although the need to plan for retirement is widely acknowledged, many people fail to plan adequately or leave it until they are approaching retirement age and are faced with the reality of assessing whether they can
afford to retire. Others find the concept too difficult due to the complex aspects of superannuation, tax and social security. However, with some careful planning and guidance, people can set themselves on the road to achieving, or at least maximising, their retirement lifestyle expectations.

The first step in retirement planning involves developing a strategy based on a client’s achievable goals and their individual circumstances. A key component of this strategy involves selecting an appropriate retirement savings vehicle, such as superannuation. Although saving via the superannuation system involves locking money away until at least age 56 (phasing up to age 60), it allows money to accumulate in a concessionally taxed environment. In addition to the compulsory Superannuation Guarantee system which requires employers to make contributions for all employees (see [9 300]-[9 335]), there are also other tax and government incentives to encourage superannuation contributions. Furthermore, reforms since 1 July 2007 (see [9 025]), have enhanced the concessional tax status and retirement income flexibility of superannuation. However, superannuation contributions are subject to annual contributions limits: see [9 210] and [9 220]. Therefore, it is necessary to start early to build significant wealth in the superannuation environment.

Nevertheless, superannuation is not the only option for accumulating wealth to provide money in retirement. Although some 90% of the workforce has some superannuation coverage, many are outside the compulsory Superannuation Guarantee regime (ie non-employees) or do not want to lock away additional savings that may be required for more immediate purposes, eg saving via the family home or financing a small business: see [16 000].

After accumulating wealth over a working life, the final step in retirement planning involves managing the transition from the accumulation phase to the retirement income phase. This often involves setting up an appropriate privately-funded pension (eg an account-based pension) and carefully planning for the interaction with the social security system (where relevant).

[14 003] Retirement income policy

The government has a 3-pillar approach to providing retirement income comprising:

1. a means tested Age Pension funded from general tax revenue;
2. compulsory employer superannuation contributions through the Superannuation Guarantee system; and
3. voluntary private superannuation contributions supported by tax incentives and the government co-contribution scheme.

Age Pension

The Age Pension was introduced in 1909 and provides basic income support in retirement for people who are unable to fully support themselves. The eligibility for the Age Pension is determined by residency, age and the income and assets of the person. Applicants must be Australian residents and in Australia on the day the claim is lodged. Age Pension age is currently 65.5 but is legislated to increase gradually to 67 by 2023.

The maximum rate of Age Pension is currently benchmarked to Male Total Average Weekly earnings at 27.7% for singles and 41.3% combined for couples.
The Age Pension entitlement is subject to an income and assets test with the test producing the lower amount determining how much is payable.

Recipients of the Age Pension receive the Pensioner Concession Card which gives them access to discounted medicines under the Pharmaceutical Benefits Scheme and various concessions from Australian, State and Territory Governments. Recipients may also receive Rent Assistance which provides financial help to those who pay rent.

**Superannuation Guarantee**

The Superannuation Guarantee was introduced in 1992 and is a compulsory system requiring employers to contribute a minimum level of superannuation contributions for employees. The prescribed minimum is currently 9.5% of ordinary time earnings but is legislated to increase gradually to 12% by 2025.

Superannuation Guarantee contributions must be made for employees who earn more than $450 in a month. Employers must make compulsory superannuation contributions quarterly and there is no age limit to make contributions.

**Voluntary superannuation contributions**

Voluntary superannuation contributions are personal contributions and additional employer contributions above the Superannuation Guarantee. These contributions are encouraged by tax incentives and the government co-contribution.

Employer contributions are subject to contributions tax which otherwise would be taxed at marginal tax rates. Earnings within superannuation are taxed at 15% in accumulation phase and are exempt from tax while in pension phase.

The government co-contribution scheme provides matching contributions for low income earners who make personal contributions. The matching rate is 50% of personal contributions up to a maximum of $500.

**Retirement Income Streams Review**

In July 2014, the Government released the *Review of retirement income stream regulation* discussion paper which sought feedback on the regulatory barriers restricting the availability of appropriate income stream products and the minimum annual payment amounts for account-based income streams: see [14 405]. In May 2016, the Government released the *Retirement Income Streams Review* in response as part of the Federal Budget accepting the paper’s recommendations.

The discussion paper recommended extending to deferred lifetime annuities the same concessional tax treatment that applies to investment earnings on assets supporting superannuation income streams. This would facilitate the provision of deferred lifetime annuities that could help retirees insure against longevity risk. The Government agreed with the discussion paper’s recommendation and will develop an additional set of income stream rules which would allow lifetime products to qualify for the concessional tax treatment provided they meet a diminishing capital access schedule. The schedule would impose a maximum cap on the value of commutations and death benefits from the product and would operate as an alternative to the existing minimum payment rules.
The discussion paper also made a recommendation to form a basis for consultation on the minimum payment amounts to assess their appropriateness during changing financial market conditions. The Government agreed with the discussion paper’s recommendation and will ask the Australian Government Actuary to undertake a review of the annual minimum drawdown rate every 5 years to ensure they remain appropriate in light of any increases in life expectancy. Any other changes should only be considered in the event of significant economic shocks and based on further advice from the Australian Government Actuary.

Financial System Inquiry


The Inquiry recommended seeking broad political agreement for, and enshrining in legislation, the objectives of the superannuation system. The superannuation system does not have a consistent set of policies that work towards common objectives and this lack of agreed policy framework and objectives reduces the efficiency of the system. Having a consistent policy setting across the accumulation and retirement phases would meet the retirement income needs of Australians more efficiently and effectively. The Government agreed with the Inquiry’s recommendation and will enshrine the objectives in legislation, where it will serve as a guide to policy-makers, regulators, industry and the community about superannuation’s fundamental purpose.

The Inquiry also recommended superannuation trustees be required to pre-select a comprehensive income product for member’s retirement. The product would have minimum features determined by the Government which should include a regular and stable income stream, longevity risk management and flexibility. This product would simplify decisions at retirement and deliver better outcomes for retirees. The Government agreed with the recommendation and will consult further to develop a principles based framework for the pre-selection of a comprehensive retirement income product by superannuation trustees.

Demographic change and increased life expectancy

The government’s retirement incomes policy is increasingly focusing debate and attention on the significant implications stemming from:

- an ageing population;
- longer life expectancy;
- greater lifestyle expectations; and
- fewer taxpayers to support a growing number of retirees.

Population and demographic changes

The Intergenerational Report 2015 projects that Australia’s current population of 23.9 million will grow to 39.7 million in 2055. The 2015 Report also estimates that the proportion of people aged 65 years or over will increase to 22.6% by
June 2055 (up from 15% in 2015). The proportion of the population aged 85 and over is also projected to increase to 4.9% in 2055 (up from 2% in 2015).

Men aged 60 in 2055 are projected to live an average of 31.5 years (5.1 years longer than those aged 60 in 2015) and women an average of 33.3 years (4.2 years longer). In addition, men born in 2055 are projected to live to an average age of 95.1 (3.6 years longer than those born in 2015) and women to age 96.6 (3 years longer).

While the number of people of traditional working age (15 to 64 years) is projected to increase, their proportion in the population is projected to fall. The proportion of people aged over 65 to people of traditional working age is projected to increase from 22.8% in 2015 to 37.4% by 2055.

These changes have obvious implications for retirement planning, namely, more people are approaching retirement age and require a higher level of savings to provide an income over a longer period of retirement. The Australian Life Tables (see [24 350]) also outline the life expectancy for males and females of each age, providing a useful guide as to the required duration of a retirement income. For example, the latest Australian Life Tables 2010-12 indicate that a male aged 65 can expect to live for another 19.22 years, while a 65 year old woman can expect to live another 22.05 years. Importantly, these are only “average” life expectancies. Therefore, it is still necessary to plan for a retirement income period beyond the average life expectancy.

Over the next 20 years, the share of assets held by Generations X and Y are expected to grow from about 46% in 2010 to become the dominant superannuation customers with 84% of all assets in 2030, according to a 2011 report by Deloitte Actuaries and Consultants. The report warns that this growth in post-retirement assets will present challenges for the industry in terms of asset allocations and the degree of volatility suitable for these retirees.

Amidst continued debate regarding potential changes to superannuation, the Association of Superannuation Funds of Australia (ASFA) has released a White Paper, Super system evolution: Achieving consensus through a shared vision, May 2013, which it designed to serve as a basis for a broad consultation process regarding the future of superannuation: see ASFA’s website at http://www.superannuation.asn.au/. ASFA is not advocating a revolutionary new retirement system. Rather, it is proposing that there be consultation on the nature of the evolution of the system given the changing demographics and the economy. ASFA considers that the current system is not broken and is regarded by many international commentators as one of the best in the world. However, it notes that the core of the system was designed when the proportion of older people was not very high and the average life expectancy was much lower.

[14 006] Retiree behaviours

Retirement planning is complicated by behavioural biases which result in retirees making irrational decisions. Behavioural biases relate to how personal preferences affect how information is processed to reach decisions. Retiree behavioural biases include:

- cognitive impairment;
- loss aversion;
Cognitive impairment

Cognitive impairment is the decline in a person’s ability to perceive, remember, judge or reason. As a person ages, their cognitive capacity declines but this is offset by the acquisition of knowledge. Financial decision making requires both knowledge and cognitive capacity. According to various studies, a person’s ability to make good financial decisions peaks at around age 53 and then starts to decline.

Retirees are typically at an age where their ability to make good financial decisions is in decline. The later it is left the more likely the wrong decisions will be made.

TIP

Advisers should ensure clients make key decisions in retirement as early as possible and may consider whether it is appropriate to appoint an enduring power of attorney before significant decline in cognitive capacity.

Loss aversion

Loss aversion is the tendency for a person to strongly prefer avoiding losses to acquiring gains. The average person weighs losses 2 times more heavily than gains. Retirees are up to 5 times more loss averse than the average person meaning they weigh losses 10 times more heavily than gains.

Retirees view loss as a reduction in the value of their investments during a market downturn as well as giving up control of their investments.

TIP

Advisers should explain the importance of providing income in retirement. In accumulation, investment returns are important because it is all about saving as much as possible for retirement. In retirement however, it is all about income and achieving a desired lifestyle goal for a client’s lifetime. Advisers may consider repositioning loss for retirees as running out of income and being unable to meet their retirement goals.

Inertia

Inertia is the tendency for a person to stay with the status quo regardless of whether it is appropriate. The status quo generally involves the retiree choosing the default or not changing what they have done in the past.

Inertia stems from loss aversion and financial literacy. Loss aversion makes retirees reluctant to make financial decisions because they focus on what they can lose rather than what they can gain. Financial literacy is as issue for retirees as their cognitive capacity is declining and they are less capable to make financial decisions.
Advisers need to educate clients about the complexities of retirement and encourage them to make active decisions which will achieve their retirement goals. Advisers should also schedule regular follow-up meetings throughout retirement to keep clients engaged and to ensure goals are met.

**Framing**

Framing is the way information is presented to influence the choice a person makes. Retirees are strongly influenced by the way financial products are described. Products can be described in either the investment frame or consumption frame.

The investment frame focuses on investment returns and account balances where the consumption frame focuses on spending and regular payments. When retirement products are described in the consumption frame they appear more attractive than when they are described in the investment frame.

Advisers should consider describing retirement products in the consumption frame focusing on income needs and not investment returns. This approach may increase the attractiveness of products which may be more appropriate to meet a client’s retirement goals.

**[14 007] Retirement risks**

There are more risks in retirement than there are in accumulation and the same risks in accumulation have more impact in retirement. In accumulation it is primarily market risk that determines if a client will meet their goals when they reach retirement. In retirement there are additional risks that are equally important and when combined together can significantly impact a person meeting their goals. The retirement risks include:

- market risk;
- sequencing risk;
- longevity risk;
- inflation risk;
- contingency risk; and
- political risk.

Most people are familiar with market risk as they have experienced market volatility in accumulation but are unaware of these additional risks or the impact they can have on their retirement goals. It is important to educate clients on the implications of these risks so they understand why they need to be managed to meet their goals: see [14 118].

**Market risk**

Market risk is the risk that market volatility will reduce the value of a person’s investments. Most people understand the benefit of investing in growth
assets for the long term because over 20 years or more the benefit from the equity risk premium has tended to outweigh short-term market volatility. However, investments cannot be left alone in retirement to ride out market volatility as they have to be drawn down to provide cash flow.

**Sequencing risk**

Sequencing risk comes from the interaction of market volatility and regular cash flows needed in retirement. It is common to consider market volatility and not the sequence of returns but whenever there are cash flows out of an investment, the sequence will matter.

It can take 6 to 10 years for markets to recover from large market falls. Regular cash flows are crucial in retirement, and retirees cannot wait that long for their investments to recover before they draw down.

**EXAMPLE [14 007.10] Impact of sequencing risk**

Consider a person who retires today with $600,000 and who withdraws $43,358 per year indexed to inflation. They commence an account-based pension that is 50% allocated to Australian equities and 50% allocated to Australian bonds.

Assume that the retiree experiences 1 of 2 return paths. The first return path is the same as the return path in Australia between 1992 and 2017. The second return path is the same set of returns, but in reverse chronological order.

In the first path, the retiree experiences the 40% market fall of 2008 late in retirement, but in the second return path the retiree experiences the market fall very early in retirement.

Using data from ABS, S&P/ASX accumulation with UBS and Bloomberg AusBond indices, the following graph shows how long the investment would last.

Source: Challenger estimates
If the retiree had experienced the same returns as between 1992 and 2017, they would have approximately $600,000 remaining 25 years into retirement. If they had experienced the same returns, but in reverse order, their investment would have run out 21 years into retirement.

Longevity risk

Longevity risk is the risk that a person will outlive their investments and become entirely dependent on the Age Pension for the last years of their life. No one can predict how long they will spend in retirement as no one knows exactly how long they will live.

Life expectancy

The Australian Bureau of Statistics (ABS) life tables are a commonly used measure of life expectancy, although they are period life tables which don’t take into account improvements in mortality.

Period life table mortality rates are estimated using historical data alone and therefore represent a snapshot of mortality at a particular point in time. Mortality rates have been improving consistently for decades therefore, period life tables are likely to underestimate actual life expectancies.

A forecast of life expectancy should take into account improving mortality rates however, to do this, assumptions need to be made about how much mortality rates are likely to improve. The Australian Government Actuary (AGA) provides an estimate of mortality improvement factors that should be applied to the base table (period life expectancy) to determine how long someone will live. Their actual life expectancy will improve over time with better health and medicine.

<table>
<thead>
<tr>
<th>Age</th>
<th>Male total life expectancy</th>
<th>Female total life expectancy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2011 without improvements</td>
<td>2017 with improvements</td>
</tr>
<tr>
<td>0</td>
<td>80.1</td>
<td>91.1</td>
</tr>
<tr>
<td>15</td>
<td>80.5</td>
<td>90.1</td>
</tr>
<tr>
<td>25</td>
<td>80.9</td>
<td>89.3</td>
</tr>
<tr>
<td>35</td>
<td>81.3</td>
<td>88.5</td>
</tr>
<tr>
<td>45</td>
<td>81.8</td>
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<tr>
<td>55</td>
<td>82.7</td>
<td>87.0</td>
</tr>
<tr>
<td>65</td>
<td>84.2</td>
<td>86.9</td>
</tr>
<tr>
<td>75</td>
<td>86.7</td>
<td>88.0</td>
</tr>
</tbody>
</table>

Source: Challenger estimates

Total life expectancy is dramatically higher when mortality improvements are included with a 65 year old male and female estimated to live approximately 2 years longer than period life expectancy.
It is important to realise that measurements of period or cohort life expectancy are estimates based on averages. By definition, 50 percent of people will live for less than the estimate and 50 percent will live longer.

**Inflation risk**

Inflation is the trend of rising prices of goods and services. Movements in the Consumer Price Index (CPI) which is based on the spending patterns of private households is used to determine the level of inflation.

Most people don’t know what future inflation will do to prices. While the Reserve Bank of Australia (RBA) targets inflation on the 2-3 percent range, inflation has varied a lot historically.

![CPI graph](image)

Source: ABS

Inflation risk is the risk that inflation reduces the real purchasing power of a person’s investments. If Australia were to experience another period like the 1970s or 1980s, retirees would face a large loss of the real purchasing power of their investments.

**Inflation and longevity**

Another problem with inflation for retirees is related to time. Even low inflation rates can have a large impact on purchasing power if the time period is long enough.
If inflation averages 2.5 percent per annum, after 15 years 31 percent of the real value of each dollar will be lost and after 28 years 50% will be lost.

Contingency risk

Contingency risk is the risk of an unexpected and/or uninsurable event that impacts a person physically or financially. Contingency risk is generally higher for retirees as they experience more health issues as they get older.

Unexpected health issues can result in a number of consequences for retirees including:

- significant health care costs;
- loss of ability to live independently; and
- need to move into an aged care facility.

There are 3 stages in retirement where a person: is free of disability; has some disability; and is dependent. On average a retiree will spend more years with some disability or dependency than without.
Age now | Disability free years | Years with some disability | Dependent years | Totals
<table>
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<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Male</td>
<td>Female</td>
<td>Male</td>
<td>Female</td>
</tr>
<tr>
<td>65</td>
<td>9</td>
<td>10</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>75</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>85</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: AIHW

**TIP**
Advisers should consider the possibility of clients requiring aged care later in retirement and the options available to fund the costs. These options may include setting aside funds specifically earmarked for aged care costs, accessing equity in the clients’ home or assistance from family members.

**Political risk**

Political risk is the risk that Government policy change will adversely impact a person’s financial situation. The retirement income system has dramatically changed over the 20+ years from the introduction of the Superannuation Guarantee in 1992 to the Stronger Super reforms in 2010 and more recent changes to the Age Pension eligibility age and assets test taper rate. The Government is currently undertaking a number of reviews and inquiries into the retirement income system and it is set to change even more in the future.

There are a number of areas where Government policy change could have an impact on retirees including:

- increase in superannuation taxes;
- increase in superannuation preservation age;
- reduction in social security entitlements;
- increase in social security eligibility age; and
- increase in aged care costs.

The Government typically applies grandfathering provisions or long lead times so policy change does not impact retirees immediately. However, the Government has also made changes effective when announced with no recourse for retirees.

**[14 015] Estimating retirement income needs**

To calculate the capital amount required for retirement, it is first necessary to determine the income a person will need to meet their retirement lifestyle goal. However, many people find it difficult to estimate the income needed in retirement.

**ASFA Retirement Standard**

The ASFA Retirement Standard provides a benchmark of the annual budgets required to fund either a modest or a comfortable standard of living in retirement. The budgets are broken down into weekly expenditures in retirement.
for singles and couples combined. The budgets assume that the person owns their home outright and is relatively healthy.

A “modest lifestyle” in retirement is better than the Age Pension, but still only able to provide for fairly basic activities. A “comfortable lifestyle” in retirement is defined as enabling an older healthy retiree to be involved broad range of leisure and recreational activities and to have a good standard of living through the purchase of such things as, household goods, private health insurance, a reasonable car, good clothes, a range of electronic equipment, and domestic and occasionally international holiday travel.

<table>
<thead>
<tr>
<th></th>
<th>Single $</th>
<th>Couple combined $</th>
</tr>
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<tbody>
<tr>
<td>Modest lifestyle</td>
<td>24,250 per annum</td>
<td>34,855 per annum</td>
</tr>
<tr>
<td>Comfortable lifestyle</td>
<td>43,665 per annum</td>
<td>59,971 per annum</td>
</tr>
</tbody>
</table>

Source: ASFA

The budgets are indexed quarterly, in March, June, September and December by movements in the CPI.

The ASFA Retirement Standard also provides the capital required at retirement to support either a comfortable or a modest living standard assuming retirement is partly funded by the Age Pension.

<table>
<thead>
<tr>
<th></th>
<th>Single $</th>
<th>Couple combined $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modest lifestyle</td>
<td>50,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Comfortable lifestyle</td>
<td>545,000</td>
<td>640,000</td>
</tr>
</tbody>
</table>

The capital required to support a modest lifestyle is relatively low as the spending requirement is mostly met by the Age Pension.

**Retirement income calculators**

Computer software and various calculators available on the websites of financial institutions can also assist in determining the capital required at retirement for a person to meet their income needs. However, such calculators need to be approached with caution and consideration of the underlying methodology and assumptions used.

The Australian Securities and Investments Commission (ASIC) has a number of superannuation and retirement calculators on the MoneySmart website [https://www.moneysmart.gov.au/](https://www.moneysmart.gov.au/) which project outcomes when financial decisions are made in various scenarios:

- superannuation calculator;
- super contributions optimiser;
- super v mortgage calculator;
- super co-contribution calculator;
- employer contributions calculator;
- retirement planner;
• super and pension age calculator; and
• account-based pension calculator.

Superannuation funds are required to refer to ASIC’s superannuation calculator in their product disclosure statements to enable a person to calculate the impact of fees on their circumstances.

ASFA also has a number of superannuation and retirement calculators on the Super Guru website at http://www.superguru.com.au/:
• ASFA Retirement Standard;
• retirement projector; and
• contributions optimiser.

[14 020] Present value of the future income stream required

Another way to determine the capital required at retirement is to calculate the present value of the income needed to meet a person’s retirement lifestyle goal. The present value of an income stream is calculated as follows:

\[ P \times \frac{1 - (1 + r)^{-n}}{r} \]

Where:
• \( P \) is the income needed in retirement;
• \( r \) is the rate of return in retirement (net of inflation, fees and taxes); and
• \( n \) is the number of years in retirement.

However, it will also be necessary to convert the capital required from today’s dollars to future dollars to take into account the impact of inflation. The future value of a lump sum is calculated as follows:

\[ PV \times (1 + r)^n \]

Where:
• \( PV \) is the present value of the capital required;
• \( r \) is the rate of inflation; and
• \( n \) is the number of years until retirement.
EXAMPLE [14 020.10]

Present value of an income stream

Tim is aged 35 and estimates that he will need income of $40,000 per annum in retirement. His life expectancy when he retires at age 65 will be 26.4 (taken from Australian Life Tables 2010-12 applying the 25-year mortality improvement factors from the AGA). His superannuation will be invested in a portfolio with an assumed return of 7% per annum (net of fees and taxes). Inflation is assumed to be 3% per annum.

\[
\$40,000 \times \frac{(1 - (1 + 0.04)^{-26.4})}{0.04} = \$644,925
\]

The capital amount required in today’s dollars to fund Tim’s income in retirement is $644,925.

\[
\$644,925 \times (1 + 0.03)^{30} = \$1,565,403
\]

When Tim retires, in 30 years, the capital required in future dollars is $1,565,403.

DEVELOPING A RETIREMENT PLAN

[14 100] Developing a retirement plan – overview

Retirement planning essentially involves the same approach used in all financial planning, namely:

- establishing a relationship with a client;
- identifying a client’s financial situation and personal circumstances;
- setting goals and objectives for a client’s specific needs and risk profile;
- developing an appropriate strategy to achieve those objectives;
- implementing the strategy; and
- regularly reviewing the strategy for changing circumstances.

The main additional challenges for retirement planning are the large amount of capital that must be accumulated over a person’s working life and the complex aspects of superannuation, tax and social security.

Professional financial advisers will already have more detailed systems and procedures for developing a retirement plan than could ever be explained in this handbook. As a result, the following information attempts to address some of the basic issues and considerations that may be useful for enhancing existing practices.
Building a client profile – the first step

In order to make appropriate recommendations in relation to retirement planning, it is first necessary to establish a relationship with a client, build a detailed profile of her or his current financial situation and identify their retirement goals, needs and risk preferences.

Apart from being good professional practice, this process is a key component of the “know-your-client” rule that is also a legal requirement imposed on Australian Financial Services (AFS) licensees: see [9 375] and [21 120]. In particular, an AFS licensee is required to provide “appropriate advice” from 1 July 2013 (replacing the previous requirement to have a “reasonable basis” for the advice: s 945A Corporations Act 2001). To satisfy this requirement, it will be necessary to:

- determine the relevant personal circumstances in relation to giving the advice;
- make reasonable inquiries in relation to those personal circumstances;
- have regard to the information obtained from the client in relation to her or his personal circumstances;
- give such consideration to, and conduct such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and
- only give advice that is appropriate to the client, having regard to the consideration given and investigation conducted.

TIP

From 1 July 2013, the Future of Financial Advice (FoFA) measures have replaced the existing reasonable basis for advice rule with a duty to provide “appropriate advice”: see [1 120]. This duty is placed directly on the person who provides the advice (although penalties resulting from any breach will flow to the relevant licensee or authorised representative). Individuals who provide personal advice to retail clients are also required to act in the best interests of the client. To satisfy this new statutory best interests obligation, an adviser will need to maintain documentation to “prove” (on the balance of probabilities) that he or she has complied with each of the steps under s 961B(2) of the Corporations Act 2001: see [9 375].

Therefore, it will be necessary to obtain adequate information on all of a client’s personal, financial and business details: see also Chapter 2.
### Personal details:
- age/date of birth;
- education;
- residency status;
- family status (single, married, divorced etc);
- dependants (including those from other relationships);
- health status.

### Business details:
- business name;
- industry;
- business structure (ie sole trader, partnership, company, trust);
- percentage of ownership;
- years in operation/commencement of business;
- number of employees;
- annual turnover;
- annual profit;
- succession plan/exit strategy.

### Employment details:
- current employer and years of service;
- employment history/previous employers;
- qualifications;
- salary or wage income;
- superannuation contributions (ie employer or employee contributions);
- other work benefits (eg car, shares and options, housing, loans, school fees).

### Other income (ie non-employment or business):
- interest on bank deposits;
- dividend income on shares;
- rental income on investment properties;
- other.

### Assets (market value):
- house;
- bank deposits;
- car;
- investment property;
- shares;
- superannuation benefits (ie details from latest superannuation account statement);
- other (eg boat, jewellery).

### Liabilities:
- home loan;
- car loan;
- credit card;
- investment loan;
- HECS liability;
- future or contingent liabilities (eg children’s education, legal disputes, other).

### Expenses:
- mortgage payments;
- rent;
- food;
- car costs (eg petrol, insurance, maintenance, interest on loan);
- investment loan repayments;
- credit card repayments;
- personal loan repayments;
- home and contents insurance.

### Tax position – income tax returns

Having access to a client’s recent income tax returns can be extremely useful in terms of gauging their tax status. In particular, their current and projected marginal rate of tax and potential tax liabilities will be critical factors in developing an appropriate strategy. The tax position of a client’s assets should
also be considered for potential liabilities, eg an investment property that has experienced strong capital growth might need to be discounted in value for any contingent potential CGT liability. Recent tax returns may also identify if a client has received any superannuation lump sums or employment termination payments (see [9 675]) which may have implications for any relevant lifetime thresholds for some superannuation benefits.

Retirement lifestyle expectation and attitude

In addition to this basic personal and financial information, a client interview should also seek information on a client’s retirement lifestyle expectations. In particular, planners should seek details of their clients’ retirement income needs in terms of:

- estimated amount of retirement income required;
- the adequacy of the Age Pension;
- current level of superannuation savings;
- whether a guaranteed income stream is required for life;
- attitude to the impact of inflation on retirement income;
- access to underlying capital in case of emergency or capital expenditure;
- attitude to locking money away until retirement;
- plans to relocate or reduce their accommodation needs upon retirement;
- capital expenditure requirements on retirement (eg travel, renovations);
- health requirements; and
- plans to make gifts to children upon or near retirement.

TIP

For clients that find it difficult to determine their retirement income needs, it may be helpful for them to first consider retirement from the perspective of a retirement lifestyle plan on an annual, monthly or weekly basis. This may assist them to first understand what they might like to do in retirement and then develop a suitable budget for that lifestyle.

Other relevant issues

Other relevant factors include:

- employment security;
- expectations as to when they will retire from the workforce;
- the possibility they may not be able to work until Age Pension age;
- receipt of any employment termination payments (see [9 675]) or superannuation lump sum benefits received while under age 60 (see [9 620]) or from an untaxed source (see [9 650]) which may be subject to lifetime thresholds;
- current and future ability to set aside additional retirement savings;
- financial awareness and investment experience;
- attitude to different investment classes (eg Australian shares, international shares, property, fixed interest, cash);
• risk preferences in terms of investments and the risk/reward trade off; and
• the desire to leave a legacy for children or dependants upon their death.

TIP
Discovering relevant information about a client need not involve the client filling out a long and wordy form covering numerous issues. Instead, many of these relevant factors can be gauged and documented by carefully listening to a client’s attitude on personal issues that may give an insight into other relevant factors. For example, asking clients about how they feel about their current shareholdings or superannuation can give an insight into their investment risk preferences.

[14 110] Setting retirement savings goals and objectives

Ultimately, the client fact-finding process should be conducted with a view to understanding and documenting a client’s retirement goals and objectives that are appropriate for the specific circumstances. Any retirement goals should be:

• measurable. Generally, goals can be set in terms of a capital amount required to provide a desired retirement income that will satisfy the individual’s lifestyle expectations. After setting a target for the necessary retirement assets to provide a retirement income, the level of annual savings required over a working life can also be determined. Other measurable goals may be framed in terms of a retirement income target set against a percentage of pre-retirement earnings/expenditure. It will also invariably be necessary to identify the required real rate of return (ie taking account of inflation) necessary to achieve the objectives, eg a real rate of return over 5 years that exceeds inflation by at least 3% annually; and

• achievable. Planning for a retirement income that is beyond the savings capacity and investment return potential for an individual will be counterproductive and result in the client becoming disillusioned. If a client’s objectives are not achievable, it may be necessary to go back and consider a more modest retirement income, increase the level of annual savings, plan to retire later or reconsider her or his willingness to adjust their long-term risk preferences in order to achieve higher investment returns.

[14 115] Strategy to achieve objectives

After setting appropriate retirement goals, the next step involves developing a suitable strategy which essentially outlines the means to enable a client to achieve those objectives. This process will involve identifying and assessing all of the options that are appropriate for a client’s circumstances. For instance, it will be necessary to consider an appropriate mix of investment asset types, eg:

• Australian shares;
• international shares;
• property;
Australian fixed interest;
international fixed interest;
cash; and
other.

In setting an investment strategy, due regard should be had to the client’s individual circumstances and goals, in terms of the following considerations.

- **Risk management** – It is necessary to identify, measure and manage the risks associated with particular types of investments and the risks related to retirement: see [14 007]. Such risks also need to be assessed against the client’s risk tolerance and the required rate of return to achieve the objectives. Consideration should also be given to appropriate tools that may enable such risks to be reduced, eg via insurance or derivative products.

- **Diversification** – The level of diversification appropriate to manage and control risk and volatility of returns by spreading risk over different asset classes must match the client’s requirements.

- **Time horizon** – The term of the investment period will generally be the client’s working life. However, a shorter time horizon may be appropriate for specific investments. The term of the investment will also be relevant in assessing investments that can maximise returns over the long term (eg growth assets) but may be too volatile for a client’s risk profile in the short term.

- **Liquidity** – Generally, the long-term investment horizon means that liquidity can be kept to a minimum to achieve higher investment returns. However, consideration needs to be given to the likelihood that investments may need to be accessed before retirement, eg due to a relationship breakdown, health crisis or job loss.

- **Cash flow requirements** – Will investment assets provide regular income or capital growth? The ability to make regular saving payments and the expected timing of when benefits may need to be paid, eg at retirement or earlier access.

In developing an investment strategy, it will also be necessary to identify options for specific assets or financial products that meet these requirements. Ideally, modelling of various scenarios and options for clients will be useful to allow them to make a selection suitable for their circumstances. These challenges have also been exacerbated by the continuing fallout from the global financial crisis which has impacted some of the fundamental concepts underpinning portfolio investment theory. Accordingly, advisers need to constantly re-evaluate their investment approach in terms of asset allocations and the degree of volatility acceptable to individual clients.

**TIP**

With global interest rates expected to remain low for an extended period of time, trustees and financial advisers may need to consider more sophisticated investment strategies to deliver an adequate rate of return to satisfy members’ retirement income objectives. William H Gross, the head of global bond manager PIMCO, refers to this low-interest rate outlook as the “New Normal” or “New Neutral” for investors. To this end, financial...
planners are well placed to educate trustees and members about the benefits of asset diversification and adaptive asset allocation strategies that adjust for volatile markets and changing client circumstances. A 2013 report, *Intimate with Self Managed Superannuation*, by the SMSF Professionals’ Association of Australia (SPAA) [now renamed the Self Managed Super Fund Association – SMSF Association] and Russell Investments, also highlighted the need to consider the most appropriate asset class mix for the change in investment objectives when moving from the accumulation phase to the pension-paying phase. This “sequencing risk” (ie the risk of experiencing the worst returns at the worst possible time) is greatest in the final 15 years of accumulation and the first 10 years of benefit payments. Russell Investments warned that this decision is not as simplistic as fully migrating a portfolio from growth to defensive assets. Rather, members in pension phase should focus on ensuring that portfolios are suitably equipped to withstand market volatility and continue to provide sufficient cash flow for income throughout the various phases of retirement.

[14 118] Managing retirement risks

Risk profiling assesses a client’s attitude to market risk and determines their risk profile but it doesn’t assess their attitude to all the risks in retirement: see [14 007]. Risk profiling works well with accumulation because it is investment based and market risk is the primary concern when planning in the lead up to retirement.

Retirement is different to accumulation because income must be provided to meet spending requirements and this creates additional risks that need to be considered in the planning process. The most important of these retirement risks include:

- sequencing risk;
- longevity risk; and
- inflation risk.

**Sequencing risk**

Sequencing risk occurs when there are both market volatility and regular draw down from an investment: see [14 007]. This risk is greatest at the start of retirement because this is when investment balances are at their highest. Retirees also spend more at the start of retirement because this is when they are most active.

Advisers should consider whether it is appropriate to recommend reducing a client’s exposure to growth assets at the start of retirement to reduce the impact of realising investments during market downturns. Advisers should also consider whether investing in financial products which provide regular income, such as an annuity, at the start of retirement may be appropriate to reduce the need to regularly realise investments.

Retirement outcomes are typically illustrated using average returns which don’t take into account sequencing risk. This can produce very different
outcomes to that actually achieved in retirement. Sequencing risk should be incorporated into retirement modelling to give a more accurate picture and ensure the risk can be better managed.

**Longevity risk**

Longevity risk is the risk of underestimating life expectancy and running out of money: see [14 007]. The commonly used period life expectancies from the ABS life tables don’t take into account mortality improvement and provide figures that are too low. Cohort life expectancies, which take into account improving mortality rates, are a more realistic measure and should be used in retirement planning. Whether using period or cohort life expectancies, these figures are only averages and therefore 50 percent will live longer.

Advisers should consider investing in financial products which provide regular income for a client’s lifetime, such as an annuity to ensure a basic standard of living can be achieved all through retirement.

**Inflation risk**

Inflation is the risk that investments and income lose real purchasing power over time as general price levels rise: see [14 007]. Retirees no longer receive a wage or salary that gets inflation protection from the way real wages tend to increase over time.

Advisers may consider incorporating assets into a portfolio which provides a hedge against inflation such as property, cash and inflation linked bonds. Advisers should also consider financial products that can be indexed to inflation such as annuities.

[14 120] Maximising retirement benefits – basic factors

Broadly, a retirement savings strategy should seek to maximise the end benefits available subject to the client’s resources and risk profile. In summary, the final retirement benefits available will be determined by the simple formula:

- **Regular savings** will largely be determined by the client’s budget and her or his willingness to sacrifice current consumption to provide future consumption. It will also be affected by the duration of the client’s working life and planned retirement age. If a client has no capacity to set aside retirement savings against more immediate consumption needs (eg mortgage commitments), it may still be helpful to review the budget to identify any capacity. By demonstrating the compounding benefits of saving over a longer time horizon, it may also be possible to convince a client of the advantages of forgoing some present day consumption in their budget. Furthermore, the annual superannuation contribution limits (see [9 210] and [9 220]) mean that it is important to start accumulating superannuation earlier and more regularly.

- **Investment returns** is where the client has the biggest potential to make choices that will dramatically influence the final retirement income. The earlier someone starts to plan for retirement, the more benefit they will obtain from the time value of money and the power of compounding returns. The longer time horizon for investing means that there is greater potential to achieve higher returns through growth assets, as the
short-term volatility risk can be discounted. Therefore, regardless of the level of savings available, it is critical to maximise the investment returns, subject to a client's risk profile. For those clients whose only retirement savings will be via the compulsory Superannuation Guarantee, maximising the net investment return (eg via appropriate investment choices) may also deliver substantial long-term benefits. As a general rule, a 1% increase/decrease in fund earnings has the effect of a 5% increase/decrease in retirement living standards. Therefore, investment choice options (and choice of fund: see [9 335]) can have a significant impact on living standards at retirement.

- **Fees** – Accessing financial products that can deliver similar investment returns over the long term at a lower cost will effectively produce a higher net investment return. Therefore, the longer time horizon of retirement saving will deliver substantial end benefits for small savings in fees. However, any consideration of fees must be placed into the context of the net investment returns available, ie higher fees are acceptable where a higher long-term return can be achieved. There are also substantial benefits in consolidating multiple superannuation accounts to stop the unnecessary duplication of fees and charges. ASIC’s and ASFA’s online calculators can also demonstrate the substantial impact of a fund’s fees and charges on an individual’s superannuation in simple dollar figures: see [14 015].

- **Tax** – Minimising the level of tax to be paid on retirement savings and investments will ultimately increase the amount available to provide substantially higher retirement income via the compounding effect over the longer time horizon. Therefore, it is necessary to select an appropriate retirement savings vehicle for the client’s individual circumstances: see [14 125]. From 1 July 2007, no tax is payable on superannuation benefits paid (either as a lump sum or pension) from a taxed source to a person aged 60 and over: see [9 620]. As a result, the taxing points focus on contributions and fund investment earnings (and potentially upon death): see [9 020].

The timing of retirement will also have a critical impact on the level of retirement savings achieved.

Even for those clients who appear to have little capacity to save for their retirement, there is still a lot of potential to maximise their retirement benefits by carefully considering all of the aspects they can control. No matter how small, compounding the savings achieved over the longer time horizon will produce substantial benefits to what would otherwise have been achieved.

**[14 125] Retirement savings vehicles – tax considerations**

The tax consequences of an investment will obviously be a key factor in determining the net investment returns. Therefore, careful consideration needs to be given to the after-tax returns on an investment strategy, as it is this after-tax amount that will be available to provide a retirement income.

As a result, consideration needs to be given to the different investment vehicles that can be used to hold various assets in a tax-effective manner. In addition, the advantages and disadvantages of each option should be considered against the individual’s particular circumstances which will obviously change
over the course of her or his life. Broadly, the investment options that can be used to accumulate wealth to provide a retirement income include the following.

- **Superannuation** – Accumulating retirement savings in the superannuation system provides generous tax concessions: see [14 200]-[14 270].

- **Small business** – Prudent investment in a small business may produce a higher level of growth than that available through traditional investments. Small business CGT concessions may also allow the proceeds of the sale of a small business to be converted into superannuation benefits at retirement in a tax-effective manner.

- **Family home** – Where an individual’s savings capacity is absorbed by their mortgage commitments (especially for the young), focusing on reducing this debt level may be an appropriate strategy at that stage of life, depending on other investments available. However, such a strategy does not enable risks to be reduced via diversification and may ultimately require the equity in the family home to be unlocked to provide a retirement income.

- **Other non-superannuation investments** – Depending on the individual’s tax position, accumulating wealth via investments in assets outside the superannuation system (eg property, managed funds) may be appropriate depending on the individual’s tax position or their unwillingness to lock money away until retirement. However, subject to some investment restrictions, most investments will achieve a higher after-tax return if held in the superannuation system instead of in an individual’s own name. Family trusts and private companies may also be tax-effective investment vehicles (see [12 510]), depending on the particular investment asset and the individual’s desire not to have money locked away until retirement.

### [14 130] The retirement plan – presentation and disclosure

When an appropriate strategy has been developed, it should be presented to a client and explained in plain language, where possible. In particular, this presentation to the client should outline the proposed course of action, the nature of the underlying financial products recommended and the possible risks. It may also be preferable to outline various scenarios and allow the client to make a selection appropriate to their circumstances. This could require negotiating the strategy with the client in terms of any concerns or issues.

**Disclosure requirements**

Importantly, it will also be necessary to comply with the financial services reform (FSR) disclosure obligations (see [3 500]-[3 520]) in terms of providing a financial services guide (FSG), statement of advice (SoA) and product disclosure statement (PDS).

- **Financial Services Guide** – Broadly, an up-to-date FSG must be given to a client as soon as practicable after it becomes apparent to the AFS licensee that the financial service will be, or is likely to be, provided to the client, and must be given to the client before the financial service is provided: s 941D Corporations Act 2001. Among other things, the FSG and SoA must disclose information about the remuneration (including...
commissions) or other benefits that the adviser (or related parties) may receive in respect of the provision of the services or advice. Note that the FoFA reforms ban the payment and receipt of certain “conflicted remuneration” which could reasonably be expected to influence the financial product advice given to retail clients from 1 July 2013: see [4 050].

• **Statement of Advice** – If an SoA is not the means by which the advice is provided, an SoA must be given to the client when, or as soon as practicable after, the advice is provided and, in any event, before providing any further financial service advice. However, the exception from the requirement to provide a full SoA for small investment advice under $15,000 (see [3 300]) does not apply in respect of a superannuation product or RSA product, unless the client already has an interest in the product: s 946AA of the Corporations Act 2001. Likewise, the conditional relief from the former “suitability rule” in s 945A of the Corporations Act 2001 for superannuation fund trustees providing personal advice to fund members about their existing superannuation fund does not extend to retirement planning advice: see ASIC Class Order [CO 09/210] and Regulatory Guide RG 200. An Example SoA for providing scaled advice to a new client is set out in ASIC Regulatory Guide RG 90 (August 2013). Note that the FoFA reforms introduced new rules for the types of intra-fund advice that can be provided by superannuation trustees to members to ensure intra-fund advice is provided consistently with the member’s best interests obligations: see [9 375].

• **Product Disclosure Statement** – If the advice includes a recommendation to acquire a financial product, the adviser is required to give a PDS to the client at the time the advice is given: s 1012C of the Corporations Act 2001. Among other things, the PDS must include information about any significant risks and fees and charges.

| TIP | If recommendations are based on information relating to the client’s personal circumstances that is incomplete or inaccurate, and the adviser knows that the information is incomplete or inaccurate, the adviser must warn the client in this respect. Specifically, at the time the advice is given, the adviser must warn the client that the advice is, or may be, based on incomplete or inaccurate information relating to the client’s personal circumstances. Further, the warning should state that the client should, before acting on the advice, consider the appropriateness of the advice, having regard to her or his own circumstances: s 961H Corporations Act 2001. The SoA must at least contain a record of this warning. |

### Duty to act in best interests of client

The Government’s FoFA reforms have implemented a statutory duty to require financial advisers to act in the best interests of their clients and to place the best interests of their clients ahead of their own from 1 July 2013: see [9 375]. Advisers are also required to provide “appropriate advice” and warn clients if the advice is based on incomplete or inaccurate information. A ban also applies...
to the receipt and payment of certain conflicted remuneration (including certain product commissions and soft-dollar benefits) that “could reasonably be expected to influence” the advice given to retail clients. Instead, separate fees for the product and advice are required. The previous obligation under s 945B of the Corporations Act 2001 to warn clients if the advice is based on incomplete or inaccurate information has been replaced from 1 July 2013 with a disclosure obligation under s 961H placed directly on the person who provides the advice. The SoA must at least contain a record of this warning. Note that a provider also has a duty to make reasonable inquiries to obtain complete and accurate information under the best interests obligation. Importantly, there is nothing in the best interests duty prescribing how much the provider can charge the client.

**TIP**

For advisers who have always put their client’s interests first, the FoFA rules merely codified what the majority of advisers had already been doing when dealing with clients. Essentially, satisfying the best interests obligations involves refining the prior approach to the SoA. However, to substantiate compliance with the best interests obligations, financial advisers may need to adjust their systems to generate appropriate documentation to “prove” that these new obligations have been satisfied: see [9 375]. That is, the requirement to act in a client’s best interests is about the “process of providing advice”, rather than trying to justify the quality of the advice against financial outcomes.

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**[14 135] Retirement plan – implementation and regular review**

After the retirement plan has been finalised and agreed by the client, it will be necessary for the client to sign a formal agreement authorising the adviser to implement the strategy.

Given that a retirement plan will generally have a time horizon over the client’s working life, it will be necessary to regularly review the progress of the plan against the client’s retirement objectives. In addition, adjustments may be required to the plan for the inevitable changes in a client’s circumstances. The interval between reviews may also be determined by the nature of various strategies. For instance, more active share trading may require more regular review periods while residential property investments may be reviewed annually. An agreed program of reviews should be scheduled with the client in advance.

**TIP**

Financial advisers are required give clients a Fee Disclosure Statement (FDS) to continue charging an ongoing fee for longer than 12 months. Advisers are also required to have clients, who entered into an ongoing fee arrangement after 1 July 2013, opt-in (or renew) their fee arrangement every 2 years under the FoFA reforms: see [25 500].
SUPERANNUATION

[14 200] Superannuation – overview

Superannuation is just another form of savings and investment which enables people to accumulate wealth during their working life to provide income in retirement. However, it is arguably the most important in terms of the $2 trillion-plus it has attracted in savings and investments. Further, some 87% of the workforce has some superannuation coverage and superannuation is increasingly becoming the second largest asset for people, next to the family home. This is largely due to the Superannuation Guarantee regime which, since 1992, has required all employers to make superannuation contributions on behalf of their employees (currently 9.5% of an employee’s ordinary time earnings). The minimum level of employer support has been legislated to increase gradually from 9.5% to 12% by 2025: see [9 315].

In addition to the Superannuation Guarantee system, the Government offers tax and other incentives to encourage people to make voluntary contributions: see [14 225]. As superannuation is an “investment vehicle” rather than an asset class itself, the tax benefits of investing in assets via a superannuation structure effectively increase the net after-tax returns for many individuals with a marginal tax rate (plus Medicare levy) above the 15% rate for superannuation funds.

However, the concessional tax environment of superannuation has a cost to an investor in that it requires the money to be locked away until retirement. Therefore, it is necessary to carefully assess the tax advantages of superannuation against an individual’s personal tax status and other circumstances. See also Mercer, “Securing Retirement Incomes – Tax, Super and the Age Pension: assessing the value of total government support”, February 2012.

[14 210] Locking money away in superannuation

In return for providing tax concessions and other benefits for superannuation contributions, the government requires this money to be subject to a comprehensive regulatory regime. This regulatory system seeks to ensure that superannuation money is only applied in a manner that is consistent with the government’s retirement savings objectives, i.e. the provision of benefits in retirement. Importantly, superannuation benefits cannot be accessed until an individual is at least age 56 (phasing up to age 60 for those born after 30 June 1964): see [9 600].

This requirement to preserve superannuation benefits until retirement will be a significant consideration, especially for those who do not want to lock all their savings away as this money may be required for more immediate or contingent purposes, e.g. saving for a home deposit or reducing debts. Therefore, it is critical to ensure that a client is aware of this requirement from the outset. Of course, as people approach retirement age, the negative aspect of locking money away in superannuation is also discounted more and more. However, locking money away in superannuation does have a positive aspect in that it enforces a disciplined long-term savings regime.

[14 215] Superannuation Guarantee

The Superannuation Guarantee (SG) was introduced in 1992 and is the compulsory component of the government’s retirement income policy. Employers...
are required to contribute a minimum level of superannuation contributions for employees every quarter. There is no maximum age for an employee to receive SG contributions.

The prescribed minimum is currently 9.5% of ordinary time earnings, but is legislated to increase gradually to 12% by 2025.

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<th>SG rate</th>
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Ordinary time earnings are generally what an employee earns for their ordinary hours of work. For the payments included in ordinary time earnings, go to https://www.ato.gov.au.

The SG does not apply to certain employees, including:
- employees paid less than $450 in a calendar month;
- part-time employees under age 18 (working 30 hours or less per week);
- employees paid for work of a domestic or private nature for 30 hours or less per week;
- resident employees paid by non-resident employers for work done outside Australia;
- non-resident employees paid for work done outside Australia;
- non-resident employees who hold a 413, 456, 457, 956 or 977 visa and meet certain employment criteria;
- employees participating in the Commonwealth’s Community Development Employment Program; and
- employees in their capacity as members of the Defence Force Reserves.

Employers are required to make SG contributions up to a maximum contribution base of $52,760 per quarter. Where an employee is employed by multiple employers, the maximum contribution base applies to each employer. The maximum contributions base is indexed on 1 July each year by movements in Average Weekly Ordinary Time Earnings (AWOTE).

SG contributions must be made to the employee’s chosen superannuation fund within 28 days after the end of each quarter. Where the employer does not meet their SG obligation by the cut-off date, they will be subject to the Superannuation Guarantee Charge.
SG contributions are mandated employer contributions and will be subject to contributions tax and count towards the employee’s concessional contributions cap: see [14 260].

[14 220] Salary sacrifice

Salary sacrifice is an arrangement where an employee agrees to sacrifice earnings in return for additional employer contributions.

Additional employer contributions can be made at any time where the employee is under age 65. Where an employee is aged 65 to 74, additional employer contributions can only be made where they meet the work test before the contribution is made: see [14 225]. Additional employer contributions cannot be made where the employee is aged 75 or over.

For the arrangement to be effective, only prospective earnings can be sacrificed. Earnings to which the employee is already entitled cannot be sacrificed under an effective arrangement.

Under an effective salary sacrifice arrangement, the sacrificed earnings do not form part of the employee’s assessable income. The additional employer contributions will be subject to contributions tax and will count towards the employee’s concessional contributions cap: see [14 260].

Under an ineffective salary sacrifice arrangement, the sacrificed earnings continue to form part of the employee’s assessable income. The additional superannuation contributions will not be subject to contributions tax and will count towards the employee’s non-concessional contributions cap: see [14 265].

Salary sacrifice arrangements are at the discretion of the employer. There is no legal obligation for an employer to offer salary sacrifice to employees.

### EXAMPLE [14 220.10]

Angela is aged 50, working full time and earning a salary of $100,000 per annum. She currently makes personal contributions of $6,000 per annum to superannuation from her after-tax income. She is considering an effective salary sacrifice arrangement.

Angela makes salary sacrifice contributions of $9,837 per annum to her superannuation instead of personal contributions of $6,000 per annum. The salary sacrificed contributions no longer form part of her assessable income.

<table>
<thead>
<tr>
<th></th>
<th>No salary sacrifice</th>
<th>Salary sacrifice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary</td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>Salary sacrifice contribution</td>
<td>Nil (Nil)</td>
<td>($9,837)</td>
</tr>
<tr>
<td>Tax payable (including Medicare levy)</td>
<td>($26,632)</td>
<td>($22,795)</td>
</tr>
<tr>
<td>After-tax income</td>
<td>$73,368</td>
<td>$67,368</td>
</tr>
</tbody>
</table>
Angela’s after-tax income has reduced to $67,368 per annum; however, she maintains the same take home pay. This increases her net contribution to superannuation by $2,361 per annum.

Salary sacrifice contributions are classified as employer contributions and may be used by employers to meet their SG obligation.

Salary sacrifice contributions may reduce the contribution base on which the SG obligation is calculated.

Advisers should ensure clients’ salary sacrifice arrangements are in writing and do not negatively impact on other entitlements.

### [14 225] **Personal contributions**

Personal contributions are made from after-tax income or from business profits. A person can make personal contributions for themselves or on behalf of another person.

Personal contributions can be made at any time where a person is under age 65. Where a person is aged 65 to 74, personal contributions can only be made if they meet the work test before the contribution is made. A person meets the work test if they have been gainfully employed for at least 40 hours in a period of not more than 30 consecutive days in that financial year. Personal contributions cannot be made where a person is aged 75 or over.

#### Personal deductible contributions

Personal contributions made to a complying superannuation fund on or after 1 July 2017 can be claimed as a tax deduction where the receiving fund is not a:

- Commonwealth public sector superannuation scheme in which the person has a defined benefit interest;
- constitutionally protected fund; or
- superannuation fund that notified the Commissioner before the start of the financial year that they elected to treat all personal contributions as non-deductible.

Personal contributions made to a complying superannuation fund before 1 July 2017 can be claimed as a tax deduction where less than 10% of the person’s assessable income, reportable fringe benefits and reportable employer superannuation contributions are attributable to employment-related activities.
Reportable employer superannuation contributions are employer contributions where the employee has the capacity to influence the size of the contribution or the way the contribution is made (eg salary sacrifice contribution: see [14 220]). Employment-related activities result in a person being treated as an employee for SG purposes.

To claim a tax deduction for personal contributions, the person must give the trustee of the superannuation fund a valid notice of intention to claim a tax deduction and receive acknowledgement of the notice from the trustee. The notice of intention must be given to the trustee before the earlier of:

- the day the person lodges their income tax return for the financial year in which the contribution is made; and
- the end of the following financial year.

A notice of intention will be invalid in the following circumstances:

- the notice includes all or part of an amount covered by a previous notice;
- when the notice is given to the trustee:
  - the person was not a member of the superannuation fund;
  - the trustee no longer holds the contribution; or
  - the trustee has commenced paying an income stream based in whole or part on the contribution; or
- before the notice is given to the trustee:
  - the person had made a contributions splitting application in relation to the contribution; and
  - the trustee had not rejected the application.

A valid notice of intention cannot be revoked or withdrawn. However, a valid notice of intention can be varied but only to reduce the amount claimed in the notice. The variation to the notice must be given to the trustee before the earlier of:

- the day the person lodges their income tax return for the financial year in which the contribution is made; and
- the end of the following financial year.

A valid notice of intention cannot be varied if, when the variation to the notice is given to the trustee:

- the person was not a member of the superannuation fund;
- the trustee no longer holds the contribution; or
- the trustee has commenced paying an income stream based in whole or part on the contribution.

Personal contributions, where a valid notice of intention to claim a tax deduction is given and acknowledged, will be subject to contributions tax and count towards the person’s concessional contributions cap: see [14 260].

Personal contributions which are not claimed as a tax deduction will not be subject to contributions tax and will count towards the person’s non-concessional contributions cap: see [14 265].
If a superannuation fund is partially rolled over before a notice of intention is given to the trustee, a notice of intention will be invalid if the personal contribution remaining in the superannuation fund is less than the amount claimed as a tax deduction.

Advisers should ensure clients give the trustee of the superannuation fund a notice of intention before a superannuation fund is partially rolled over.

**EXAMPLE [14 225.10]**

Mark is aged 50, running his own business and earning assessable income of $100,000 per annum. He has $140,000 in superannuation made up of $20,000 tax-free and $120,000 taxable (taxed element) components.

Mark makes a $20,000 personal contribution to his superannuation fund on 1 July 2017. The personal contribution increases the tax-free component of his superannuation. The components in his superannuation fund after the personal contribution are $40,000 tax-free and $120,000 taxable (taxed element).

Mark subsequently rolls over $40,000 from his superannuation fund to another superannuation fund. The components of the rollover are determined by the proportions of components just before the rollover.

The proportions of components are calculated as the tax-free and taxable (taxed element) components divided by the value of his superannuation fund.

\[
\frac{\text{Tax-free}}{\text{Value}} = \frac{40,000}{160,000} = 25% \\
\frac{\text{Taxed element}}{\text{Value}} = \frac{120,000}{160,000} = 75%
\]

The proportions of components just before the rollover are 25% tax-free and 75% taxable (taxed element). The proportions of components will be applied to his rollover.

\[
\begin{align*}
\text{Tax-free} & \times 25\% = 10,000 \\
\text{Taxed element} & \times 75\% = 30,000
\end{align*}
\]

His rollover will be made up of $10,000 tax-free and $30,000 taxable (taxed element) components. The components in his superannuation fund after the rollover are $30,000 tax-free and $90,000 taxable (taxed element).

Mark gives the trustee a notice of intention to claim a tax deduction for the $20,000 personal contribution. The notice of intention is invalid because the trustee no longer holds the contribution. Mark can only claim a deduction for the personal contribution remaining in his superannuation fund.

The personal contribution remaining in his superannuation fund is calculated as the personal contribution divided by the tax-free component before the rollover times the tax-free component after the rollover.

\[
(\frac{20,000}{40,000}) \times 30,000 = 15,000
\]

Mark can claim a deduction for the $15,000 personal contribution remaining in his superannuation fund.
If an income stream is commenced from a superannuation fund before a notice of intention is given to the trustee, the notice of intention will be invalid even if the personal contribution remaining in the superannuation fund is greater than the amount claimed as a tax deduction.

Advisers should ensure clients give the trustee of the superannuation fund a notice of intention before an income stream is commenced.

The tax deduction for personal contributions is limited to the person’s taxable income for the financial year in which the contribution is made. Personal contributions claimed as a tax deduction which have been subsequently disallowed by the ATO will count towards the person’s non-concessional contributions cap.

[14 235] Spouse contributions

Spouse contributions are personal contributions made on behalf of a spouse.

A person may be entitled to a tax offset for spouse contributions made on or after 1 July 2017 where the following conditions are met:

- the receiving spouse lives with the contributing spouse:
  - in a relationship that is registered under a State or Territory law; or
  - on a genuine basis in a relationship as a couple;
- the contributing and receiving spouse are Australian residents for tax purposes;
- the receiving spouse’s assessable income, reportable fringe benefits and reportable employer superannuation contributions are less than $40,000 for the financial year;
- the contributing spouse cannot claim a tax deduction for the contribution;
- the contribution is made to a complying superannuation fund;
- the receiving spouse is:
  - under age 65; or
  - aged 65 to 69 and they meet the work test before the contribution is made (see [14 225]);
- the receiving spouse has not exceeded their non-concessional contributions cap for the financial year; and
- the receiving spouse has a total superannuation balance (see [14 270]) less than the general transfer balance cap (see [14 400]) immediately before the start of the financial year.

The tax offset is calculated as 18% of the lesser of the following:

- $3,000 reduced by $1 for every $1 of receiving spouse’s assessable income, reportable fringe benefits and reportable employer superannuation contributions over $37,000; and
- the amount of the spouse contribution.
EXAMPLE [14 235.10]

Fiona is aged 50, working part-time and earning a salary of $38,500 per annum. She has not exceeded her non-concessional contributions cap for the financial year and her total superannuation balance is less than the general transfer balance cap. Her husband Michael makes a spouse contribution of $2,000 to her superannuation on 1 July 2017.

$3,000 is reduced by $1 for every $1 of Fiona’s assessable income over $37,000:

\[3,000 - (38,500 - 37,000) = 1,500\]

As this is less than the spouse contribution of $2,000, the tax offset is calculated on $1,500:

\[1,500 \times 18\% = 270\]

Michael’s tax offset for his spouse contribution is $270.

A person may be entitled to a tax offset for spouse contributions made before 1 July 2017 where the following conditions are met:

- the receiving spouse lives with the contributing spouse:
  - in a relationship that is registered under a State or Territory law; or
  - on a genuine basis in a relationship as a couple;
- the contributing and receiving spouse are Australian residents for tax purposes;
- the receiving spouse’s assessable income, reportable fringe benefits and reportable employer superannuation contributions are less than $13,800 for the financial year;
- the contributing spouse cannot claim a tax deduction for the contribution;
- the contribution is made to a complying superannuation fund; and
- the receiving spouse is:
  - under age 65; or
  - aged 65 to 69 and they meet the work test before the contribution is made (see [14 225]).

The tax offset is calculated as 18% of the lesser of the following:

- $3,000 reduced by $1 for every $1 of the receiving spouse’s assessable income, reportable fringe benefits and reportable employer superannuation contributions over $10,800; and
- the amount of the spouse contribution.

Spouse contributions will not be subject to contributions tax and will count towards the receiving spouse’s non-concessional contributions cap: see [14 265].

Spouse contributions can only be made where the receiving spouse is under age 70 at the time of the contribution.
Government co-contribution

The Government co-contribution is a matching superannuation contribution from the government available to low income earners who make personal contributions.

A person may be entitled to receive the Government co-contribution for personal contributions made on or after 1 July 2017 where the following conditions are met:

- the person makes 1 or more personal contributions during the financial year;
- 10% or more of the person’s assessable income, reportable fringe benefits and reportable employer superannuation contributions is attributable to:
  - employment-related activities; or
  - carrying on a business;
- the person’s assessable income, reportable fringe benefits and reportable employer superannuation contributions less business deductions are less than $51,813 for the financial year;
- the person lodges an income tax return for the financial year;
- the person is under age 71 at the end of the financial year;
- the person does not hold an eligible temporary visa at any time during the financial year unless they are a New Zealand citizen;
- the person has not exceeded their non-concessional contributions cap for the financial year; and
- the person has a total superannuation balance (see [14 270]) less than the general transfer balance cap (see [14 400]) immediately before the start of the financial year.

The Government co-contribution is $0.50 for every $1 of personal contributions up to a maximum co-contribution of $500.

The maximum Government co-contribution reduces by $0.03333 for every $1 of a person’s assessable income, reportable fringe benefits and reportable employer superannuation contributions over $36,813.

**EXAMPLE [14 245.10]**

Peter is aged 50, working part time and earning a salary of $40,000 per annum. He has not exceeded his non-concessional contributions cap for the financial year and his total superannuation balance is less than the general transfer balance cap. He makes a personal contribution of $800 to his superannuation on 1 July 2017.

The maximum Government co-contribution reduces by $0.03333 for every $1 of Peter’s assessable income over $36,813:

\[
500 - (40,000 - 36,813) \times 0.03333 = 393.77
\]

The maximum Government co-contribution Peter can receive is $393.77.
A person may be entitled to receive the Government co-contribution for personal contributions made before 1 July 2017 where the following conditions are met:

- the person makes 1 or more personal contributions during the financial year;
- 10% or more of the person’s assessable income, reportable fringe benefits and reportable employer superannuation contributions is attributable to:
  - employment-related activities; or
  - carrying on a business;
- the person’s assessable income, reportable fringe benefits and reportable employer superannuation contributions less business deductions are less than $51,021 for the financial year;
- the person lodges an income tax return for the financial year;
- the person is under age 71 at the end of the financial year; and
- the person does not hold an eligible temporary visa at any time during the financial year unless they are a New Zealand citizen.

The Government co-contribution is $0.50 for every $1 of personal contributions up to a maximum co-contribution of $500.

The maximum Government co-contribution reduces by $0.03333 for every $1 of a person’s assessable income, reportable fringe benefits and reportable employer superannuation contributions over $36,021.

The Government co-contribution will not be subject to contributions tax and will not count towards the person’s concessional or non-concessional contributions cap.

**Contribution splitting**

Contribution splitting allows a person to transfer concessional contributions to their spouse: see [14 260]. A person may request to split a contribution:

- in the financial year following the financial year in which the contributions were made; or
- in the financial year in which the contributions were made where the entire superannuation benefit is being withdrawn or rolled over.

The maximum amount of contributions that may be split is the lesser of:

- 85% of the concessional contributions for the financial year; and
- the concessional contributions cap for the financial year (see [14 260]).

Contributions may only be split where, at the time of the request, the person’s spouse:

- is under preservation age (see [14 310]); or
- has reached preservation age and is under age 65 and does not meet the retirement condition of release (see [14 320]).

There is no legal obligation for the trustee of a superannuation fund to offer contribution splitting.
Concessional contributions cap

Concessional contributions are generally superannuation contributions made from pre-tax income and subject to contributions tax on entry to the superannuation fund.

Concessional contributions include:
- Superannuation Guarantee contributions;
- personal contributions claimed and allowed as a tax deduction;
- salary sacrifice contributions;
- voluntary employer contributions; and
- amounts allocated from fund reserves.

Concessional contributions exclude:
- contributions made to non-complying superannuation funds;
- rollovers of untaxed benefits from untaxed superannuation schemes; and
- the growth portion of a transfer from a foreign superannuation fund which the person elects to have taxed in the Australian superannuation fund.

Contributions made to constitutionally protected superannuation funds and unfunded defined benefit funds on or after 1 July 2017 count towards a person’s concessional contributions cap. However, these contributions on their own cannot result in excess concessional contributions: see [9 211].

From 1 July 2017, where a person has a defined benefit interest, the amount of concessional contributions for the financial year is the sum of:
- concessional contributions which do not relate to defined benefit interests;
- notional taxed contributions for each defined benefit interest (see [9 210]); and
- the amount by which defined benefit contributions exceed the notional taxed contributions (see [9 211]).

The concessional contributions cap is currently $25,000 per financial year. The cap is indexed by movements in AWOTE (rounded down to the nearest $2,500).

Before 1 July 2017, the concessional contributions cap was $35,000 per financial year for people aged 49 or over at 30 June of the previous financial year and $30,000 per financial year for everyone else.

Concessional contributions within the cap are taxed at up to 15% within the superannuation fund. Concessional contributions in excess of the cap are included in the person’s assessable income and taxed at their marginal tax rate less a 15% tax offset for contributions tax paid within the superannuation fund. An excess concessional contributions charge will apply to the increase in the person’s tax liability attributable to their excess concessional contributions.

Excess concessional contributions will count towards a person’s non-concessional contributions cap: see [14 265]. A person can elect to have up to 85% of their excess concessional contributions released from their superannuation fund. The amount of excess concessional contributions released will continue to
be included in the person’s assessable income; however, the amount will not count towards a person’s non-concessional contributions cap.

From 1 July 2018, a person will be able to carry forward the unused concessional contributions cap if their total superannuation balance (see [14 270]) just before the start of the financial year is less than $500,000. Amounts of unused concessional contributions cap will be able to be accessed on a rolling basis for 5 years.

Where a person’s taxable income, concessional contributions, reportable fringe benefits and total net investment losses are more than $250,000 for the financial year, they will be subject to Div 293 tax. Concessional contributions that, in addition to taxable income, reportable fringe benefits and total net investment losses, exceed $250,000 will be taxed at an additional 15% payable by the person or the tax liability may be released from the superannuation fund and paid to the ATO. The additional 15% tax will not apply to excess concessional contributions.

Non-concessional contributions cap

Non-concessional contributions are generally superannuation contributions made from after-tax income and are not subject to contributions tax on entry to the superannuation fund.

Non-concessional contributions include:

- personal contributions not claimed as a tax deduction;
- personal contributions for which a tax deduction has been denied;
- spouse contributions;
- the non-growth portion of a transfer from a foreign superannuation fund; and
- excess concessional contributions.

Non-concessional contributions exclude:

- Government co-contributions;
- rollovers within the Australian superannuation system;
- contributions of proceeds from the disposal of business assets that qualify for the 15-year exemption or retirement exemption up to the CGT cap; and
- contributions arising from structured settlements or orders for personal injury.

The non-concessional contributions cap is currently $100,000 per financial year. The non-concessional contributions cap is set at 4 times the concessional contributions cap. Where a person is under age 65 at 1 July of the financial year, they can bring forward the next 2 financial years of non-concessional contribution caps and contribute up to $300,000 in that financial year without exceeding the cap. When non-concessional contributions exceed $100,000, the bring-forward is automatically triggered and the non-concessional contributions cap is $300,000 for that 3-financial-year period.

A person’s non-concessional contributions cap will be nil where they have a total superannuation balance (see [14 270]) equal to or exceeding the general transfer balance cap (see [14 400]) immediately before the start of the financial year.
Before 1 July 2017, the non-concessional contributions cap was $180,000 per financial year. Where a person was under age 65 at 1 July of the financial year, they could bring forward the next 2 financial years of non-concessional contribution caps and contribute up to $540,000 in that financial year without exceeding the cap.

Non-concessional contributions within the cap are not subject to contributions tax within the superannuation fund. Non-concessional contributions in excess of the cap are taxed at 49% to the person. The tax liability must be released from the superannuation fund and paid to the ATO.

A person can elect to have their excess non-concessional contributions plus 85% of associated earnings released from their superannuation fund. The amount of excess non-concessional contributions released will not be subject to excess non-concessional contributions tax. The associated earnings released will be included in the person’s assessable income and taxed at their marginal tax rate less a 15% tax offset for earnings tax paid within the superannuation fund.

**TIP**
Where a person has retired and wants to trigger the bring-forward in the financial year they turn age 65, the contribution cannot be made after they turn 65 unless they meet the work test: see [14 225].

Advisers must ensure clients who do not meet the work test make the contribution before they turn 65.

**[14 270] Total superannuation balance**

A person’s total superannuation balance at a particular time is the sum of:

- accumulation phase value of their superannuation interests;
- if the person has a transfer balance account, their transfer balance adjusted for any structured settlement contributions and the current value of account-based income streams; and
- the amount of any roll-over superannuation benefits not reflected in their accumulation phase values or their transfer balance as they are in transit between superannuation funds, reduced by the sum of any structured settlement contributions.

A person’s total superannuation balance is relevant to determine eligibility for:

- the non-concessional contributions cap (see [14 265]);
- the unused concessional contributions cap carry-forward (see [14 260]);
- the Government co-contribution (see [14 245]); and
- the tax offset for spouse contributions (see [14 235]).
[14 300] Preservation

Benefits in superannuation are subject to preservation and cannot be accessed until a condition of release has been met. Superannuation benefits can be classified into 3 categories:

- preserved benefits;
- restricted non-preserved benefits; and
- unrestricted non-preserved benefits.

Preserved benefits include all contributions made to superannuation from 1 July 1999 and all investment earnings within superannuation from 1 July 1999. They also include employment termination payments rolled over into superannuation from 1 July 2004. Preserved benefits can only be accessed when a condition of release has been met subject to any cashing restrictions.

Restricted non-preserved benefits generally include personal contributions made to superannuation before 1 July 1999. They also generally include employment termination payments rolled over into superannuation before 1 July 2004. Restricted non-preserved benefits can only be accessed when a member terminates gainful employment with an employer who contributed to the same superannuation fund prior to the termination or when another condition of release has been met subject to any cashing restrictions.

Unrestricted non-preserved benefits are superannuation benefits for which a member has met a condition of release with a nil cashing restriction. They also include investment earnings on unrestricted non-preserved benefits before 1 July 1999. Unrestricted non-preserved benefits can be accessed at any time as a lump sum or income stream.

[14 310] Transition to retirement

The transition to retirement (TTR) condition of release was introduced in July 2005 and was designed to allow a person who has reached preservation age and is still working to access their superannuation in the form of a transition to retirement income stream.

Preservation age is determined by a person’s date of birth:

<table>
<thead>
<tr>
<th>Person born</th>
<th>Preservation age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1 July 1960</td>
<td>55</td>
</tr>
<tr>
<td>1 July 1960 to 30 June 1961</td>
<td>56</td>
</tr>
<tr>
<td>1 July 1961 to 30 June 1962</td>
<td>57</td>
</tr>
<tr>
<td>1 July 1962 to 30 June 1963</td>
<td>58</td>
</tr>
<tr>
<td>1 July 1963 to 30 June 1964</td>
<td>59</td>
</tr>
<tr>
<td>On or after 1 July 1964</td>
<td>60</td>
</tr>
</tbody>
</table>

[14 315] Transition to retirement income streams

A TTR income stream is a non-commutable account-based pension (see [14 405]) or annuity (see [14 410]) commenced under the TTR condition of release.
TTR income streams are subject to the minimum payment standards and must meet the minimum payment requirements every year and are also subject to a maximum annual income payment.

Commutations cannot be made from a TTR income stream except in the following circumstances:

- cashing out unrestricted non-preserved benefits;
- paying a superannuation contributions surcharge;
- giving effect to a payment split under the Family Law Act; and
- giving effect to a release authority.

From 1 July 2017, TTR income streams which are not in the retirement phase will not qualify for a tax exemption on the earnings from assets that support the income stream. TTR income streams will not be in the retirement phase unless one of the following conditions of release has been met:

- retirement (see [14 320]);
- reaching age 65;
- permanent incapacity (see [14 325]); or
- terminal illness (see [14 330]).

A TTR income stream which is not in the retirement phase does not count towards a person’s transfer balance account (see [14 400]). However, the value of the income stream does count towards the accumulation phase value for their total superannuation balance: see [14 270].

**Payment standards for transition to retirement income streams**

The minimum annual payment is calculated at commencement and then at 1 July every year. The minimum annual payment is calculated according to the formula in Sch 7 of the *Superannuation Industry (Supervision) Regulations 1994* (SISR 1994) (rounded to the nearest $10):

\[ \text{Account balance} \times \text{percentage factor} \]

The account balance is the purchase price of the TTR income stream at commencement and then the account balance at 1 July every year. The percentage factor is determined by the age of the beneficiary at commencement and then at 1 July every year. The percentage factors are provided in the table in Sch 7 of the SISR 1994: see [14 405].

Where the TTR income stream commences partway through the financial year, the payment is pro-rated for the number of days remaining in the year. However, if the TTR income stream commences on or after 1 June, no payment is required for that financial year.

The maximum annual income payment is 10% of the account balance. As with the minimum annual payment, the account balance is the purchase price of the TTR income stream at commencement and then the account balance at 1 July every year. Unlike the minimum annual payment, the maximum annual income payment is not pro-rated where the TTR income stream commences partway through the financial year.
Regular payments and lump sum withdrawals made from a TTR income stream must be paid from the preservation classes in the following order:

- first, unrestricted non-preserved;
- second, restricted non-preserved;
- third, preserved.

**TIP**

Cashing out unrestricted non-preserved benefits from a TTR income stream does not count towards the maximum annual income payment.

Where a client has unrestricted non-preserved and preserved benefits within their superannuation fund, advisers can separate the benefits by commencing an account-based pension with the unrestricted non-preserved benefits before commencing a TTR income stream with the preserved benefits.

The trustee of a superannuation fund may preserve all the superannuation money used to commence a TTR income stream.

*Taxation of transition to retirement income streams*

TTR income streams are subject to superannuation member benefits rules under Div 301 of the ITAA 1997. Where the beneficiary is aged 60 or over, regular payments and lump sum withdrawals will be tax-free. Where the beneficiary is under age 60, the taxation will depend on the components of the TTR income stream: see [14 350].

The components of a TTR income stream are determined at commencement by the sum of the components of the superannuation money used to commence the income stream. The proportions of components at commencement are then applied to all regular payments and lump sum withdrawals made from the TTR income stream: see [14 340].

**TIP**

Where a person reduces working hours in the lead-up to retirement, a TTR income stream can be used to replace their reduction in salary. Alternatively, where a person continues working full time in the lead-up to retirement, a TTR income stream can be used in conjunction with salary sacrifice as a tax-effective way of increasing their retirement savings: see [14 220].

**EXAMPLE [14 315.10]**

David is age 60, working full time and earning $110,000 per annum of employment income. He is considering retirement and has $300,000 in his superannuation account. He wants to start working part time, which will reduce his employment income to $70,000 per annum, without reducing his after-tax income.
David withdraws $300,000 from his superannuation and commences a non-commutable account-based pension drawing $25,165 for the financial year. As he is age 60, his pension payments will be tax-free.

<table>
<thead>
<tr>
<th>Cash flow</th>
<th>Current situation</th>
<th>TTR strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income</td>
<td>$110,000</td>
<td>$70,000</td>
</tr>
<tr>
<td>Tax payable (incl Medicare levy)</td>
<td>($30,532)</td>
<td>($15,697)</td>
</tr>
<tr>
<td>TTR pension</td>
<td>Nil</td>
<td>$25,165</td>
</tr>
<tr>
<td>After-tax income</td>
<td>$79,468</td>
<td>$79,468</td>
</tr>
</tbody>
</table>

David’s employment income has reduced by $40,000. However, he only has to draw $25,165 from his non-commutable account-based pension to maintain the same after-tax income.

Death benefits from transition to retirement income streams

Death benefits payable from a TTR income stream are subject to compulsory cashing rules under reg 6.21 of the SISR 1994. Death benefits can only be paid to the deceased’s estate or a dependant of the deceased at the time of death as defined under the Superannuation Industry (Supervision) Act 1993 (SIS Act): see [14 335].

The taxation of death benefits is subject to the superannuation death benefits rules under Div 302 of the ITAA 1997. The taxation will depend on the components of the TTR income stream, the form of the benefit and if the benefit is paid to a dependant of the deceased at the time of death as defined under s 302-195 of the ITAA 1997: see [14 355].

The proportions of components of a TTR income stream at commencement will apply to lump sum death benefits and income stream death benefits.

[14 320] Retirement

The retirement condition of release allows a person to access their superannuation when they retire. A person is taken to be retired in the following circumstances:

- the person has reached preservation age (see [14 310]):
  - an arrangement under which the person was gainfully employed has come to an end; and
  - the trustee is reasonably satisfied that the person never intends to be gainfully employed again on at least a part-time basis (10 hours or more per week);
- the person has reached age 60:
  - an arrangement under which the person was gainfully employed has come to an end; and
  - the person reached that age on or before the ceasing of that employment; or
the trustee is reasonably satisfied that the person never intends to be gainfully employed again on at least a part-time basis (10 hours or more per week).

TIP Where a person declares they have retired, there is nothing to prevent them from changing their mind and returning to gainful employment. However, when the declaration is made, the person must not have the intention of returning to gainful employment.

Permanent incapacity

The permanent incapacity condition of release allows a person who has ceased gainful employment to access their superannuation when the trustee is reasonably satisfied that the person is unlikely, because of ill health, to engage in gainful employment for which the person is reasonably qualified by education, training or experience.

The SIS Act defines permanent incapacity as a person being unable to engage in “any” occupation to which they are reasonably qualified. However, many insurers define total and permanent disablement (TPD) as a person being unable to engage in their “own” occupation ever again, which is a more lenient definition than that of the SIS Act.

Where a TPD insurance policy is held within superannuation and the insurer has an “own” occupation definition, a claim may be paid to a superannuation fund, but the trustee may not be able to cash out the benefit.

From 1 July 2014, new insurance policies can only be held within superannuation where the insured event is consistent with the relevant condition of release. Insurance policies already held within superannuation before 1 July 2014 can continue under existing policy terms.

Terminal illness

The terminal illness condition of release allows a person who has a terminal medical condition to access their superannuation. A terminal medical condition exists in relation to a person if the following circumstances exist:

- 2 registered medical practitioners have certified, jointly or separately, that the person suffers from an illness, or has incurred an injury, that is likely to result in the death of the person within a period that ends not more than 24 months after the date of certification;
- at least 1 of the registered medical practitioners is a specialist practising in an area related to the illness or injury suffered by the person; and
- for each of the certificates, the certification period has not ended.

Death

The death condition of release allows superannuation to be paid to the deceased’s estate or a dependant of the deceased at the time of death as defined under the SIS Act. A dependant, as defined under the SIS Act, includes:

- the deceased’s spouse;
• the deceased’s child of any age;
• any other person with whom the deceased had an interdependency relationship just before death; or
• any other person who was financially dependent on the deceased just before death.

A spouse includes the person who at the time of death was:
• although not legally married to the deceased, living with the deceased on a genuine domestic basis in a relationship as a couple; or
• in a relationship with the deceased that is registered under a law of a State or Territory.

A child includes any person who at the time of death was:
• the deceased’s adopted child;
• the deceased’s stepchild;
• the deceased’s ex nuptial child;
• a child of the deceased’s spouse; or
• the deceased’s child within the meaning of the Family Law Act.

A person has an interdependency relationship with the deceased at the time of death if:
• they have a close personal relationship;
• they live together;
• one or each of them provides the other with financial support; and
• one or each of them provides the other with domestic support and personal care.

Death benefits can be paid in a number of forms including:
• a single lump sum;
• an interim lump sum (not exceeding the amount of benefits ascertained at the date of death) and a final lump sum (not exceeding the balance of benefits ascertained in relation to the death);
• one or more pensions, each of which is a superannuation income stream that is in the retirement phase; or
• one or more annuities, each of which is a superannuation income stream that is in the retirement phase.

Death benefit income streams can only be paid to a dependant of the deceased with additional restrictions for a child. A child can only receive a death benefit income stream where at the time of the death the child:
• is under age 18;
• is under age 25 and financially dependent on the deceased; or
• has a disability described in s 8(1) of the Disability Services Act 1986.

Death benefit income streams paid to a child under age 25 must be withdrawn as a tax-free lump sum when the child reaches age 25 unless they have a disability described in s 8(1).
Proportioning rule for superannuation benefits

Benefits paid from superannuation are subject to the proportioning rule which requires that income streams and lump sum withdrawals contain both tax-free and taxable components in proportion. This rule applies differently depending on whether superannuation is in accumulation or pension phase.

In accumulation phase, the tax-free and taxable components of lump sum withdrawals are determined by the proportions of components of the superannuation just before the withdrawal. The tax-free component is the sum of the contributions segment and the crystallised segment less the tax-free component of previous withdrawals. The taxable component is the total amount in the superannuation less the tax-free component.

The contributions segment is made up of all contributions made to superannuation from 1 July 2007 which have not been included in the assessable income of the superannuation fund. These contributions include:

- personal contributions not claimed as a tax deduction;
- personal contributions for which a tax deduction has been denied;
- spouse contributions;
- Government co-contribution;
- contributions of proceeds from the disposal of assets that qualify for the small business 15-year exemption or retirement exemption up to the CGT cap;
- contributions arising from structured settlements or order for personal injury; and
- the non-growth portion of a transfer from a foreign superannuation fund.

The crystallised segment is the 30 June 2007 value of the following components:

- undeducted contributions;
- concessional component;
- post-June 1994 invalidity component;
- CGT exempt component; and
- pre-July 1983 component.

The taxable component may be a taxed element or an untaxed element. Benefits paid from untaxed superannuation schemes contain an untaxed element. These schemes are not subject to contributions tax or earnings tax. Public sector superannuation schemes and constitutionally protected superannuation funds are untaxed superannuation schemes. Benefits paid from taxed superannuation schemes only contain an untaxed element where it is a death benefit that includes insurance benefits.

EXAMPLE [14 340.10]

Natalie is aged 55 and has retired. She has $100,000 in superannuation made up of $30,000 undeducted contributions before 1 July 2007 and $30,000 personal contributions after 1 July 2007. She makes a lump sum withdrawal of $50,000.
The tax-free component of her superannuation will be the sum of the contributions segment and the crystallised segment. The taxable component will be the total amount in her superannuation less the tax-free component.

\[
\frac{30,000 + 30,000}{100,000 - 60,000} = \frac{60,000}{40,000}
\]

The components of her superannuation are $60,000 tax-free and $40,000 taxable (taxed element). The proportions of components are calculated as the tax-free and taxable (taxed element) components divided by the value of her superannuation.

\[
\frac{60,000}{100,000} = 60\%
\]
\[
\frac{40,000}{100,000} = 40\%
\]

The proportions of components just before the withdrawal are 60% tax-free and 40% taxable (taxed element). The proportions of components will be applied to her lump sum withdrawal.

\[
\frac{50,000 \times 60\%}{50,000 \times 40\%} = \frac{30,000}{20,000}
\]

Her lump sum withdrawal will be made up of $30,000 tax-free and $20,000 taxable (taxed element) components.

3 years later, Natalie has $75,000 in superannuation. She has not made any further personal contributions. She makes a lump sum withdrawal of $20,000.

The tax-free component of her superannuation will be the sum of the contributions segment and the crystallised segment less the tax-free component of her previous withdrawal. The taxable component will be the total amount in her superannuation less the tax-free component.

\[
\frac{30,000 + 30,000 - 30,000}{75,000 - 30,000} = \frac{30,000}{45,000}
\]

The components of her superannuation are $30,000 tax-free and $45,000 taxable (taxed element). The proportions of components are calculated as the tax-free and taxable (taxed element) components divided by the value of her superannuation.

\[
\frac{30,000}{75,000} = 40\%
\]
\[
\frac{45,000}{75,000} = 60\%
\]

The proportions of components just before the withdrawal are 40% tax-free and 60% taxable (taxed element). The proportions of components will be applied to her lump sum withdrawal.

\[
\frac{20,000 \times 40\%}{20,000 \times 60\%} = \frac{8,000}{12,000}
\]
Her lump sum withdrawal will be made up of $8,000 tax-free and $12,000 taxable (taxed element) components.

In pension phase, the tax-free and taxable components of regular payments and lump sum withdrawals are determined by the proportions of components of the income stream at commencement. The components of the income stream at commencement are the sum of the components of the superannuation money used to commence the income stream.

**EXAMPLE [14 340.20]**

Justin is aged 55 and has retired. He has $200,000 in an employer superannuation fund made up of $20,000 tax-free and $180,000 taxable (taxed element) components and $100,000 in a personal superannuation fund made up of $40,000 tax-free and $60,000 taxable (taxed element) components. He rolls over both superannuation funds into an account-based pension.

The components in his account-based pension are the sum of the components of the superannuation money used to commence his account-based pension.

\[
\frac{20,000 + 40,000}{180,000 + 60,000} = \frac{60,000}{240,000}
\]

The components in his account-based pension are $60,000 tax-free and $240,000 taxable (taxed element). The proportions of components are calculated as the tax-free and taxable (taxed element) components divided by the value of his account-based pension.

\[
\frac{60,000}{300,000} = 20%
\]

\[
\frac{240,000}{300,000} = 80%
\]

The proportions of components at commencement of his account-based pension are 20% tax-free and 80% taxable (taxed element). The proportions of components will be applied to all regular payments and lump sum withdrawals made from his account-based pension.

**[14 350] Taxation of member benefits**

Member benefits are subject to superannuation member benefits rules under Div 301 of the ITAA 1997. The taxation will depend on the components of the benefit, the age of the member and the form of the benefit.

The tax-free component is not subject to taxation and is excluded from income tax return calculations regardless of the age of the member or the form of the benefit. Where the member is aged 60 or over, the taxable (taxed element) component is also not subject to taxation and is excluded from income tax return calculations regardless of the form of the benefit.

The low rate cap applies to lump sum withdrawals which contain taxable components for members from preservation age to age 59. The taxable components within the low rate cap receive a tax offset so that the taxed
elements are tax-free and the untaxed elements are taxed at a maximum rate of 15%. The low rate cap applies first to the taxed elements and then the untaxed elements paid in the same financial year. The low rate cap is reduced by the taxable component of any lump sum withdrawals made in previous financial years that received a tax offset.

The untaxed plan cap applies to lump sum withdrawals paid from untaxed superannuation schemes. The untaxed plan cap is measured on a per superannuation plan basis. The taxable (untaxed element) components over the untaxed plan cap are taxed at a maximum rate of 45%.

### Taxation of lump sum withdrawals

<table>
<thead>
<tr>
<th>Component</th>
<th>Age</th>
<th>Amount</th>
<th>Maximum tax rate¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax-free</td>
<td>Any age</td>
<td>Entire amount</td>
<td>0%</td>
</tr>
<tr>
<td>Taxable (taxed element)</td>
<td>60 or over</td>
<td>Entire amount</td>
<td>0%</td>
</tr>
<tr>
<td></td>
<td>Preservation age to 59</td>
<td>First $200,000²</td>
<td>0%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over $200,000²</td>
<td>15%</td>
</tr>
<tr>
<td></td>
<td>Under preservation age</td>
<td>Entire amount</td>
<td>20%</td>
</tr>
<tr>
<td>Taxable (untaxed element)</td>
<td>60 or over</td>
<td>First $1,445,000³</td>
<td>15%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over $1,445,000³</td>
<td>45%</td>
</tr>
<tr>
<td></td>
<td>Preservation age to 59</td>
<td>First $200,000²</td>
<td>15%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$200,000² – $1,445,000³</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over $1,445,000³</td>
<td>45%</td>
</tr>
<tr>
<td></td>
<td>Under preservation age</td>
<td>First $1,445,000³</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Over $1,445,000³</td>
<td>45%</td>
</tr>
</tbody>
</table>

¹ Medicare levy will apply except where tax rate is nil.
² Low rate cap.
³ Untaxed plan cap.

### Taxation of income streams

<table>
<thead>
<tr>
<th>Component</th>
<th>Age</th>
<th>Maximum tax rate¹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax-free</td>
<td>Any age</td>
<td>0%</td>
</tr>
<tr>
<td>Taxable (taxed element)</td>
<td>60 or over</td>
<td>0%</td>
</tr>
<tr>
<td></td>
<td>Preservation age to 59</td>
<td>MTR² less 15% tax offset</td>
</tr>
<tr>
<td></td>
<td>Under preservation age</td>
<td>MTR²</td>
</tr>
<tr>
<td>Taxable (untaxed element)</td>
<td>60 or over</td>
<td>MTR² less 10% tax offset</td>
</tr>
<tr>
<td></td>
<td>Under age 60</td>
<td>MTR²</td>
</tr>
</tbody>
</table>

¹ Medicare levy will apply except where tax rate is nil.
² Marginal tax rate.
EXAMPLE [14 350.10]

Nathan is aged 55 and has retired. He has $500,000 in superannuation made up of $100,000 tax-free and $400,000 taxable (taxed element) components. He makes a lump sum withdrawal of $300,000.

The tax-free and taxable (taxed element) components of the lump sum withdrawal will be determined by the proportions of the components of his superannuation just before the withdrawal. The proportions of components are calculated as the tax-free and taxable (taxed element) components divided by the value of his superannuation.

\[
\frac{100,000}{500,000} = 20% \\
\frac{400,000}{500,000} = 80%
\]

The proportions of components just before the withdrawal are 20% tax-free and 80% taxable (taxed element). The proportions of components will be applied to his lump sum withdrawal.

\[
\begin{align*}
300,000 \times 20% &= 60,000 \\
300,000 \times 80% &= 240,000
\end{align*}
\]

His lump sum withdrawal will be made up of $60,000 tax-free and $240,000 taxable (taxed element) components. The tax-free component will be tax-free. As he is under age 60, the first $200,000 of the taxable (taxed element) component will be tax-free and the amount over $200,000 will be taxed at 15% plus Medicare levy.

[14 355] Taxation of death benefits

Death benefits are subject to the superannuation death benefits rules under Div 302 of the ITAA 1997. The taxation will depend on the components of the benefit, the form of the benefit and if the benefit is paid to a dependant of the deceased at the time of death as defined under s 302-195 of the ITAA 1997.

Death benefits can be paid to the deceased’s estate in the form of a lump sum only. The taxation will depend on the components of the benefit and if it is ultimately paid to a dependant of the deceased. Any liability to taxation will be payable by the deceased estate.

A dependant as defined under s 302-195 of the ITAA 1997 includes:

- deceased’s spouse or former spouse (see [14 335]);
- deceased’s child under age 18 (see [14 335]);
- any other person with whom the deceased had an interdependency relationship just before death (see [14 335]); or
- any other person who was financially dependent on the deceased just before death.

The tax-free component is not subject to taxation and is excluded from income tax return calculations regardless of the form of the benefit or who the
benefit is paid to. The taxable (taxed element) component paid as a lump sum death benefit to a dependant is also not subject to taxation and is excluded from income tax return calculations.

Where the deceased or dependant is aged 60 or over at the time of death, the taxable (taxed element) component paid as an income stream death benefit is not subject to taxation and is excluded from income tax return calculations.

<table>
<thead>
<tr>
<th>Taxation of lump sum death benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Component</strong></td>
</tr>
<tr>
<td>Tax-free</td>
</tr>
<tr>
<td>Taxable (taxed element)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Taxable (untaxed element)</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

¹ Medicare levy will apply except where tax rate is nil.

<table>
<thead>
<tr>
<th>Taxation of income stream death benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Component</strong></td>
</tr>
<tr>
<td>Tax-free</td>
</tr>
<tr>
<td>Taxable (taxed element)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Taxable (untaxed element)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

¹ Medicare levy will apply except where tax rate is nil.
² Marginal tax rate.

**EXAMPLE [14 355.10]**

Jason is aged 55 and is working full time. He has a wife Mary who is aged 50 and a child Paul who is aged 25. He has $200,000 in superannuation made up of $50,000 tax-free and $150,000 taxable (taxed element) components.

Jason is involved in a car accident and dies. The death benefit from his superannuation is split 50/50 between Mary and Paul. Mary receives the death benefit as an account-based pension and Paul receives the death benefit as a lump sum.

The tax-free and taxable (taxed element) components of the death benefits will be determined by the proportions of the components of Jason’s superannuation just before the withdrawal. The proportions of components are calculated as the tax-free and taxable (taxed element) components divided by the value of his superannuation.

\[
\frac{50,000}{200,000} = 25% \\
\frac{150,000}{200,000} = 75% 
\]
The proportions of components at commencement of Mary’s account-based pension will be 25% tax-free and 75% taxable (taxed element). The proportions of components will be applied to all regular payments and lump sum withdrawals made from her account-based pension.

The tax-free component of any regular payments will be tax-free. As Jason was under age 60 at the time of his death, and Mary is under age 60, the taxable (taxed element) component of any regular payments will be taxed at her MTR less 15% tax offset. When she reaches age 60, the regular payments will become tax-free.

The proportions of components of Jason’s superannuation just before the withdrawal will be applied to Paul’s lump sum.

\[
\begin{align*}
$100,000 \times 25\% &= $25,000 \\
$100,000 \times 75\% &= $75,000
\end{align*}
\]

Paul’s lump sum withdrawal will be made up of $25,000 tax-free and $75,000 taxable (taxed element) components. The tax-free component will be tax-free. As he is a non-dependant for tax purposes, the taxable (taxed element) component will be taxed at 15% plus Medicare levy.

**RETIRED INCOMES**

[14 400] Pension transfer balance cap of $1.6m for retirement phase

A pension transfer balance cap of $1.6m applies from 1 July 2017 to limit the total amount of accumulated superannuation that can be transferred into retirement phase (where earnings on assets are tax-exempt: see [9 400]).

The general transfer balance cap is $1.6m for 2017-18 but indexed to CPI (in $100,000 increments). A superannuation interest will be in the “retirement phase” if it supports a superannuation income stream benefit that is in the retirement phase and currently payable. A transition to retirement income stream (see [14 315]) is not in retirement phase and, therefore, does not count towards the cap.

The concept of a “transfer balance account” is used to track each person’s net pension amounts against their transfer balance cap. If an individual’s transfer balance account exceeds their transfer balance cap, the ATO will issue a determination requiring the excess amount to be removed from retirement phase. Excess transfer balance amounts are subject to tax: initially at 15% but increasing to 30% for breaches in subsequent years. This tax is calculated on the notional earnings for the excess amount, which accrues until the breach is rectified.

At the fund level, transitional CGT rules enable complying funds to reset the cost base of assets that are adjusted because of the pension cap reforms: see [9 415].
Existing pension balances at 30 June 2017

Members with total pension balances over $1.6m at 30 June 2017 were required to commute (or "roll back") the excess amount to accumulation phase before 1 July 2017 (where it will be subject to 15% tax on future earnings: see [9 400]). Alternatively, the excess amount can be withdrawn from superannuation altogether. Individuals above the $1.6m cap should consider tax and estate planning strategies to keep certain amounts separate (to isolate specific tax components) when rolling back excess pension amounts to an accumulation account.

The ATO has acknowledged that some SMSF members may not have been in a position on 30 June 2017 to know precisely the value of the pension interests in excess of $1.6m that needed to be rolled back before 1 July 2017. Practical Compliance Guideline PCG 2017/5 accepts that a valid strategy is for a SMSF member to make a request, which is subsequently accepted by the trustee, to commute their income stream(s) by the amount that exceeds $1.6m on 30 June. Importantly, the request to commute the excess amount must be in writing before 1 July 2017 and cannot be revoked. The amount of the commutation must also be reflected in the SMSF's financial accounts for the year ended 30 June 2017, no later than the due date of the fund’s annual return. However, the ATO’s compliance approach in PCG 2017/5 will not apply where the request does not provide sufficient certainty as to which income streams are subject to the commutation or the request is dependent on the exercise of a discretion by the trustee.

TIP SMSF members with multiple pension interests should also consider the underlying tax components of each pension interest (see [14 340]) when nominating the interest from which to roll back the excess pension amount to accumulation.

Transitional relief up to $100,000

As a transitional concession, excess transfer balance amounts up to $100,000 on 30 June 2017 will not give rise to a tax liability if they are rectified by 31 December 2017.

EXAMPLE [14 400.10]

On 1 January 2017, Ian has an account-based pension worth $2m. To comply with the transfer balance cap, Ian partially commutes his pension on 15 June 2017 and receives a superannuation lump sum of $400,000.

The superannuation interest that supports Ian’s pension increases in value by $10,000 by 30 June 2017 so that the value of the interest supporting his pension is $1.61m on 30 June 2017. A credit arises in Ian’s transfer balance account for that amount on 1 July 2017. Ian has an excess transfer balance of $10,000.

On 1 August 2017, Ian makes a partial commutation of the pension and receives a debit of $10,000. Because Ian has rectified the breach of his transfer balance cap, and the excess was less than $100,000, Ian accrues no notional earnings, and he is not liable for excess transfer balance tax.
Transfer balance cap

At the time an individual first commences a retirement phase superannuation income stream, the individual’s “personal transfer balance cap” will equal the general transfer balance cap for that financial year ($1.6m for 2017-18).

If a person is receiving a superannuation income stream (other than a “transition to retirement income stream” (TRIS): see [14 315]) immediately before 1 July 2017, their transfer balance cap is set at $1.6m. The individual’s transfer balance account will be credited (increased) with the value of that superannuation interest on 30 June. If a person has more than one superannuation fund, their transfer balance account is the sum of the value of all their retirement phase superannuation income stream interests.

Proportional indexation of transfer balance cap

Where an individual starts to have a transfer balance account and has not used the full amount of their personal transfer balance cap space (up to the general cap), their cap will be subject to proportional indexation. This is calculated under s 294-40 ITAA 1997 by finding the individual’s highest transfer balance at the end of a day at an earlier point in time, comparing it to their personal transfer balance cap on that day, and expressing it as an “unused cap percentage”. Once an individual has used their entire available cap space, their personal transfer balance cap will not be subject to further indexation, even if they later commute the pension so that the transfer balance falls below the cap.

EXAMPLE [14 400.20]

Danika first commences an $800,000 retirement phase superannuation income stream on 18 November 2017. A transfer balance account is created for Danika at this time. Her personal transfer balance cap is $1.6m for 2017-18. As Danika has not made any other transfers to her retirement phase account, her highest transfer balance is $800,000. She has used 50% of her $1.6m personal transfer balance cap.

Assuming the general transfer balance cap is indexed to $1.7m in 2020-21, Danika’s personal transfer balance cap is increased proportionally to $1.65m. That is, Danika’s personal transfer balance cap is increased by 50% of the corresponding increase to the general transfer balance cap. As such, Danika can now transfer a further $850,000 to the retirement phase without breaching her personal transfer balance cap.

Transfer balance accounts – credits

<table>
<thead>
<tr>
<th>Debits (-)</th>
<th>Credits (+)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commutations (full or partial)</td>
<td>Pension value on 30 June 2017</td>
</tr>
<tr>
<td>Failure to comply with pension standards or commutation authority</td>
<td>Start value of new pension (including death benefit pension)</td>
</tr>
<tr>
<td>Family law payment splits</td>
<td>Reversionary pension value at death, credit 12 months after death (or 1 July 2017 if earlier)</td>
</tr>
<tr>
<td>Structured settlements</td>
<td>Notional earnings on excess amount</td>
</tr>
<tr>
<td>Loss from bankruptcy/fraud</td>
<td>LRBA repayment from accumulation for post-1 July 2017 LRBA</td>
</tr>
</tbody>
</table>
A person will start to have a “transfer balance account” at the time they first commence a retirement phase superannuation income stream and become a “retirement phase recipient”. This transfer balance account tracks the person’s net retirement phase amounts against their personal transfer balance cap. A credit increases the transfer balance account and reduces the amount of available unused cap space. See Law Companion Guideline LCG 2016/9.

If a person is receiving a retirement phase superannuation income stream just before 1 July 2017, their transfer balance account will be credited for the value of that superannuation interest on 30 June. The value of a superannuation interest at a particular time is the total amount of all lump sums that could be payable from that interest.

For retirement phase superannuation income streams that start on or after 1 July 2017, the commencement value will be credited to an individual’s transfer balance account on the day the income stream commences. This includes new death benefit income streams and “deferred superannuation income streams”. A credit also arises for any excess transfer balance earnings that accrue on excess transfer balance amounts. An additional credit arises for certain repayments of a limited recourse borrowing arrangement (LRBA) (see [10 242]) that shift value from a member’s accumulation interest to a retirement phase income stream interest.

**Reversionary pensions**

Modified rules apply for reversionary pensions so that the value of the pension will not be credited to a reversionary beneficiary’s transfer balance account until 12 months after the death of the original superannuation member. This gives the reversionary beneficiary time to bring their pension accounts within the cap. If the reversionary pension commenced before 1 July 2017, the credit arises on the later of 1 July 2017 and 12 months after the death of the original member. While the credit is deferred until 12 months after the date of the death, the amount of the credit is the value of the superannuation interest at the time it becomes payable to the reversionary beneficiary (ie at the date of death). To qualify as a reversionary pension, the entitlement must automatically revert to the reversionary beneficiary upon the member’s death and not involve any discretion on the part of the trustee as to whom it is paid: see Law Companion Guideline LCG 2017/3.

By contrast, in the case of a non-reversionary pension where a trustee has a discretion to pay a death benefit in the form of a new superannuation income stream, the beneficiary’s transfer balance account is credited for the market value of the interest at the time it becomes payable (or its value on 30 June 2017 if the pension commenced before 1 July 2017).

**EXAMPLE [14 400.30]**

**Reversionary pension**

Larissa commenced a pension on 1 October 2000. The rules of the pension allow for it to revert to a dependant beneficiary. Larissa dies on 1 January 2017. Brad is Larissa’s spouse and is the reversionary beneficiary of this pension. As Brad
is a reversionary beneficiary, Larissa’s pension automatically becomes payable to Brad on the date of Larissa’s death (1 January 2017). The value of the superannuation interest that supports the reversionary pension just before 1 July 2017 is $1m.

A transfer balance credit arises in Brad’s transfer balance account 12 months from the day that the reversionary income stream first became payable to Brad (1 January 2018). The transfer balance credit that arises is equal to the value of the superannuation interest that supports the reversionary pension just before 1 July 2017 ($1m) and not the value of the superannuation interest when the transfer balance credit arises (1 January 2018).

While it is possible to roll over death benefits to a dependant beneficiary (see [9 725]), any excess transfer balance amount cannot be rolled back into accumulation phase as a death benefit superannuation income stream needs to be in retirement phase.

**Debits for commutations**

An individual’s transfer balance account is debited when they commute (in full or in part) a retirement phase superannuation income stream into a lump sum. A debit for a commutation arises at the time the person “receives” the lump sum.

A transfer balance debit could be higher (due to growth) or lower (due to draw-downs or losses) than the commencement value of the superannuation income stream. As such, the amount of a debit applied for a full commutation may exceed the balance of the individual’s transfer balance account. Just as investment gains are not credited towards an individual’s transfer balance account, investment losses (and minimum pension drawn-downs: see [14 405]) do not give rise to debits. A debit arises when an individual stops being the retirement phase recipient of a superannuation income stream because of a failure to comply with the pension standards (see [14 405]).

A transfer balance debit also arises for:

- a structured settlement for a personal injury that is contributed to superannuation (see [5 225]);
- a family law payment split (see [9 735]);
- a bankruptcy clawback (see [9 510]) or a loss suffered as a result of fraud or dishonesty (if the offender is convicted);
- a notice by the Commissioner about a non-commutable excess transfer balance for a defined benefit income stream.

**Transfer balance account reporting (TBAR)**

Superannuation funds are required to lodge an electronic Transfer Balance Account Report (TBAR) to enable the ATO to administer the regime. This reporting obligation commences from 1 October 2017, but a transitional event-based approach has deferred until 1 July 2018 reporting for SMSF income streams on 30 June 2017 and newly-commenced income streams. However, certain commutations that are rolled over to another fund, or required to correct an excess transfer balance, need to be reported 10 days after the month in which it occurs.
Child pensions

Modified transfer balance cap rules apply for eligible child dependants receiving a superannuation death benefit income stream from a deceased person. Except in the case of a child with a permanent disability, the child’s modified transfer balance account will cease when they are required to commute all their superannuation income streams when they turn 25 or the capital is exhausted.

Excess balance determinations by Commissioner

If an individual’s transfer balance account exceeds their transfer balance cap, the ATO will issue an excess transfer balance determination to crystallise the amount of the individual’s excess transfer balance that must be removed (ie commuted) from retirement phase. An individual with more than one superannuation income stream can make an irrevocable election to choose which income stream or amount to commute. The election must be given to the ATO within 60 days.

Commutation authorities

Where an excess transfer balance determination is issued, the ATO will issue a “commutation authority” directing the income stream provider to commute the individual’s retirement phase interests by the amount of the excess (including the notional earnings) – this is called the “crystallised reduction amount”. If the individual does not make a valid election to choose which income stream to commute, the ATO will issue a commutation authority to each income stream provider specified in the default commutation notice.

A superannuation income stream provider must pay within 60 days the lesser of the reduction amount stated in the commutation authority or the maximum available release amount.

Notional earnings on excess balances

Where an individual’s transfer balance account exceeds their personal transfer balance cap, “excess transfer balance earnings” accrue daily (at the GIC rate). This means that notional earnings compound daily (at the average annual GIC rate: see [5 735]) until the breach is rectified or the ATO issues a determination. Excess transfer balance earnings are also credited towards an individual’s transfer balance account.

Excess transfer balance tax

An individual will be personally liable to pay excess transfer balance tax on the notional earnings for the amount in excess of the transfer balance cap. The standard rate of excess transfer balance tax is 15% of the notional earnings on the excess transfer balance (or 30% for an excess transfer balance tax assessment received in a subsequent financial year).

An excess transfer balance tax assessment is due and payable 21 days after the ATO issues the assessment.
EXAMPLE [14 400.40]

**Excess transfer balance tax**

On 1 August 2018, Audrey’s SMSF starts a pension for her worth $2m. Audrey has a personal transfer balance cap of $1.6m. On 1 August 2018, she has an excess transfer balance of $400,000. She realises her mistake 30 days later and decides to make a partial commutation of the pension to remove the excess.

Over the course of the 30-day period, Audrey’s transfer balance account is credited with excess transfer balance earnings of $3,036 (assuming an annual GIC rate of 9.2%). This brings her transfer balance account up to $2,003,036.

Audrey calculates her excess transfer balance at the end of the 30-day period and, on that day, makes a partial commutation in return for a lump sum of $403,036. Audrey receives a debit for that amount in her transfer balance account. This brings her transfer balance account back in line with the $1.6m transfer balance cap.

Subsequently, on 1 July 2019, Audrey starts a second pension worth $1m. She has no available cap space, meaning she breaches her cap for a second time and has an excess transfer balance of $1m. Sixty days later, the ATO issues a determination to Audrey identifying a crystallised reduction amount of $1,015,236 ($1m excess plus 60 days of notional earnings). The ATO issues a commutation authority to Audrey’s SMSF 65 days after issuing the determination. Ten days after the ATO issues the commutation authority, Audrey’s SMSF complies with the authority and makes a partial commutation, paying her a lump sum of $1,015,236.

Audrey accrued notional earnings during the 60-day period before the determination and the subsequent 75-day period before the fund partially commuted the pension. The Commissioner assesses Audrey for excess transfer balance tax as follows.

<table>
<thead>
<tr>
<th>Excess transfer balance amount ($)</th>
<th>Period</th>
<th>Excess transfer balance earnings ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>400,000</td>
<td>30 days</td>
<td>3,036</td>
</tr>
<tr>
<td></td>
<td>Tax @ 15%</td>
<td>455</td>
</tr>
<tr>
<td>1,000,000</td>
<td>60 days</td>
<td>15,236</td>
</tr>
<tr>
<td>1,015,236</td>
<td>75 days</td>
<td>19,372</td>
</tr>
<tr>
<td></td>
<td>Subtotal</td>
<td>34,608</td>
</tr>
<tr>
<td></td>
<td>Tax @ 30%</td>
<td>10,382</td>
</tr>
</tbody>
</table>

**Capped defined benefit income streams**

Defined benefit income streams are counted towards an individual’s transfer balance cap under modified rules. These “capped defined benefit income streams” include certain non-commutable, lifetime and life expectancy pensions and annuities listed in s 294-130 ITAA 1997. See Law Companion Guideline LCG 2016/10 (lifetime pensions) and LCG 2017/1 (life expectancy and market linked pensions). An additional range of defined benefit income streams are prescribed by regulations to receive this modified tax treatment: reg 294-130.01 ITA Regs.

Where an individual receives a capped defined benefit income stream (such as a lifetime pension), a credit arises in their transfer balance account equal to the “special value” of the superannuation interest. For a lifetime pension, the
special value is calculated by multiplying the “annual entitlement” by 16; see Law Companion Guideline LCG 2016/10. The annual entitlement is worked out by annualising the first income stream benefit payable from the income stream across an income year. For a life expectancy or market-linked pension, the special value is calculated by multiplying the annual entitlement by the product’s “remaining term” (rounded up to the next whole year).

For superannuation income streams that are in the retirement phase prior to 1 July 2017, the credit is equal to the special value just before 1 July. This is based on the first income stream benefit that the individual is entitled to receive on or after 1 July 2017.

**EXAMPLE [14 400.50]**

**Special value for defined benefit income streams**

Johannes is 65 on 1 July 2017 and has been receiving a lifetime pension since he was 62. The first pension benefit Johannes is entitled to receive on or after 1 July 2017 is a fortnightly pension payment of $5,753.42.

His annual entitlement is $149,999.88 ($5,753.42 / 14 days x 365). The special value is worked out by multiplying his annual entitlement by 16. The special value of Johannes’ lifetime pension is $2,399,998.08 ($149,999.88 x 16). A credit will arise in his transfer balance account on 1 July 2017 equal to this amount.

As capped defined benefit income streams generally cannot be commuted and cashed as a lump sum, a capped defined benefit income stream, of itself, will not result in an excess transfer balance for an individual.

**Excess transfer balance - special rule for capped defined benefit pensions**

In order to achieve equivalent tax treatment to other types of superannuation pensions, the value of a capped defined benefit income stream is counted towards an individual’s $1.6m transfer balance cap. However, as capped defined benefit income streams generally cannot be commuted and cashed as a lump sum, a capped defined benefit income stream, of itself, will not result in an excess transfer balance. Nevertheless, a defined benefit income stream may limit an individual’s ability to maintain retirement phase pensions with other funds.

If an individual has a capped defined benefit income stream, they will also have a separate “capped defined benefit balance” for the purposes of determining any excess transfer balance under the modified rules in s 294-140 ITAA 1997. The excess transfer balance is the lesser of the amount by which the transfer balance account exceeds their personal transfer balance cap and their separate “capped defined benefit balance”.

If an individual has a capped defined benefit income stream and an account-based pension, and exceeds both their transfer balance cap and capped defined benefit balance, the individual will not be forced to commute their capped defined benefit income stream (even if it exceeds their $1.6m cap). However, the individual will need to choose to make a commutation of the account-based pension to reduce the excess amount if they wish to keep their capped defined benefit pension in place.
**Additional income tax – defined benefit income cap**

An individual may be liable to additional income tax to the extent that defined benefit pension income exceeds the individual’s separate “defined benefit income cap” for a financial year (being the general transfer balance cap for the corresponding financial year divided by 16): see [9 632]. As the general transfer balance cap is $1.6m for 2017-18, the defined benefit income cap is $100,000 pa.

In a taxed fund, 50% of the excess capped defined benefit income stream payments will be included in the recipient’s assessable income and taxed at the marginal rates to the extent they exceed $100,000 pa. This tax treatment applies despite any underlying tax free component for the excess amount. For untaxed defined benefit funds, the 10% tax offset is limited to the first $100,000 pa of defined benefit income the individual receives from 1 July 2017: see [9 632].

While the defined benefit income cap is not indexed, it will increase over time in line with increases in the general transfer balance cap (indexed). As the defined benefit income cap is based on the general (not the individual’s) transfer balance cap, this indexation is not lost if the individual meets or exceeds their personal transfer balance cap.

**[14 405] Account-based pensions**

An account-based pension is an income stream commenced with superannuation money where a condition of release has been met. Account-based pensions have an account balance attributed to a beneficiary from which regular payments or lump sum withdrawals can be made until the balance is exhausted. The account balance can be invested in assets as permitted under the Superannuation Industry (Supervision) Act 1993 (SIS Act), with movements in the balance based on investment performance. Regular payments can be made fortnightly, monthly, quarterly, half yearly or yearly, and lump sum withdrawals can be made at any time unless the account-based pension is a transition to retirement income stream: see [14 315].

Account-based pensions can automatically continue to a reversionary beneficiary in the event of the recipient’s death where the beneficiary is a dependant of the recipient at the time of death as defined under the SIS Act: see [14 335].

Account-based pensions are subject to the minimum payment standards. There is no maximum payment except in the case of a transition to retirement income stream, where the annual income payment is capped at 10% of the account balance: see [14 315].

**Minimum payment standards for account-based pensions**

The minimum annual payment is calculated at commencement and then at 1 July every year. The minimum annual payment is calculated according to the formula in Sch 7 of the Superannuation Industry (Supervision) Regulations 1994 (SISR 1994) (rounded to the nearest $10):

\[
\text{Account balance x percentage factor}
\]
The account balance is the purchase price of the account-based pension at commencement and then the account balance at 1 July every year. The percentage factor is determined by the age of the beneficiary at commencement and then at 1 July every year. The percentage factors are provided in the table in Sch 7 of the SISR 1994:

<table>
<thead>
<tr>
<th>Age</th>
<th>Percentage factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 65</td>
<td>4%</td>
</tr>
<tr>
<td>65-74</td>
<td>5%</td>
</tr>
<tr>
<td>75-79</td>
<td>6%</td>
</tr>
<tr>
<td>80-84</td>
<td>7%</td>
</tr>
<tr>
<td>85-89</td>
<td>9%</td>
</tr>
<tr>
<td>90-94</td>
<td>11%</td>
</tr>
<tr>
<td>95 or more</td>
<td>14%</td>
</tr>
</tbody>
</table>

Where the account-based pension commences part way through the financial year, the payment is pro-rated for the number of days remaining in the year. However, if the account-based pension commences on or after 1 June, no payment is required for that financial year.

**Taxation of account-based pensions**

Account-based pensions are subject to superannuation member benefits rules under Div 301 of the ITAA 1997. Where the beneficiary is aged 60 or over, regular payments and lump sum withdrawals will be tax-free. Where the beneficiary is under age 60, the taxation will depend on the components of the account-based pension: see [14 350].

The components of an account-based pension are determined at commencement by the components of the superannuation money used to commence the pension. The proportions of components at commencement are then applied to all regular payments and lump sum withdrawals made from the account-based pension: see [14 340].

**Nominating beneficiaries**

Beneficiaries, other than reversionary beneficiaries, can be nominated on account-based pensions to receive the remaining account balance in the event of the recipient’s death. There are a number of beneficiary nomination options available for account-based pensions:

- non-binding nomination;
- binding nomination; or
- non-lapsing nomination.

Non-binding nominations are a preferred nomination which the trustee will take into consideration in deciding to whom to pay death benefits. The nomination is valid indefinitely unless another valid nomination is made, and it cannot override a binding nomination or a non-lapsing nomination. The nomination does not bind the trustee as to whom to pay death benefits, or the form of the death benefit.

Binding nominations bind the trustee to pay death benefits to beneficiaries and/or the deceased’s estate. The nomination is valid for 3 years from the date
the nomination is made and must be witnessed by 2 people who are not nominated. The nomination does not bind the trustee as to the form of the death benefit.

Non-lapsing nominations bind the trustee to pay death benefits to beneficiaries and/or the deceased’s estate. The nomination is valid indefinitely subject to meeting the trustee requirements for a valid nomination. The nomination does not bind the trustee as to the form of the death benefit.

**Death benefits from account-based pensions**

Death benefits payable from an account-based pension are subject to compulsory cashing rules under reg 6.21 of the SISR 1994. Death benefits can only be paid to the deceased’s estate or a dependant of the deceased at the time of death as defined under the SIS Act: see [14 335].

The taxation of death benefits is subject to the superannuation death benefits rules under Div 302 of the ITAA 1997. The taxation will depend on the components of the account-based pension, the form of the benefit and whether the benefit is paid to a dependant of the deceased at the time of death as defined under s 302-195 of the ITAA 1997: see [14 355].

The proportions of components of an account-based pension at commencement will apply to lump sum death benefits and income stream death benefits.

**[14 410] Immediate annuities**

An immediate annuity is an income stream purchased with a single lump sum which provides regular payments either for an agreed term or for the rest of a person’s life. Immediate annuities are paid by life insurance companies and can be purchased with ordinary money or superannuation money. The regular payments are determined by the life insurance company at the time the annuity is purchased and will depend on:

- the purchase price of the annuity;
- the term of the annuity or the life expectancy of the annuitant;
- any residual capital value (RCV) payable at the end of the term;
- any guarantee periods for lump sum payment on death or voluntary withdrawal; and
- prevailing interest rates at the time the annuity is purchased.

**Fixed term annuities**

Fixed term annuities provide regular payments for a chosen fixed term unless the annuity is withdrawn early.

Generally, regular payments can be made monthly, quarterly, half yearly or yearly but must be made at least yearly and may increase every year by a fixed percentage or in line with inflation. Where the term of the annuity is 1 year, the regular payment must be made at least half yearly.

Fixed term annuities can have a residual capital value (RCV) of between 0% and 100% of the purchase price. An annuity with 100% RCV has all the capital paid back at the end of the term. An annuity with 0% RCV has all the capital
paid back during the term. As a result, the regular payments from an annuity with 0% RCV will be higher than the regular payments from an annuity with 100% RCV.

Voluntary lump sum withdrawals can be made from fixed term annuities; however, this will reduce the regular payments and/or the RCV payable at the end of the term.

Beneficiaries can generally be nominated on fixed term annuities to receive the remaining benefits of the annuity in the event of the annuitant’s death. The regular payments can continue to the beneficiary for the remaining term of the annuity, or the beneficiary can elect to withdraw the remaining benefits as a lump sum payment. Where there is no beneficiary nominated, the regular payments can continue to the deceased’s estate for the remaining term of the annuity, or the withdrawal value can be paid as a lump sum to the deceased’s estate.

**Lifetime annuities**

Lifetime annuities provide regular payments for a person’s lifetime and, if chosen, the lifetime of another person unless the annuity is withdrawn within any guarantee periods. Where the annuity is owned jointly or has a reversionary beneficiary, in the event of an annuitant’s death, the regular payments will continue to be made to that other person.

Generally, regular payments can be made monthly, quarterly, half yearly or yearly, but must be made at least yearly and may increase every year by a fixed percentage or in line with inflation.

Lifetime annuities can have a guaranteed period which guarantees either a withdrawal value or minimum regular payments to be made within that period. The guaranteed period can generally be nominated by the annuitant or determined by the life insurance company. Most lifetime annuities also allow for voluntary lump sum withdrawals to be made during the guaranteed period.

Beneficiaries, other than reversionary beneficiaries, can sometimes be nominated on lifetime annuities to receive the remaining benefits of the annuity in the event of the annuitant’s death within the guaranteed period. Generally, the regular payments can continue to the beneficiary until the end of the guaranteed period or the beneficiary can elect to withdraw the remaining benefits as a lump sum payment. Where there is no beneficiary nominated, the regular payments can continue to the deceased’s estate until the end of the guaranteed period, or the withdrawal value can be paid as a lump sum to the deceased’s estate.

**[14 415] Ordinary money annuities**

Ordinary money annuities can be purchased by a person, a company or a trust. Annuities can be owned jointly and can have a reversionary beneficiary.

**Taxation of ordinary money annuities**

**Regular payments**

Regular payments are subject to taxation under s 27H of the ITAA 1936. An annuity with a residual capital value (RCV) less than 100% of the purchase price will have a deductible amount which reduces the assessable income from the
regular payments for taxation purposes every financial year. The deductible amount is calculated as follows:

\[
\text{(Purchase price – RCV) / relevant number}
\]

The relevant number is the term for a fixed term annuity or the life expectancy of the annuitant for a lifetime annuity. Where the lifetime annuity is owned jointly or has a reversionary beneficiary, the relevant number is the longest life expectancy. The life expectancy is currently taken from the Australian Life Tables 2010-12 at the time the annuity is purchased.

Where the deductible amount is greater than the regular payment, the unused deductible amount can be carried forward to the following financial year for taxation purposes. The unused deductible amount can only reduce assessable income from the same annuity.

**Example [14 415.10]**

John is aged 65 and purchases a fixed term annuity for 10 years with $180,000. His annuity pays $16,821 in the first year indexed by 5% per annum for 10 years and has no residual capital value.

The deductible amount for his fixed term annuity is calculated as the purchase price divided by the term:

\[
\frac{$180,000}{10} = $18,000
\]

The deductible amount reduces the assessable income from his fixed term annuity every year:

<table>
<thead>
<tr>
<th>Year</th>
<th>Regular payment</th>
<th>Deductible amount</th>
<th>Assessable income</th>
<th>Unused deductible amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$16,821</td>
<td>$18,000</td>
<td>$0</td>
<td>$1,179</td>
</tr>
<tr>
<td>2</td>
<td>$17,662</td>
<td>$18,000</td>
<td>$0</td>
<td>$1,517</td>
</tr>
<tr>
<td>3</td>
<td>$18,546</td>
<td>$18,000</td>
<td>$0</td>
<td>$971</td>
</tr>
<tr>
<td>4</td>
<td>$19,473</td>
<td>$18,000</td>
<td>$502</td>
<td>$0</td>
</tr>
<tr>
<td>5</td>
<td>$20,446</td>
<td>$18,000</td>
<td>$2,446</td>
<td>$0</td>
</tr>
<tr>
<td>6</td>
<td>$21,469</td>
<td>$18,000</td>
<td>$3,469</td>
<td>$0</td>
</tr>
<tr>
<td>7</td>
<td>$22,542</td>
<td>$18,000</td>
<td>$4,542</td>
<td>$0</td>
</tr>
<tr>
<td>8</td>
<td>$23,669</td>
<td>$18,000</td>
<td>$5,669</td>
<td>$0</td>
</tr>
<tr>
<td>9</td>
<td>$24,853</td>
<td>$18,000</td>
<td>$6,853</td>
<td>$0</td>
</tr>
<tr>
<td>10</td>
<td>$26,095</td>
<td>$18,000</td>
<td>$8,095</td>
<td>$0</td>
</tr>
</tbody>
</table>

As the deductible amount is greater than the regular payment in years 1 and 2, there is no assessable income from his fixed term annuity, and the unused deductible amount carries forward to the following financial year. In year 3, the deductible amount is less than the regular payment; however, there is still no assessable income because of the unused deductible amount.
EXAMPLE [14 415.20]

Anthony is aged 65 and purchases a lifetime annuity with $170,000. His annuity pays $7,567 in the first year indexed to inflation for the rest of his life.

The deductible amount for his lifetime annuity is calculated as the purchase price divided by his life expectancy:

\[
\frac{170,000}{19.22} = 8,845
\]

The deductible amount reduces the assessable income from his lifetime annuity every year:

<table>
<thead>
<tr>
<th>Year</th>
<th>Regular payment</th>
<th>Deductible amount</th>
<th>Assessable income</th>
<th>Unused deductible amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$7,567</td>
<td>$8,845</td>
<td>$0</td>
<td>$1,278</td>
</tr>
<tr>
<td>2</td>
<td>$7,756</td>
<td>$8,845</td>
<td>$0</td>
<td>$2,367</td>
</tr>
<tr>
<td>3</td>
<td>$7,950</td>
<td>$8,845</td>
<td>$0</td>
<td>$3,262</td>
</tr>
<tr>
<td>4</td>
<td>$8,149</td>
<td>$8,845</td>
<td>$0</td>
<td>$3,958</td>
</tr>
<tr>
<td>5</td>
<td>$8,352</td>
<td>$8,845</td>
<td>$0</td>
<td>$4,451</td>
</tr>
<tr>
<td>6</td>
<td>$8,561</td>
<td>$8,845</td>
<td>$0</td>
<td>$4,735</td>
</tr>
<tr>
<td>7</td>
<td>$8,775</td>
<td>$8,845</td>
<td>$0</td>
<td>$4,805</td>
</tr>
<tr>
<td>8</td>
<td>$8,995</td>
<td>$8,845</td>
<td>$0</td>
<td>$4,655</td>
</tr>
<tr>
<td>9</td>
<td>$9,219</td>
<td>$8,845</td>
<td>$0</td>
<td>$4,281</td>
</tr>
<tr>
<td>10</td>
<td>$9,450</td>
<td>$8,845</td>
<td>$0</td>
<td>$3,676</td>
</tr>
<tr>
<td>11</td>
<td>$9,686</td>
<td>$8,845</td>
<td>$0</td>
<td>$2,835</td>
</tr>
<tr>
<td>12</td>
<td>$9,928</td>
<td>$8,845</td>
<td>$0</td>
<td>$1,752</td>
</tr>
<tr>
<td>13</td>
<td>$10,177</td>
<td>$8,845</td>
<td>$0</td>
<td>$420</td>
</tr>
<tr>
<td>14</td>
<td>$10,431</td>
<td>$8,845</td>
<td>$1,166</td>
<td>$0</td>
</tr>
<tr>
<td>15</td>
<td>$10,692</td>
<td>$8,845</td>
<td>$1,847</td>
<td>$0</td>
</tr>
</tbody>
</table>

As the deductible amount is greater than the regular payment in years 1 to 7, there is no assessable income from his lifetime annuity and the unused deductible amount carries forward to the following financial year. In years 8 to 13, the deductible amount is less than the regular payment; however, there is still no assessable income because of the unused deductible amount.

Lump sum withdrawals from annuities will impact the deductible amount where the withdrawal is comprised of a capital component. The deductible amount will be recalculated after the withdrawal as follows:

\[
\text{(Capital remaining – RCV)} / \text{term remaining}
\]

The capital remaining is the purchase price of the annuity less any deductible amounts used to reduce the assessable income from the regular payments less the capital component of the withdrawal.
EXAMPLE [14 415.30]

John is aged 65 and purchases a fixed term annuity for 10 years with $180,000. His annuity pays $16,821 in the first year indexed by 5% per annum for 10 years and has no residual capital value.

The deductible amount for his fixed term annuity is calculated as the purchase price divided by the term:

$$\frac{180,000}{10} = \$18,000$$

Five years later, John withdraws $20,000 from his fixed term annuity which is comprised entirely of capital.

The capital remaining in his fixed term annuity after the withdrawal is calculated as the purchase price less deductible amounts used to reduce assessable income for 5 years less the withdrawal:

\[
\begin{array}{|c|c|c|c|c|}
\hline
\text{Year} & \text{Regular payment} & \text{Deductible amount} & \text{Deductible amount used} \\
\hline
1 & \$16,821 & \$18,000 & \$16,821 \\
2 & \$17,662 & \$18,000 & \$34,483 \\
3 & \$18,546 & \$18,000 & \$53,029 \\
4 & \$19,473 & \$18,000 & \$72,000 \\
5 & \$20,446 & \$18,000 & \$90,000 \\
\hline
\end{array}
\]

$$180,000 - 90,000 - 20,000 = 70,000$$

The deductible amount for his fixed term annuity is recalculated as the capital remaining divided by the term remaining:

$$\frac{70,000}{5} = \$14,000$$

**Lump sum withdrawals**

Lump sum withdrawals are subject to taxation where the withdrawal is comprised of an income component. Lump sum withdrawals from fixed term annuities are generally comprised entirely of capital with no income assessable. Lump sum withdrawals from lifetime annuities are generally comprised of an income and a capital component, with the income component assessable in the financial year of the withdrawal.

Where a lifetime annuity is fully withdrawn during the guarantee period, the income component is calculated as follows:

Withdrawing amount = capital remaining
The capital remaining is the purchase price of the annuity less any deductible amounts used to reduce the assessable income from the regular payments.

**EXAMPLE [14 415.40]**

Mary is aged 65 and purchases a lifetime annuity with $100,000. Her annuity pays $3,468 in the first year indexed to inflation for the rest of her life.

The deductible amount for her lifetime annuity is calculated as the purchase price divided by her life expectancy:

\[
\frac{100,000}{22.05} = 4,535
\]

Five years later, Mary fully withdraws her lifetime annuity and receives a lump sum of $95,545.

The capital remaining in her lifetime annuity is calculated as the purchase price less deductible amounts used to reduce assessable income for 5 years.

<table>
<thead>
<tr>
<th>Year</th>
<th>Regular payment</th>
<th>Deductible amount used</th>
<th>Deductible amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$3,468</td>
<td>$4,535</td>
<td>$3,468</td>
</tr>
<tr>
<td>2</td>
<td>$3,555</td>
<td>$4,535</td>
<td>$7,023</td>
</tr>
<tr>
<td>3</td>
<td>$3,644</td>
<td>$4,535</td>
<td>$10,667</td>
</tr>
<tr>
<td>4</td>
<td>$3,735</td>
<td>$4,535</td>
<td>$14,402</td>
</tr>
<tr>
<td>5</td>
<td>$3,828</td>
<td>$4,535</td>
<td>$18,230</td>
</tr>
</tbody>
</table>

\[100,000 - 18,230 = 81,770\]

The income component is the withdrawal amount less capital remaining at the time of withdrawal.

\[95,545 - 81,770 = 13,775\]

As the withdrawal amount is greater than the remaining capital, $13,775 will be assessable in the financial year of the withdrawal.

1. Challenger annuity quote, 1 August 2017, 10-year fixed term, monthly payments, 5% indexation, no residual capital value, 2.2% upfront adviser fee.
2. Challenger annuity quote, 1 August 2017, lifetime, monthly payments, CPI indexation, 25% withdrawal guarantee, 2.2% upfront adviser fee.
3. Challenger annuity quote, 1 August 2017, 10-year fixed term, monthly payments, 5% indexation, no residual capital value, 2.2% upfront adviser fee.
4. Challenger annuity quote, 1 August 2017, lifetime, monthly payments, CPI indexation, 100% withdrawal guarantee, 2.2% upfront adviser fee.
Superannuation annuities

Annuities can be purchased with superannuation money which is classified as unrestricted non-preserved benefits. Superannuation annuities cannot be jointly owned but can have a reversionary beneficiary.

Superannuation annuities are subject to the minimum payment standards, although how the rules apply will depend on the RCV of the annuity. Where an annuity has no residual capital value, the minimum payment requirements must be met in the first year only. Where an annuity has an RCV, the minimum payment requirements must be met every anniversary year.

**TIP**

Lifetime annuities have no RCV and therefore only have to meet the minimum payment standards in the first year.

Minimum payment standards for superannuation annuities

The minimum annual payment is calculated at commencement for all annuities and then at the anniversary of commencement every year for annuities with an RCV. The minimum annual payment is calculated according to the formula in Sch 7 of the SISR 1994 (rounded to the nearest $10):

\[
\text{Purchase price} \times \text{percentage factor}
\]

The percentage factor is determined by the age of the annuitant at commencement and then at the anniversary of commencement every year. The percentage factors are provided in the table in Sch 7 of the SISR 1994: see [14 405].

Taxation of superannuation annuities

Superannuation annuities are subject to superannuation member benefits rules under Div 301 of the ITAA 1997. Where the annuitant is aged 60 or over, regular payments and voluntary lump sum withdrawals will be tax-free. Where the annuitant is under age 60, taxation will depend on the components of the annuity: see [14 350].

The components of a superannuation annuity are determined at commencement by the components of the superannuation money used to purchase the annuity. The proportions of components at commencement are then applied to all regular payments and lump sum withdrawals made from the annuity: see [14 340].

Death benefits from superannuation annuities

Death benefits payable from a superannuation annuity are subject to compulsory cashing rules under reg 6.21 of the SISR 1994. Death benefits can only be paid to the deceased’s estate or to a dependant of the deceased at the time of death as defined under the SIS Act: see [14 335].

The taxation of death benefits is subject to the superannuation death benefits rules under Div 302 of the ITAA 1997. The taxation will depend on the
components of the annuity, the form of the benefit and whether the benefit is paid to a dependant of the deceased at the time of death as defined under s 302-195 of the ITAA 1997: see [14 355].

The proportions of components of a superannuation annuity at commencement will apply to lump sum death benefits and income stream death benefits.

[14 425] Age Pension

The Age Pension was introduced in 1909 and is the safety net of the government’s retirement income policy. The Age Pension is paid to people who have retired but are unable to fully support themselves. The eligibility for the Age Pension is determined by age, residency and the income and assets of the person.

The Age Pension age is currently 65.5 but is legislated to increase gradually to 67 by 2023 depending on when the person was born:

<table>
<thead>
<tr>
<th>Person born</th>
<th>Age Pension age</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 1949 to 30 June 1952</td>
<td>65</td>
</tr>
<tr>
<td>1 July 1952 to 31 December 1953</td>
<td>65.5</td>
</tr>
<tr>
<td>1 January 1954 to 30 June 1955</td>
<td>66</td>
</tr>
<tr>
<td>1 July 1955 to 31 December 1956</td>
<td>66.5</td>
</tr>
<tr>
<td>On or after 1 January 1957</td>
<td>67</td>
</tr>
</tbody>
</table>

The government has proposed to further gradually increase the Age Pension age to 70 by 2035:

<table>
<thead>
<tr>
<th>Person born</th>
<th>Age Pension age</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 1958 to 31 December 1959</td>
<td>67.5</td>
</tr>
<tr>
<td>1 January 1960 to 30 June 1961</td>
<td>68</td>
</tr>
<tr>
<td>1 July 1961 to 31 December 1962</td>
<td>68.5</td>
</tr>
<tr>
<td>1 January 1963 to 30 June 1964</td>
<td>69</td>
</tr>
<tr>
<td>1 July 1964 to 31 December 1965</td>
<td>69.5</td>
</tr>
<tr>
<td>On or after 1 January 1966</td>
<td>70</td>
</tr>
</tbody>
</table>

The Social Services and Other Legislation Amendment (2014 Budget Measures No 5) Bill 2014, which proposed the change, lapsed when the Federal Election was called on 9 May 2016.

To meet the residency requirement, the applicant must be an Australian resident and in Australia on the day the claim is lodged, unless claiming under an International Social Security Agreement. In addition, the applicant must meet one of the following:

- be an Australian resident for a continuous period of at least 10 years;
- be an Australian resident for a number of periods that total more than 10 years, with at least 5 years in a continuous period;
- be a woman who is widowed in Australia when both she and her late partner were Australian residents and who has 104 weeks of residence immediately before the claim;
- be receiving Widow B Pension, Widow Allowance or Partner Allowance immediately before reaching Age Pension age; or
- have a qualifying residence exemption (refugee or former refugee).

Residence in countries with which Australia has an International Social Security Agreement may count towards meeting the residency requirement. Where the residency requirement is met with residence in an agreement country, any Age Pension received from the agreement country will generally reduce the Australian Age Pension dollar for dollar.

There are different rates of Age Pension depending on whether the recipient is single, a member of a couple or a member of an illness separated couple:

<table>
<thead>
<tr>
<th>Age Pension</th>
<th>Single</th>
<th>Couple each</th>
<th>Couple each (illness separated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic rate</td>
<td>$808.30 per fortnight</td>
<td>$609.30 per fortnight</td>
<td>$808.30 per fortnight</td>
</tr>
<tr>
<td>Maximum Pension</td>
<td>$65.90 per fortnight</td>
<td>$49.70 per fortnight</td>
<td>$65.90 per fortnight</td>
</tr>
<tr>
<td>Supplement</td>
<td>$14.10 per fortnight</td>
<td>$10.60 per fortnight</td>
<td>$14.10 per fortnight</td>
</tr>
<tr>
<td>Total</td>
<td>$888.30 per fortnight</td>
<td>$669.60 per fortnight</td>
<td>$888.30 per fortnight</td>
</tr>
</tbody>
</table>

The basic rate of Age Pension is indexed twice a year, on 20 March and 20 September, by the greater of movements in the CPI and the Pensioner and Beneficiary Living Cost Index. The couple combined rate is then benchmarked to 41.76% of MTAWE and increased if the benchmark would give a higher rate. The single rate is set at 66.33% of the couple combined rate.

The basic rate of Age Pension is taxable and is subject to an income and assets test, with the test producing the lower amount determining how much is payable.

**Income test – Age Pension**

Under the income test, the Age Pension reduces at a rate of $0.50 per fortnight for every $1.00 per fortnight of assessable income above the income limit:

\[
(Assessable \text{ income} - \text{income limit}) \times $0.50
\]

The income limit will depend on whether the recipient is single or a member of a couple. When assessable income reaches the income cut-off limit, the Age Pension is not payable:

<table>
<thead>
<tr>
<th></th>
<th>Single</th>
<th>Couple combined</th>
<th>Couple combined (illness separated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income limit</td>
<td>$168 per fortnight</td>
<td>$300 per fortnight</td>
<td>$300 per fortnight</td>
</tr>
<tr>
<td>Income cut-off limit</td>
<td>$1,944.60 per fortnight</td>
<td>$2,978.40 per fortnight</td>
<td>$3,853.20 per fortnight</td>
</tr>
</tbody>
</table>

Assessable income includes:
- gross employment income;
• net rental income from real estate;
• net business income;
• distributions and dividends from private trusts and companies;
• attributed income from controlled private trusts and companies;
• deemed income from financial investments (see [14 450]);
• income from income streams (see [14 485]); and
• income from outside Australia.

Assets test – Age Pension

Under the assets test, the Age Pension reduces at a rate of $3.00 per fortnight for every $1,000 of assessable assets above the assets limit:

\[(\text{Assessable assets} - \text{assets limit})/\$1,000 \times 3.00\]

The assets limit will depend on whether the recipient is single or a member of a couple and whether they are a homeowner or a non-homeowner. When assessable assets reach the assets cut-off limit, the Age Pension is not payable:

<table>
<thead>
<tr>
<th></th>
<th>Single</th>
<th>Couple combined</th>
<th>Couple combined (illness separated)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Homeowner</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets limit</td>
<td>$253,750</td>
<td>$380,500</td>
<td>$380,500</td>
</tr>
<tr>
<td>Assets cut-off limit</td>
<td>$550,000</td>
<td>$827,000</td>
<td>$973,000</td>
</tr>
<tr>
<td><strong>Non-homeowner</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assets limit</td>
<td>$456,750</td>
<td>$583,500</td>
<td>$583,500</td>
</tr>
<tr>
<td>Assets cut-off limit</td>
<td>$753,000</td>
<td>$1,030,000</td>
<td>$1,176,000</td>
</tr>
</tbody>
</table>

Assessable assets include:
• personal effects and household contents;
• motor vehicles, caravans and boats;
• real estate;
• businesses and farms;
• surrender value of life insurance policies;
• attributed assets of controlled private trusts and companies;
• financial investments (see [14 450]); and
• asset tested income streams (see [14 485]).

EXAMPLE [14 425.10]

Geoff is aged 65, is single and has retired. He owns his own home and has $250,000 in an account-based pension and $50,000 in his bank account.

Under the income test, his account-based pension and financial investments are subject to the deeming rules: see [14 450]. The assessable income from his account-based pension and financial investments is $346.04 per fortnight.
His total assessable income of $346.04 per fortnight is above the income limit of $168 per fortnight for a single recipient. Therefore, the rate of Age Pension will be reduced under the income test.

\[(346.04 - 168) \times 0.50 = 89.02\]

Under the income test, the rate of Age Pension will be reduced by $89.02 per fortnight.

Under the assets test, his financial investments are assessed.

\[250,000 + 50,000 = 300,000\]

His total assessable assets of $300,000 are above the assets limit of $253,750 for a single homeowner recipient. Therefore, the rate of Age Pension will be reduced under the assets test.

\[(300,000 - 253,750)/1,000 \times 3.00 = 138.75\]

Under the assets test, the rate of Age Pension will be reduced by $138.75 per fortnight.

\[888.30 - 138.75 = 749.55\]

His Age Pension will be $749.55 per fortnight determined by the assets test.

---

**[14 430] Age Service Pension**

The Age Service Pension is paid to veterans who have retired but are unable to fully support themselves. A veteran cannot receive an Age Service Pension as well as an Age Pension: see [14 425]. The eligibility for the Age Service Pension is determined by qualifying service, age, residency and the income and assets of the veteran.

A veteran has qualifying service if they:

- served during World War 1 or World War 2 and incurred danger from hostile forces;
- served in an operational area after World War 2 and were allotted for duty, or were a member of a unit that was allotted for duty in that operational area; or
- served in the defence forces of a Commonwealth or Allied country during a conflict in which Australia took part and incurred danger from hostile forces.

The Age Service Pension age is 60. However, unlike the Age Pension age, it is not legislated to increase.

To meet the residency requirement, the applicant must be an Australian resident and in Australia on the day the claim is lodged. In addition, the applicant must meet one of the following:
• be an Australian resident for a continuous period of at least 10 years;
• be an Australian resident for a number of periods that total more than 10 years with at least 5 years in a continuous period; or
• have a qualifying residence exemption (refugee or former refugee).

The basic rate of Age Service Pension is the same as for the Age Pension.
The basic rate of Age Service Pension is taxable and is subject to an income and assets test in the same way as the basic rate of Age Pension.

**Partner Service Pension**

The Partner Service Pension is paid to partners, former partners and widows of veterans. The eligibility for the Partner Service Pension is determined by veteran’s qualifying service, age, residency and the income and assets of the veteran and/or partner.

A person is a partner of a veteran if they are legally married to and living with a veteran or living in a defacto relationship. If a partner has to live separately from a veteran because of illness, they are still considered a partner.

A partner is eligible for the Partner Service Pension if the veteran:
• is receiving, or is eligible to receive, a Service Pension; or
• has qualifying service but is not yet eligible to receive a Service Pension.

Where a veteran is receiving or is eligible to receive a Service Pension, the Partner Service Pension age is 60. Where a veteran has qualifying service but is not yet eligible to receive a Service Pension, the Partner Service Pension age is the same as for the Age Pension: see [14 425].

The residency requirement for the Partner Service Pension is the same as for the Age Service Pension.

The basic rate of Partner Service Pension is the same as for the Age Pension.
The basic rate of Partner Service Pension is taxable and is subject to an income and assets test in the same way as the Age Pension.

**Pensioner Concession Card**

Recipients of the Age Pension or a Service Pension automatically receive the Pensioner Concession Card which gives them access to discounted medicines listed in the Pharmaceutical Benefits Scheme Schedule and various concessions from the Australian, State and Territory Governments.


Australian Government concessions include:
• bulk billing for doctors’ appointments at the doctor’s discretion;
• more refunds for out-of-hospital medical expenses through the Medicare Safety Net;
• assistance with hearing services through the Department of Health; and
• discounted mail redirection through Australia Post.

State and Territory Government concessions include:
• reduction on property and water rates;
• reduction on energy bills;
• reduced fares on public transport; and
• reductions on motor vehicle registration.

[14 440] War Widow’s Pension

The War Widow’s Pension is paid to widowed partners of veterans who have died as a result of war service or eligible defence service.

A person can claim the War Widow’s Pension if they were legally married to, or in a de facto relationship with, an Australian veteran immediately before their death and have not remarried, or entered into a de facto relationship with, another person. If a person is already receiving the War Widow’s Pension and remarries or enters into a de facto relationship, the pension will not be affected.

The War Widow’s Pension is automatically paid, regardless of whether death was a result of war service or eligible defence service, if the veteran was:
• an ex-prisoner of war;
• receiving the Extreme Disablement Adjustment;
• receiving a Disability Pension at the special or temporary special rate;
• receiving a Disability Pension at the intermediate rate; or
• receiving a Disability Pension at an increased rate for a specified condition (items 1 to 8 of s 27(1) of the Veterans’ Entitlements Act 1986).

The rate of War Widow’s Pension is $902.80 per fortnight (includes the Energy Supplement) and is indexed twice a year, on 20 March and 20 September, by the greater of movements in the CPI and MTAWE.

The War Widow’s Pension is not taxable and is not subject to an income or assets test.

Recipients of the War Widow’s Pension automatically receive the gold Repatriation Health Card which gives them access to fully funded medical and specialist services listed in the Medicare Benefits Schedule, discounted medicines listed in the Repatriation Pharmaceutical Benefits Scheme Schedule and various concessions from State and Territory Governments.


State and Territory Government concessions include:
• reduction on property and water rates;
• reduction on energy bills;
• reduced fares on public transport; and
• reductions on motor vehicle registration.

Recipients of the War Widow’s Pension may also receive the Income Support Supplement.
**Income Support Supplement**

The Income Support Supplement is paid in addition to the War Widow’s Pension to Australian war widows who have limited means. A war widow cannot receive an Income Support Supplement as well as an Age Service Pension (see [14 430]) or Age Pension (see [14 425]).

The eligibility for the Income Support Supplement is determined by residency and the income and assets of the war widow.

To meet the residency requirement, the applicant must be an Australian resident and in Australia on the day the claim is lodged.

The rate of Income Support Supplement is $266.60 per fortnight for singles and members of a couple and is indexed twice a year, on 20 March and 20 September, by the greater of movements in the CPI and MTAWE.

The Income Support Supplement is taxable and is subject to an income and assets test with the test producing the lower amount determining how much is payable.

**Income test – Income Support Supplement**

Under the income test, the Income Support Supplement reduces at a rate of $0.50 per fortnight for every $1.00 per fortnight of assessable income above the income limit:

\[
(Assessable \text{ income} - \text{income limit}) \times \$0.50
\]

The income limit will depend on whether the recipient is single or a member of a couple. When assessable income reaches the income cut-off limit, the Income Support Supplement is not payable:

<table>
<thead>
<tr>
<th></th>
<th>Single</th>
<th>Couple combined</th>
<th>Couple combined (illness separated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income limit</td>
<td>$1,383.20 per fortnight</td>
<td>$1,869.60 per fortnight</td>
<td>$2,730.40 per fortnight</td>
</tr>
<tr>
<td>Income cut-off limit</td>
<td>$1,916.40 per fortnight</td>
<td>$2,936.00 per fortnight</td>
<td>$3,796.80 per fortnight</td>
</tr>
</tbody>
</table>

Assessable income includes the War Widow’s Pension and income as assessed for the Age Pension: see [14 425].

**Assets test – Income Support Supplement**

Under the assets test, the Income Support Supplement reduces at a rate of $0.75 per fortnight for every $250 of assessable assets above the assets limit:

\[
(Assessable \text{ assets} - \text{assets limit})/\$250 \times \$0.75
\]

The assets limit will depend on whether the recipient is single or a member of a couple and whether they are a homeowner or a non-homeowner. When assessable assets reach the cut-off limit, the Income Support Supplement is not payable:
Assessable assets include assets as assessed for the Age Pension: see [14 425].

**EXAMPLE [14 440.10]**

Margaret is aged 85, is single and receives the War Widow’s Pension. She owns her own home and has $400,000 in a term deposit and $100,000 in her bank account.

Under the income test, her War Widow’s Pension is assessed, and her financial investments are subject to the deeming rules: see [14 450]. The assessable income from her financial investments is $596.04 per fortnight.

$902.80 + $596.04 = $1,498.84

Her total assessable income of $1,498.84 per fortnight is above the income limit of $1,383.20 per fortnight for a single recipient. Therefore, the rate of Income Support Supplement will be reduced under the income test.

($1,498.84 – $1,383.20) x $0.50 = $57.82

Under the income test, the rate of Income Support Supplement will be reduced by $57.82 per fortnight.

Under the assets test, her financial investments are assessed.

$400,000 + $100,000 = $500,000

Her total assessable assets of $500,000 are above the assets limit of $456,500 for a single homeowner recipient. Therefore, the rate of Income Support Supplement will be reduced under the assets test.

($500,000 – $456,500)/$250 x $0.75 = $130.50

Under the assets test, the rate of Income Support Supplement will be reduced by $130.50 per fortnight.

$266.60 – $130.50 = $136.10

Her Income Support Supplement will be $136.10 per fortnight determined by the assets test.
Rent assistance

Recipients of the Age Pension, a Service Pension or the Income Support Supplement may receive rent assistance, which provides financial help to those who pay rent. To be eligible for rent assistance, the recipient must pay more than the rent threshold for one of the following:

- rent other than to a State or Territory housing authority;
- service and maintenance fees in a retirement village;
- board and lodging;
- fees paid to use a caravan site; or
- fees paid to moor a vessel.

Rent assistance is payable at a rate of $0.75 for every $1.00 of rent paid above the rent threshold until the maximum payment is reached. The rent threshold and maximum payment will depend on whether the recipient is single, a member of a couple or a member of an illness separated couple:

<table>
<thead>
<tr>
<th></th>
<th>Single</th>
<th>Couple combined</th>
<th>Couple each (illness separated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent threshold</td>
<td>$117.80 per fortnight</td>
<td>$191.00 per fortnight</td>
<td>$117.80 per fortnight</td>
</tr>
<tr>
<td>Maximum payment</td>
<td>$132.20 per fortnight</td>
<td>$124.60 per fortnight</td>
<td>$132.20 per fortnight</td>
</tr>
</tbody>
</table>

The rent threshold and maximum payment are indexed twice a year, on 20 March and 20 September, by movements in the CPI.

Rent assistance is not taxable and is not subject to a separate income or assets test.

Means testing financial investments

Financial investments are all assessed in the same way under the income and assets test. Financial investments include:

- cash;
- bank, building society and credit union accounts;
- term deposits;
- managed investments;
- listed shares and securities;
- bonds, notes and debentures;
- gold, silver or platinum bullion;
- short-term income streams; and
- superannuation investments if over Age Pension age.

Income test – financial investments

Under the income test, financial investments are subject to the deeming rules, which apply a deemed rate of interest to the gross market value of investments to determine the income assessed. The actual income from the investment is not assessed. The deeming rate will depend on the total value of
financial investments and whether the recipient is single or a member of a couple:

<table>
<thead>
<tr>
<th></th>
<th>Couple combined</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $50,200</td>
<td>First $83,400</td>
<td>1.75% per annum</td>
</tr>
<tr>
<td>Over $50,200</td>
<td>Over $83,400</td>
<td>3.25% per annum</td>
</tr>
</tbody>
</table>

**EXAMPLE [14 450.10]**

Isabel is aged 65, is single and has $200,000 in a term deposit and $50,000 in her bank account.

The first $50,200 of financial investments is deemed at 1.75% per annum and the remaining financial investments are deemed at 3.25% per annum.

\[
50,200 \times 1.75\% + (250,000 - 50,200) \times 3.25\% = 7,372
\]

The assessable income from her financial investments is $7,372 per annum.

**Assets test – financial investments**

Under the assets test, the net market value of financial investments is the assessed asset value. The net market value is the gross market value less the value of any loans secured against the investment. The net market value is reassessed every year in March and September.

**[14 455] Means testing income streams**

Income streams are assessed differently under the income and assets tests depending on the type and category of the income stream. Income streams include:

- account-based pensions and annuities (see [14 405]);
- allocated pensions and annuities;
- term allocated pensions;
- immediate annuities (see [14 410]); and
- defined benefit pensions.

Income streams are classified into 3 categories:

- asset-tested long-term;
- asset-tested short-term;
- asset-test exempt.

**Asset-tested long-term income streams**

Asset-tested long-term income streams have a term greater than 5 years or, where the person has a life expectancy of 5 years or less, a term equal to, or greater than, their life expectancy.
Income test – asset-tested long-term income streams

Under the income test, asset-tested long-term income streams are subject to the deduction amount rules which reduce the gross annual payment from the income stream by the deduction amount every year to determine the income assessed. The deduction amount is calculated as follows:

\[
\text{(Purchase price – RCV)}/\text{relevant number}
\]

The relevant number is the term for a fixed term income stream or the life expectancy of the person for a lifetime income stream. Where the lifetime income stream has a reversionary beneficiary, the relevant number is the longest life expectancy. The life expectancy is currently taken from the Australian Life Tables 2010-12 at the time the income stream is commenced.

**EXAMPLE [14 455.10]**

Andrew is aged 65 and purchases a lifetime annuity with $150,000. His annuity pays $6,677\(^5\) in the first year indexed to inflation for the rest of his life.

The deduction amount for his lifetime annuity is calculated as the purchase price divided by his life expectancy:

\[
$150,000/19.22 = $7,804
\]

The deduction amount reduces the assessable income from his lifetime annuity every year:

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross annual payment</th>
<th>Deduction amount</th>
<th>Assessable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$6,677</td>
<td>$7,804</td>
<td>$0</td>
</tr>
<tr>
<td>2</td>
<td>$6,844</td>
<td>$7,804</td>
<td>$0</td>
</tr>
<tr>
<td>3</td>
<td>$7,015</td>
<td>$7,804</td>
<td>$0</td>
</tr>
<tr>
<td>4</td>
<td>$7,190</td>
<td>$7,804</td>
<td>$0</td>
</tr>
<tr>
<td>5</td>
<td>$7,370</td>
<td>$7,804</td>
<td>$0</td>
</tr>
<tr>
<td>6</td>
<td>$7,554</td>
<td>$7,804</td>
<td>$0</td>
</tr>
<tr>
<td>7</td>
<td>$7,743</td>
<td>$7,804</td>
<td>$0</td>
</tr>
<tr>
<td>8</td>
<td>$7,937</td>
<td>$7,804</td>
<td>$132</td>
</tr>
<tr>
<td>9</td>
<td>$8,135</td>
<td>$7,804</td>
<td>$331</td>
</tr>
<tr>
<td>10</td>
<td>$8,338</td>
<td>$7,804</td>
<td>$534</td>
</tr>
<tr>
<td>11</td>
<td>$8,547</td>
<td>$7,804</td>
<td>$742</td>
</tr>
<tr>
<td>12</td>
<td>$8,760</td>
<td>$7,804</td>
<td>$956</td>
</tr>
<tr>
<td>13</td>
<td>$8,979</td>
<td>$7,804</td>
<td>$1,175</td>
</tr>
<tr>
<td>14</td>
<td>$9,204</td>
<td>$7,804</td>
<td>$1,400</td>
</tr>
<tr>
<td>15</td>
<td>$9,434</td>
<td>$7,804</td>
<td>$1,630</td>
</tr>
</tbody>
</table>

As the deduction amount is greater than the gross annual payment in years 1 to 7, there is no assessable income from his lifetime annuity. In years 8 to 15, the deduction amount is less than the gross annual payment and there is assessable income.
Deeming of account-based income streams

Since 1 January 2015, account-based income streams have been subject to the deeming rules unless the grandfathering provisions apply. For account-based income streams which are not grandfathered, the account balance is added to other financial investments and the total value deemed: see [14 450].

For an account-based income stream to be grandfathered, the following conditions must be met:

• the account-based income stream must have commenced before 1 January 2015 and the recipient must have been receiving an income support payment immediately before that date and continuously thereafter;
• where a grandfathered account-based income stream reverts to a reversionary beneficiary, the beneficiary must be receiving an income support payment at the time of reversion and continuously thereafter.

Account-based income streams which are grandfathered will continue to be subject to the deduction amount rules.

Assets test – asset-tested long-term income streams

Under the assets test, asset-tested long-term income streams are assessed as account-based or non-account-based.

If the income stream is account-based, the account balance is the assessed asset value. The purchase price is assessed at commencement and then the account balance is reassessed every year in February and August.

If the income stream is non-account-based, the purchase price is reduced by the deduction amount every year to determine the assessed asset value:

\[
\text{Purchase price} - (\text{deduction amount} \times \text{term elapsed})
\]

The purchase price is assessed at commencement, and then the asset value is recalculated every 6 months (every 12 months where the payment is made annually) from the commencement date.

EXAMPLE [14 455.20]

Michelle is aged 65 and purchases a lifetime annuity for $120,000. Her annuity makes annual payments.

Her lifetime annuity is a non-account-based income stream. The deduction amount for her annuity is calculated as the purchase price divided by her life expectancy:

\[
\frac{120,000}{22.05} = 5,442
\]
The deduction amount reduces the assessed asset value of her lifetime annuity every year:

<table>
<thead>
<tr>
<th>Year</th>
<th>Assessed asset value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$120,000</td>
</tr>
<tr>
<td>2</td>
<td>$114,558</td>
</tr>
<tr>
<td>3</td>
<td>$109,116</td>
</tr>
<tr>
<td>4</td>
<td>$103,674</td>
</tr>
<tr>
<td>5</td>
<td>$98,232</td>
</tr>
<tr>
<td>6</td>
<td>$92,790</td>
</tr>
<tr>
<td>7</td>
<td>$87,348</td>
</tr>
<tr>
<td>8</td>
<td>$81,906</td>
</tr>
<tr>
<td>9</td>
<td>$76,464</td>
</tr>
<tr>
<td>10</td>
<td>$71,022</td>
</tr>
<tr>
<td>11</td>
<td>$65,580</td>
</tr>
<tr>
<td>12</td>
<td>$60,138</td>
</tr>
<tr>
<td>13</td>
<td>$54,696</td>
</tr>
<tr>
<td>14</td>
<td>$49,254</td>
</tr>
<tr>
<td>15</td>
<td>$43,812</td>
</tr>
</tbody>
</table>

**Asset-tested short-term income streams**

Asset-tested short-term income streams have a term of 5 years or less, and where the person has a life expectancy less than 5 years, a term less than their life expectancy.

**Income test – asset-tested short-term income streams**

Under the income test, asset-tested short-term income streams are subject to the deeming rules, which apply a deemed rate of interest to the assessed asset value of the income stream to determine the income assessed. The deeming rates are the same as for financial investments.

**Assets test – asset-tested short-term income streams**

Under the assets test, asset-tested short-term income streams are assessed in the same way as asset-tested long-term income streams.

**EXAMPLE [14 455.30]**

Melissa is aged 65, is single and purchases a fixed term annuity for 5 years with $140,000. Her annuity makes annual payments and has no residual capital value.

Her fixed term annuity is a non-account-based income stream. The deduction amount for her annuity is calculated as the purchase price divided by the term:

\[ \frac{140,000}{5} = 28,000 \]
The deduction amount reduces the assessed asset value of her fixed term annuity every year on which the deemed rate of interest is applied.

<table>
<thead>
<tr>
<th>Year</th>
<th>Assessed asset value</th>
<th>Deemed income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$140,000</td>
<td>$3,797 per annum</td>
</tr>
<tr>
<td>2</td>
<td>$112,000</td>
<td>$2,887 per annum</td>
</tr>
<tr>
<td>3</td>
<td>$84,000</td>
<td>$1,977 per annum</td>
</tr>
<tr>
<td>4</td>
<td>$56,000</td>
<td>$1,067 per annum</td>
</tr>
<tr>
<td>5</td>
<td>$28,000</td>
<td>$490 per annum</td>
</tr>
</tbody>
</table>

The assessable income from her fixed term annuity reduces as the assessed asset value reduces.

Asset-test exempt income streams

Asset-test exempt income streams must comply with all the requirements under ss 9A, 9B or 9BA of the Social Security Act 1991 (Cth).

Income test – asset-test exempt income streams

Under the income test, complying income streams are subject to the deduction amount rules in the same way as asset-tested long-term income streams.

Assets test – asset-test exempt income streams

Under the assets test, complying income streams commenced before 20 September 2004 receive a 100% exemption. Complying income streams commenced between 20 September 2004 and 20 September 2007 receive a 50% exemption.

Complying income streams commenced after 20 September 2007 will not receive an assets test exemption unless they are the result of the commutation of a complying income stream commenced before 20 September 2007. There are a number of conditions which must be met for the new income stream to retain the assets test exemption of the original income stream.

Commonwealth Seniors Health Card

The Commonwealth Seniors Health Card (CSHC) gives self-funded retirees access to discounted medicines listed in the Pharmaceutical Benefits Scheme Schedule and various concessions from the Australian, State and Territory Governments. The eligibility for the CSHC is determined by age, residency and the income of the person.


Australian, State and Territory Government concessions include:

- bulk billed doctors’ appointments at the doctor’s discretion;
- more refunds for out-of-hospital medical expenses through the Medicare Safety Net;

Commonwealth Seniors Health Card
• concessional rail travel on Great Southern Rail services, such as the Indian Pacific, The Ghan and The Overland; and
• health, household, transport, education and recreation concessions offered by State and Territory Governments.

To receive the CSHC, the person must have reached Age Pension or Age Service Pension age but not qualify for the Age Pension or Age Service Pension because of their income or assets: see [14 425].

To meet the residency requirement, the person must be an Australian resident, in Australia on the day the claim is lodged and continue to meet the residency requirement for as long as they hold the card.

The CSHC is subject to an income test, where the card is only available if adjusted taxable income plus deemed income from account-based income streams is below the income threshold. The income threshold will depend on whether the person is single, a member of a couple or a member of an illness separated couple:

<table>
<thead>
<tr>
<th>Income threshold</th>
<th>Single</th>
<th>Couple combined</th>
<th>Couple combined (illness separated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted taxable income includes:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• taxable income;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• reportable superannuation contributions;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• total net investment losses;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• target foreign income; and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• employer provided fringe benefits.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Since 1 January 2015, account-based income streams have been subject to the deeming rules for the CSHC income test unless the grandfathering provisions apply. For account-based income streams which are not grandfathered, the deemed income will be added to adjusted taxable income to determine eligibility for the card.

For an account-based income stream to be grandfathered, the following conditions must be met:

• the account-based income stream must have commenced before 1 January 2015, and the recipient must have been a holder of the CSHC immediately before that date and continuously thereafter;
• where a grandfathered account-based income stream reverts to a reversionary beneficiary, the beneficiary must be a holder of the CSHC at the time of reversion and continuously thereafter.
[14 485] Case studies disclaimer

Case studies have been constructed by the author and bear no connection to any person(s) living or deceased and are intended for education purposes only to assist those interested to understand retirement and the workings of superannuation and Centrelink rules which are subject to legislative change at any point in time.

Case studies are intended for educational purposes only. There are numerous methods available to financial planners for re-arranging a person’s financial affairs that can be as equally beneficial to retirees. The strategies adopted are for illustrative and educational purposes. They should not be relied upon by readers for their own or others’ own personal financial matters. Consultation about a person’s own personal financial matters should always be sought from skilled and qualified professionals.

[14 487] Case study 1 – transitioning to retirement

Joy is age 60 and earning $90,000 per annum of employment income. Her employer contributes 9.5% Superannuation Guarantee (SG) into her superannuation account. She would like to increase her contribution to superannuation without reducing her after-tax income. She currently has $250,000 in her superannuation account.

Joy is over preservation age and can access her superannuation as a TTR income stream. She withdraws $250,000 from her superannuation and commences a non-commutable account-based pension drawing $10,000 for the financial year. As she is age 60, her pension payments will be tax-free.

Joy can contribute up to $25,000 of SG and salary sacrifice contributions for the financial year without exceeding the concessional contributions cap. She salary sacrifices $15,473 into her superannuation account. Her salary sacrificed contributions will be taxed at 15% on entry to her superannuation. Her total concessional contribution to superannuation will be $24,023 for the financial year.

The tables below illustrate her additional contribution to superannuation and her after-tax income for the financial year using the TTR strategy.

<table>
<thead>
<tr>
<th>Cash flow</th>
<th>Current situation</th>
<th>TTR strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross income</td>
<td>$90,000</td>
<td>$90,000</td>
</tr>
<tr>
<td>Salary sacrifice</td>
<td>Nil</td>
<td>($15,473)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>$90,000</td>
<td>$74,527</td>
</tr>
<tr>
<td>Tax payable (incl Medicare levy)</td>
<td>($22,732)</td>
<td>($17,259)</td>
</tr>
<tr>
<td>TTR pension</td>
<td>Nil</td>
<td>$10,000</td>
</tr>
<tr>
<td>After-tax income</td>
<td>$67,268</td>
<td>$67,268</td>
</tr>
</tbody>
</table>
Joy salary sacrifices $15,473 into her superannuation. However, she only has to draw $10,000 from her non-commutable account-based pension to maintain the same after-tax income. This increases her net contribution to superannuation by $3,153 for the financial year.

**Case study 2 – creating layers of income in retirement**

Mark and Sandra are married, both age 67 and are retired. They own their home and have $20,000 in personal assets. They both currently have $200,000 in account-based pensions.

Mark and Sandra estimate they will need $40,000 per annum to maintain a modest lifestyle in retirement but would prefer $50,000 per annum for a more comfortable lifestyle particularly during the first 10 years. They are currently eligible for a part Age Pension of $31,738 per annum combined.

A lifetime annuity can provide a series of regular payments for the rest of their lives. They withdraw $50,000 each from their account-based pensions and purchase lifetime annuities. Their lifetime annuities pay $5,344 in the first year combined, indexed to inflation for the rest of their lives.

A fixed term annuity can provide a series of regular payments for the first 10 years of retirement. They withdraw $20,000 each from their account-based pensions and purchase 10-year fixed term annuities. Their fixed term annuities pay $4,240 in the first year combined, indexed to inflation for 10 years.

An account-based pension allows them to select from a range of investments and decide how much pension they draw subject to minimum payment requirements. Mark and Sandra are both age 65 and their minimum payment requirement is 5% of the account balance. They draw $13,000 in the first year combined from their account-based pensions.

Mark and Sandra’s overall asset allocation is 50% growth and 50% defensive. The account-based pension can be invested in 77% growth assets and 23% defensive assets as the lifetime and fixed term annuities are defensive assets and make up 33% of their overall asset allocation.
The table below illustrates the breakup of their income in the first year of retirement.

<table>
<thead>
<tr>
<th>Income stream</th>
<th>Investment</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age Pension</td>
<td>N/A</td>
<td>$31,738</td>
</tr>
<tr>
<td>Lifetime annuities</td>
<td>$100,000</td>
<td>$5,344</td>
</tr>
<tr>
<td>Fixed term annuities</td>
<td>$40,000</td>
<td>$4,240</td>
</tr>
<tr>
<td>Account-based pensions</td>
<td>$260,000</td>
<td>$13,000</td>
</tr>
<tr>
<td>Total</td>
<td>$400,000</td>
<td>$54,322</td>
</tr>
</tbody>
</table>

Mark and Sandra’s total income is $54,322 in the first year. The Age Pension and lifetime annuities will provide them with income to maintain at least a modest lifestyle for the rest of their lives. The fixed term annuities will provide them with income for discretionary spending during the first 10 years of retirement. The account-based pensions can provide them with income to maintain a more comfortable lifestyle until the account balance runs out.

1 Challenger annuity quote, 1 August 2017, lifetime, monthly payments, CPI indexation, 2.2% upfront adviser fee.
2 Challenger annuity quote, 1 August 2017, 10-year term, nil RCV, monthly payments, CPI indexation, 2.2% upfront adviser fee.

Case study 3 – maximising Centrelink entitlements in retirement

Angela is single, age 65 and has retired. She recently sold her home and has moved in with family. She currently has $50,000 in her bank account and $300,000 in an account-based pension.

Angela is currently eligible for a part Age Pension of $19,969 per annum. Her Age Pension is reduced as a result of the income test. She would like to increase her Age Pension entitlement.

A lifetime annuity has a deduction amount which reduces the assessable income from the annuity for Age Pension purposes every year. She withdraws $100,000 from her account-based pension and purchases a lifetime annuity. Her lifetime annuity pays $5,000 per annum for the rest of her life. The deduction amount for her lifetime annuity is calculated as the purchase price divided by her life expectancy when she purchases the annuity. Her life expectancy is 22.05 years.

Deduction amount: $100,000 / 22.05 = $4,535 per annum.

The deduction amount reduces the assessable income for Age Pension purposes from her lifetime annuity every year.

Lifetime annuity assessable income: $5,000 – $4,535 = $465 per annum.

If $100,000 remained in Angela’s account-based pension, it would have been subject to the deeming provisions with 3.25% assessed as income for Age Pension purposes every year.

Deemed income: $100,000 x 3.25% = $3,250 per annum.

By purchasing the lifetime annuity, Angela has reduced her assessable income for Age Pension purposes by 2,785 in the first year.
Angela is able to increase her Age Pension entitlement by $1,392 in the first year of retirement by purchasing a lifetime annuity.

1 Challenger annuity quote, 1 August 2017, lifetime, monthly payments, 75% withdrawal guarantee, 2.2% upfront adviser fee.

## PITFALLS – RETIREMENT PLANNING

### [14 500] Traps to be wary of in retirement planning

**How much is enough?**

- It is generally accepted that compulsory employer Superannuation Guarantee contributions alone will not necessarily be enough to meet the retirement income expectations of most people. The minimum level of employer support has been legislated to gradually increase from 9% to 12% by 2025: see [9 315]. Industry consensus suggests that a savings target of at least 12-15% of salary over 30 years is required.

- Superannuation calculators that attempt to estimate the level of savings to satisfy a person’s retirement expectations need to be approached with caution taking into account the underlying methodology and assumptions used.

- A retired couple broadly require about $59,971 pa to fund a comfortable standard of living in retirement or $34,855 pa for a couple to achieve a modest retirement lifestyle.

- As a general rule, a 1% increase/decrease in fund earnings can result in a 5% increase/decrease in retirement living standards. Therefore, investment choice options (and choice of fund: see [9 335]) can have a significant impact on living standards at retirement.

- The absence of employment income in retirement will generally mean that any tax benefits from geared investments will be reduced.

### Financial advice

- From 1 July 2013, commissions have been banned and financial advisers are subject to a statutory duty to act in the best interest of the client: see [4 050].

- The duty to warn clients if the advice is based on incomplete or inaccurate information has been placed directly on the person who provides the advice from 1 July 2013. A provider also has a duty to make reasonable inquiries to obtain complete and accurate information under the best interests obligation: see [14 130].

- From 1 July 2013, the reasonable basis for advice rule has been replaced with a duty to provide “appropriate advice”. This duty is placed directly on the person who provides the advice: see [14 130].
Social security

- It is advisable to give detailed consideration to the operation of the social security means tests 5 years before retirement to provide adequate time to address the potential application of the social security gifting/deprivation rules.

- The qualifying age for the Age Pension will progressively increase from 65 to 67 by 2023. The Government has further proposed to increase the eligibility age for the Age Pension to 70 by 2035: see [14 425].

- The assets test taper rate has been increased from $1.50 per $1,000 of assets to $3.00 per $1,000 of assets from 1 January 2017.

- The Pension Bonus Scheme is closed to new entrants from 20 September 2009 (and the final date for late registrations was 1 July 2014): see [24 542].

- A “Work Bonus” for Age Pensioners excludes the first $250 of employment income earned per fortnight from the income test for the Age Pension: see [14 425].

- The social security deeming rules have been extended to new account-based pensions for the purposes of the Age Pension income test from 1 January 2015: see [14 485]. Likewise, the Government has aligned the income test for the Commonwealth Seniors Health Card with the Age Pension deeming rules for untaxed superannuation income generated by account-based pensions from 1 January 2015.

- Account-based pensions in place before 1 January 2015 continue to be assessed under the original social security income test rules, provided that the pensioner is receiving income support before 1 January 2015 and this continues uninterrupted from that day. While the grandfathering rules are often more beneficial in the early years for a pension, there will come a point in time where the new deeming rules may generate a more beneficial outcome: see [14 485].

Voluntary contributions

- The concessional contributions cap has been reduced to $25,000 from 1 July 2017 (see [9 210]) making it even more important to start accumulating superannuation early.

- The non-concessional contributions cap has been reduced to $100,000 from 1 July 2017 (or $300,000 over 3 financial years for those under age 65) restricting the opportunity to transfer significant wealth to superannuation immediately prior to retirement: see [9 220].

- Individuals can withdraw excess non-concessional contributions made from 1 July 2013 plus 85% of associated earnings. The non-concessional contributions withdrawn will not be subject to excess non-concessional contributions tax and the associated earnings withdrawn will be taxed at the individual’s marginal tax rate less a 15% offset: see [9 225].

- Taxpayers seeking to implement a superannuation re-contribution strategy should carefully consider the potential application of the anti-avoidance provisions contained in Pt IVA of ITAA 1936.
• From 1 July 2013, excess concessional contributions tax has been abolished. Instead, excess concessional contributions are included in an individual’s assessable income from the 2013-14 income year. Individuals are able to elect to release up to 85% of their excess concessional contributions from their superannuation fund to the Commissioner as a “credit” to cover the additional tax liability: see [9 213].

• A taxpayer intending to claim a deduction for a personal superannuation contribution should ensure a valid deduction notice is given to the trustee (and an acknowledgement is received) before commencing a pension from the superannuation fund: see [9 240].

• Those aged 65-74 approaching retirement should consider working at least the first 40 hours of a new financial year before retiring. This will effectively enable them to get an extra year’s worth of voluntary non-concessional contributions into the superannuation system: see [9 205].

• Spouse contribution splitting remains relevant to effectively transfer contributions to the older spouse who will reach age 60 (and tax-free benefit status) first: see [9 255]. It may also enable access to 2 low rate cap thresholds for benefits taken between age 56-59: see [9 625].

Salary sacrifice arrangements

• A superannuation salary sacrifice arrangement will only be effective where it has been entered into before the employee has earned the entitlement to receive the relevant amount of salary, wages or bonus.

• A salary sacrifice arrangement can be combined with a transition to retirement pension for those who have reached their preservation age. Such a strategy is especially tax effective where the individual is aged 60 or over and will not pay any tax on the pension income: see [14 220]. Spouse superannuation contributions and salary sacrifice contributions do not qualify for the government’s co-contribution for eligible low-income employees.

• Salary sacrificing arrangements (and deductions for personal contributions) are effectively restricted to the individual’s concessional contributions cap: see [14 260].

• Certain salary sacrificed superannuation contributions (“reportable employer superannuation contributions”) are included in the income tests to qualify for certain tax concessions and government assistance programs from 1 July 2009: see [9 240].

• If an employee is already salary sacrificing more than 9.5% of her or his ordinary time earnings from 1 July 2014, the employer will technically already be complying with the higher Superannuation Guarantee rate. Therefore, employees already salary sacrificing above 9.5% should review their arrangements to clarify the employer’s obligations: see [14 220].

Accessing benefits

• A transfer balance cap of $1.6m has been introduced from 1 July 2017 to limit the amount of superannuation that can be transferred to pension phase and receive the income tax exemption on earnings.
A person can maintain their superannuation in the accumulation phase indefinitely and draw down lump sums as required. However, depending on the individual’s circumstances, there may be an advantage in transferring to pension phase and receiving the income tax exemption on earnings.

Preservation age has increased to age 56 and will continue phasing to age 60 for those born after 30 June 1960: see [9 608].

People who have reached their preservation age but are not retired can access their superannuation as a transition to retirement income stream: see [14 315].

Allocated pensions commenced before 1 July 2007 are able to operate under the new minimum payment rules for account-based pensions without the need to commute and restart a new pension. However, consideration should be given to commuting an existing allocated pension to trigger the operation of the new proportional rule which may be beneficial for estate planning purposes: see [14 340].

Existing complying pensions commenced before 1 July 2007 generally cannot be converted to an account-based pension. However, where permitted by the fund’s trust deed, it is possible to convert a complying lifetime or life expectancy pension into another complying pension such as a market linked income stream (MLIS): see [14 485].

A complying lifetime pension that is commuted to commence an MLIS will not be a concessional contribution: see [9 210]. However, an allocation from a pension reserve account supporting a complying lifetime pension is a concessional contribution to the extent that the amount allocated is applied to commence an account-based pension: see [14 260].

The potential for pensioners taking minimum annual payments to have significant amounts of capital remaining in superannuation upon death also raises estate planning issues where there is no “dependant” to ultimately receive the benefits tax-free: see [14 355].

The recipient of an account-based pension bears the risk of poor investment performance in relation to the underlying assets supporting the pension. By comparison with a superannuation annuity (see [14 420]), the investment risk is borne by the product issuer who guarantees the level of income payments. Therefore, the success of an account-based pension in terms of the level of income payments received during the specified term will largely depend on the investment performance of the underlying assets.

For superannuation funds paying MLISs, the investment strategy needs to be especially mindful of the liquidity and solvency requirements to make the specific annual pension payments. Unlike account-based pensions, a MLIS does not have the luxury of commuting the benefits to be paid out as a lump sum in specie.

Death of a member

From 1 July 2007, it is no longer possible to revert a pension to a non-dependant on death. Instead, they must be paid to a non-dependant as a lump sum: see [9 705].
• Careful consideration needs to be given to the estate planning consequences of maintaining benefits in a superannuation fund until the member’s ultimate death. While death benefits continue to be tax-free if paid to a member before death, the benefits may be taxable as a death benefit if ultimately paid to a non-dependant: see [14 355].

• Despite the abolition of end benefits tax for those aged 60 and over from 1 July 2007, a re-contribution strategy may still produce tax benefits for those seeking to access benefits before age 60 or for estate planning purposes where a benefit will ultimately be paid to a non-dependant: see [14 355].

• The Government has expanded the definition of a “superannuation income stream benefit” to allow the tax exemption for fund earnings on investments supporting superannuation income streams to continue following the death of a pension member from 1 July 2012, until the deceased member’s benefits have been paid out of the fund.

FURTHER INFORMATION

[14 600] Further information

Further information on subject matter relevant to this chapter can be found in:

• Thomson Reuters’ Australian Superannuation Handbook 2017-18, by Stuart Jones. This Handbook is the authoritative guide to the operation of the superannuation system, updated 6-monthly.

• Thomson Reuters’ Superannuation & Financial Services Bulletin.

• Thomson Reuters’ Australian Superannuation Legislation 2017.

• Thomson Reuters’ Death & Taxes: Tax effective estate planning, 5th edition.

• Thomson Reuters’ Australian Superannuation Practice Commentary.

• Thomson Reuters’ Australian Tax Handbook 2017 – Tax Return Edition – Chapter 39 (Superannuation contributions), 40 (Superannuation benefits) and 41 (Superannuation funds).

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CHAPTER OBJECTIVES

[19 000] Chapter objectives and relevance for financial planners

This chapter is designed to provide planners with the knowledge required to advise clients who need aged care or who are considering aged care. Aged care is a broad area with various options including life interests, retirement villages, home care and residential aged care. The rules associated with these options can be very complex and the strategies to meet clients’ needs can vary significantly depending on their circumstances.

The need for aged care is often sudden with decisions having to be made with a sense of urgency. This can be a very emotional time for clients particularly when the situation requires that they move out of their home. The complexity of aged care combined with the urgency of the situation can result in unintended outcomes when decisions are made without seeking advice.

This chapter will assist planners to understand the aged care system and deliver strategies that help clients to navigate this complex and emotional life stage. The various aged care options are explained as well as the traps to be aware of. Case studies are used to identify appropriate strategies in different circumstances and demonstrate the value of advice for clients.

INTRODUCTION

[19 001] Aged care planning – introduction

Aged care is a growing area of concern within society giving the financial planning industry the opportunity to provide valuable advice to Australia’s rapidly ageing population. In June 2011, the Productivity Commission projected the number of people over age 85 would increase from 400,000 in 2010 to 1.8 million by 2050. In addition, it is expected that 3.5 million people will access aged care services each year by 2050.

The government implemented a number of changes to the aged care system on 1 July 2014 as part of the aged care reforms in response to the projected growth in the older population. The aged care reforms have increased the complexity of the system, with clients having more choice for aged care but have also increased the cost of aged care with clients of greater means having to pay more.

This increased complexity means it is more important than ever for clients to receive advice to help them make informed decisions covering a wider range of options. For example, decisions regarding keeping or selling a former home, paying for accommodation in residential aged care and where funds are invested can have a significant impact on the cost of aged care.
Aged care reforms

The “Living Longer Living Better” aged care reforms introduced significant changes to home care and residential aged care from 1 July 2014.

The reforms to residential aged care were designed to encourage greater investment in facilities by revising the financing arrangements to reflect the true cost of providing aged care and strengthen the sustainability of the system. Residents will have more choice about how they pay for their accommodation and those with lower means will continue to have this met in full or in part by the Government.

The reforms to home care will assist a person who wishes to remain living at home to do so for as long as possible. The number of home care packages will be increased and recipients will be given more choice and flexibility in the way care and support is provided.

A person with greater means in both residential aged care and home care will have to pay more for their ongoing care. Caps have been put in place to protect those who receive care over a longer period.

Who do the reforms apply to?

The new rules apply to a person who entered residential aged care or started to receive home care on or after 1 July 2014.

A person who was already in residential aged care or receiving home care before 1 July 2014 will have the previous rules grandfathered: see [19 215].

Grandfathering will cease and the new rules will apply for a person who:

• does not receive care for a period of more than 28 days; or
• changes facilities or providers and decides to have the new rules apply to them.

GROWING OLDER ISSUES

Pre-planning and longevity

As people grow older, the importance of proper retirement planning cannot be stressed enough. Pre-planning upwards of 5 years before retirement is absolutely necessary in many instances. During this time, people gain a trust and strengthening of the relationships they develop with their retirement planning specialists such as their lawyer, accountant and financial planner. Keeping one’s children informed can have advantages if there happen to be any health or medical issues which crop up unexpectedly. Other issues also crop up periodically such as Government reforms and changing legislation which do need specialist advice that children may not be able to provide. Therefore, professional advice is essential in these areas.

With proper pre-planning, one can manage more of the traps and pitfalls that accompany the ageing process. Some have experience and are well “armed” with knowledge to handle various situations which crop up because they had to deal with an elderly parent or relative at a time in the past. This still does not fully “arm” a person for what they are about to grow into – their own future destiny with growing older themselves – it becomes the ultimate – close to home – experience!
One of the worst things that can happen to us is living too long and our accumulated savings and investments running out before we do! Such is the problem of longevity. Thankfully, Centrelink is there for those cases – in most cases anyway – although one ought not assume the provision of government benefits will always be there to fill the gap – with an ageing population and improved health services, the cost of government benefits is on the increase, and that has to be funded from somewhere.

**TIP**
Ensure enduring powers of attorney and medical powers of attorney are established very early in the retirement planning process.

### [19 105] Four major stressors

There are generally 4 major “stressors” on a person’s life and well-being. These are among the top 20 which usually can create future ongoing health issues and in some cases they directly lead to death. The top 4 stressors are:

1. getting married;
2. being retrenched. Not an essential aged care issue but losing one’s job and income-earning capacity produces great emotional and financial strains. Homes can be placed in jeopardy and breakdown of relationships may occur;
3. moving home. This is one of 2 predominant stressors which affect many as they age. While it may mean moving from one home to another, in this context, it often means moving into some form of aged care. While the latter will invariably involve a financial planner and/or accountant (with issues such as cost, how to finance the move, accommodations payments etc), moving home is such an emotional issue in its own right that planners would be well served to be attuned to their clients’ needs here. It may be as simple as helping them talk through the issues involved;
4. Losing a loved one – the most traumatic stress of all.

### [19 115] Healthy lifestyle – exercise, hobbies etc

Maintaining a healthy lifestyle is just as important as having a secure financial future. Financial planners might not consider they should be directly involved in this aspect of their clients’ lives, but an appreciation of the benefits of a healthy lifestyle in respect of a client can assist in planning the needs of that client. Issues such as Alzheimer’s disease now frequently arise, and links are now being made between the disease and unhealthy living, poor diet, and lack of exercise.

Gone are the days when a male worked until age 65 before retiring – but note that the qualifying age for the Age Pension is gradually increasing from age 65 to 67 by July 2023 – or beyond while the female stayed at home.

Also gone are the problems associated with the male not having anything to do after retiring. Still, it is important for all those facing retirement to ensure they have external hobbies, and community, cultural and sporting group associations established well before retirement.
Retirement villages also play an important role in a healthy lifestyle. They do an excellent job of providing numerous facilities for their residents such as games rooms, gyms, pools/spas and saunas, walking tracks, the allowance of pets, general community halls, dining facilities, a courtesy bus service to towns and shopping facilities nearby.

Aged care facilities serve an important role in our society but have been known to “trap”, so to speak, people who would not ordinarily expect to be there. For example, a younger person who suffers a workplace accident could end up in a wheelchair and require help to wash, get dressed and do simple tasks. Accommodation in a nursing home or aged care facility might result. A financial planner attuned to such problems may be able to suggest alternatives, and/or consider what benefits the client may be entitled to.

Be aware of potential loneliness issues for older clients

Loneliness can be one of the greatest problems associated with growing older. An article published in the Melbourne Herald Sun newspaper on 12 December 2012 mentioned “feeling lonely can increase the risk of Alzheimer’s in later life, a study suggests. Researchers who found the link drew a distinction between being alone and loneliness. Participants who felt lonely were more than twice as likely to develop Alzheimer’s and other forms of dementia over 3 years as those who did not. When influential factors including mental and physical health were taken into account, loneliness was still associated with a 64% increased risk of the disease.”

Many retirees do not consider this issue until it is too late. Often they rely on their spouse to be their only contact. Some extend their boundaries to include trusted relatives while others choose to include some close friends. Maintaining a group of friends enhances one’s lifestyle as, all too often, the loss of a spouse through death, permanent separation due to ill health or having a debilitating illness can create stress and loneliness. Loneliness for men can occur when both members of a partnered couple move into aged care. Aged care facilities usually do not contain the same amenities as found around the family home or unit (such as a shed and tools/machinery). While a female partner readily interacts with other women inside the aged care facility, a male partner’s quality of life can be diminished if he does not have access to resources such as a shed or machinery to work on. As a result, many aged care facilities are now ensuring that worksheds are incorporated in their plans as well as appropriate tools/machinery – thus providing men with a lower stress environment. Men’s Sheds have also emerged in various places that enable retirees to intermingle with people of like-ages and like-skills. Socialising and networking are an important way of overcoming loneliness – as simple as catching up with some friends over a roast lunch at the local hotel, café or restaurant one day a week is maybe all it takes.

Another solution to loneliness can be for the elderly to acquire a pet. Having the joy of a pet in the home can make all the difference for the elderly. Of course, more issues can arise should the person be required to leave their home for an aged care facility or they die.

Extremely hot or cold days often create their own mini-disaster, especially for the elderly who live alone. It would therefore be prudent for neighbours,
friends or relatives who live nearby to check a couple of times a day in a form of a “welfare check”, maybe to water their gardens, ensure the cooler or heater are working effectively, that there is sufficient water, clothing and food available. If there are pets, to ensure their welfare also. Sometimes the elderly “forget” how long it has been since they had a drink, which can lead to dehydration very quickly.

[19 125] Prepaid funeral plans

Death may be a morbid topic to discuss, but it is inevitable, and financial planners can have a role in planning for it.

Having a pre-paid funeral plan (or funeral insurance as it is also known) provides added peace of mind as the deceased has usually made plans beforehand thus taking away further anxiety from the bereaved. Afterwards, there are the notifications to Centrelink or the Department of Veterans Affairs (DVA) and other Government departments (Electoral, Medicare etc). Since 1 January 1990, there has been a Bereavement Allowance (covered in Chapter 18), which assists in a way with the costs of dying.

Of course, pre-paid funeral plans (and their PDSs) should be examined carefully, and professional advice taken, before proceeding. With funeral insurance, people are usually required to make regular payments in exchange for payment of a cash amount when they die. These payments are ongoing and refunds are not generally provided if a payment is missed or the policy is cancelled.

Funeral insurance is regulated by the Commonwealth through the Life Insurance Act 1995 and the financial service provider provisions of the Corporations Act 2001. Funeral insurance policies fall under the jurisdiction of APRA and ASIC.

[19 130] Hoarding

Hoarding has been an issue for some people as they grow older because they are simply unable to “let go” of various items they have accumulated throughout their lives – these objects have a strong sentimental “value” for the person. For others, it is an obsession to venture outdoors and bring home what most would consider “trash” scavenged from refuse bins such as aluminium cans, plastic bags/containers etc. Hoarding can go unnoticed for some considerable time – especially if there are no regular visits being made by family or friends to the hoarder’s living quarters. When it does become apparent that action is necessary, the real problem is convincing the “hoarder” that they do not really need to keep the item(s) they have accumulated.

Counsellors are available from local health care facilities, social workers and Local Government departments to assist relatives/friends who need to help a “hoarder” overcome their affliction as painlessly as possible.

Notwithstanding the above, it would seem prudent to retain all receipts and documents associated with Government agencies such as the ATO and Centrelink.

In its very broadest sense, hoarding can result in health issues arising. It may seem strange, but some of those issues can be related to the valuable “Meals on Wheels” services that are provided. It is not unknown for the elderly to store or
“hoard” their meals when delivered to be eaten at a later time, often without refrigerating the meal. The health ramifications can be serious with cases where people have been known to die from food poisoning.

**[19 145] Having a will and a power of attorney**

The issues of having a properly drafted will (see [15 015]), an enduring power of attorney-financial and a medical power of attorney (POA) (sometimes known as a power of guardianship) (see [15 800]) need to be considered in the planning stages of retirement. In addition, the proper storage of items (see [19 150]) such as a will, power of attorney, private medical details, titles to properties, banking and investment details, personal details such as birth certificates, marriage certificates, copies of passports and drivers’ licences all need to be addressed adequately in any adverse event that may afflict us.

**[19 150] Storage**

Storage of personal belongings, tools and larger furniture items when one is moving home – which means the storage issue is either relatively shorter term or longer term if a home is up for sale following admittance to an aged care facility due to a stroke or other ageing health factor – can incur ongoing and unexpected costs. The fact the home has to be sold to meet the admission fees for the aged care facility means off-loading much of the contents by one of various means be it a garage sale, “gifting” to friends and relatives, dumping some contents into the rubbish disposal system or carting it to the local recycling centre, refuse dump or tip. Then there are the contents that have a “sentimental” value such as photos, trinkets and items that will be appropriate to display at the new location. All these issues need to be considered. That is why “moving home” is one of the 4 major stressors in our lives: see [19 105].

**[19 155] Identification**

Over the past 10-12 years or so, proof of identity has become highly relevant for anyone dealing with financial institutions, Government departments or simply travelling. The Federal Government introduced Counter Terrorism and Anti Money Laundering (AML) laws in December 2007. One of the best forms of identification is either a State Government-issued driver’s licence or a Federal DFAT-issued Passport. This is because they contain picture identification plus other relevant details about the person such as date of birth. Other secondary forms of identification are quite acceptable; however, more than one document is usually required – sometimes up to 3 documents are necessary, eg a Pension Concession Card and a statement of income/assets issued by a Federal Department (eg ATO and Centrelink).

As people age, an inclination may exist to hand in their driver’s licence for various reasons (eg poor sight, frailty, being admitted to an aged care facility, stroke or other illness). Some people may have never had a passport in their lives.

A birth certificate is also an important source of ID, but a problem can arise here where people have never had one or it has been lost or destroyed. A trip to the local births, deaths and marriages office can be required, but beware that this process itself involves the production of ID, eg passport, driver’s licence, Medicare card, credit card etc.
TIP

It is essential to provide adequate proof of identification (POID) when lodging any claim for entitlements with Centrelink or DVA. When pre-planning for an entitlement such as the Age Pension, gather or hold adequate POID to ensure a claim is processed efficiently.

CENTRELINK CONSIDERATIONS

[19 200] Seek professional advice

It is important to understand the interaction between aged care and Centrelink and the implications for entitlements particularly where there is a change of living arrangements. Decisions regarding the amount paid for a life interest, keeping or selling a former home and paying for accommodation in residential aged care can have a significant impact on Centrelink entitlements.

Certainly for those considering aged care, it is important to make contact with a financial planner well versed in the operation of Centrelink and the various entitlements administered.

While Financial Information Service (FIS) officers can assist with entitlement issues, they cannot make specific investment recommendations to suit a client’s risk profile, budgetary requirements, investment objectives, their current and future needs or their lifestyle requirements, among other matters of importance.

By engaging a qualified financial planner, clients who need aged care or are considering aged care will be better able to make informed decisions and avoid costly mistakes.

[19 202] Age Pension

The Age Pension is paid to retirees who have reached Age Pension age and are unable to fully support themselves. The Age Pension age is currently 65.5 but is legislated to increase gradually to 67 by 2023 depending on when the person was born, as follows.

<table>
<thead>
<tr>
<th>Person born</th>
<th>Age Pension age</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 1949 to 30 June 1952</td>
<td>65</td>
</tr>
<tr>
<td>1 July 1952 to 31 December 1953</td>
<td>65.5</td>
</tr>
<tr>
<td>1 January 1954 to 30 June 1955</td>
<td>66</td>
</tr>
<tr>
<td>1 July 1955 to 31 December 1956</td>
<td>66.5</td>
</tr>
<tr>
<td>On or after 1 January 1957</td>
<td>67</td>
</tr>
</tbody>
</table>
In the 2014-15 Federal Budget, the Government announced it would further gradually increase the Age Pension age to 70 by 2035, as follows.

<table>
<thead>
<tr>
<th>Person born</th>
<th>Age Pension age</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 July 1958 to 31 December 1959</td>
<td>67.5</td>
</tr>
<tr>
<td>1 January 1960 to 30 June 1961</td>
<td>68</td>
</tr>
<tr>
<td>1 July 1961 to 31 December 1962</td>
<td>68.5</td>
</tr>
<tr>
<td>1 January 1963 to 30 June 1964</td>
<td>69</td>
</tr>
<tr>
<td>1 July 1964 to 31 December 1965</td>
<td>69.5</td>
</tr>
<tr>
<td>On or after 1 January 1966</td>
<td>70</td>
</tr>
</tbody>
</table>

The Social Services and Other Legislation Amendment (2014 Budget Measures No 5) Bill 2014 which proposed the change lapsed when the Federal Election was called on 9 May 2016.

The Age Pension is subject to an income and assets test with the test producing the lower amount determining how much is payable. For those who satisfy the income and assets tests, the maximum assistance available for a single pensioner is $23,096 per annum ($34,819 for a pensioner couple combined) as at 1 July 2017. Pensioner couples who are separated by illness receive the single rate of Age Pension each. The detailed provisions governing access to social security benefits is outlined at [18 030]-[18 290].

As at 1 July 2017, the income test taper rate for a single pensioner is 50 cents per dollar of income above the relevant income limit of $168 per fortnight ($300 for a pensioner couple combined). For each member of a pensioner couple, the income test taper rate is 25 cents per dollar.

As at 1 July 2017, the assets test taper rate for a pensioner is $3 per $1,000 of assets above the relevant assets limits. For single homeowners, the assets limit is $253,750 ($380,500 for a pensioner couple combined) and for non-homeowners, the assets limit is $456,750 ($583,500 for a pensioner couple combined): see [24 530]. Under the assets test taper rate of $3, the Age Pension cuts out completely when a single homeowner’s assets reach $550,000 ($827,000 for a pensioner couple) and when a non-homeowner’s assets reach $753,000 ($1,030,000 for a pensioner couple combined).

Major 1 January 2017 changes

The Social Services Legislation Amendment (Fair and Sustainable Pensions) Act 2015 increased the assets test taper rate and assets limits from 1 January 2017.

Before 1 January 2017, the assets test taper rate was $1.50 per $1,000 of assets above the relevant assets limits. For single homeowners, the assets limit was $209,000 ($296,500 for a pensioner couple combined) and for non-homeowners, the assets limit was $360,500 ($448,000 for a pensioner couple combined).

There were no grandfathered provisions for Age Pension recipients immediately before 1 January 2017.

Timing – gifting and life interests

Since 1 July 2002, more stringent “gifting” rules prevent the transfer of assets without adequate consideration in excess of $10,000 in any single year and upwards of $30,000 over a 5-year period without the deprivation rules applying.
These rules count the “gifted” assets as still in the person’s possession throughout the 5-year period and are subject to the deeming rules under the income test: see [18 032].

It is vitally important for anyone who is contemplating “gifting” to seek professional advice before taking any action. The rules surrounding “gifting” before 1 July 2002 were more liberal allowing up to $10,000 to be “gifted” per pensions year (ie the anniversary date of when a person was granted their entitlement to a pension). The current rules simply allow up to $10,000 from 1 July each year to be “gifted” up to a maximum of $30,000 in any 5-year period (compared to up to $50,000 before 1 July 2002).

There are certain exemptions to the “gifting” rules. For example, a pensioner may transfer their home to their children for the right to accommodation. Depending upon the value of the property and the pensioner’s life expectancy, the whole property may not be subject to any deprivation as the pensioner has received “valuable consideration” being the life interest: see [19 360].

The Families, Housing, Community Services and Indigenous Affairs and Other Legislation Amendment (2009 Measures) Act 2010 made amendments to clarify that a gift that has been returned does not have to be assessed as a deprived asset. The amendments commenced on 14 April 2010.

[19 215] Financial investments, account-based pensions and annuities

Financial investments including bank accounts, term deposits, managed investments and shares are subject to the deeming rules under the income test: see [18 032]. Where a person is over Age Pension age, their superannuation is also included in financial investments. Under the assets test, the account balance or net market value of the investment is assessed. The net market value is the gross market value less any loans secured against the investment. While the net market value is assessed under the assets test, it is the gross market value which is subject to deeming.

Major 1 January 2015 changes

The Social Services and Other Legislation Amendment Act 2014 extended the deeming rules under the income test to new account-based pensions from 1 January 2015.

Account-based pensions held by income support recipients immediately before 1 January 2015 will be assessed under the previous rules with the pension payment reduced by the deduction amount assessed under the income test. These recipients will continue to be grandfathered unless they cease to receive an income support payment or change product providers after 1 January 2015. There was no change to the asset assessment of account-based pensions with the account balance continuing to be assessed under the assets test.

Non-account-based annuities including lifetime annuities and fixed term annuities with a term greater than 5 years (or greater than life expectancy) were not impacted by the deeming changes and continue to have the annuity payment reduced by the deduction amount assessed under the income test. Fixed term annuities with a term less than 6 years (and less than life expectancy) continue to be subject to the deeming rules as they were previously. Where a
non-account-based annuity returns capital as part of the annuity payment, the amount assessed under the assets test is the purchase price reduced by the deduction amount over the entire term of the annuity.

Commonwealth Seniors Health Cards

The Commonwealth Senior’s Health Card (CSHC) gives self-funded retirees access to discounted medicines listed in the Pharmaceutical Benefits Scheme Schedule and various concessions from the Australian and State and Territory Governments.

To receive the CSHC, the person must have reached Age Pension age but not qualify because of their income or assets. The CSHC is subject to an income test, where the card is only available if adjusted taxable income is below the income threshold. Adjusted taxable income includes:

- taxable income;
- reportable superannuation contributions;
- total net investment losses;
- target foreign income; and
- employer provided fringe benefits.

The Social Services and Other Legislation Amendment (Seniors Health Card and Other Measures) Act 2014 implemented provisions to index to CPI the income thresholds for the CSHC from 20 September 2014. Indexation of the adjusted taxable income thresholds occurs annually based on movements in the CPI each June compared to the previous June quarter. As at 1 July 2017, the income threshold for a single retiree is $52,796 per annum ($84,472 for a retiree couple combined).

The Social Services and Other Legislation Amendment (2014 Budget Measures No 6) Act 2014 has included untaxed superannuation income streams in the assessment of income to determine eligibility for the CSHC from 1 January 2015. Essentially, the changes align the income test for the CSHC with the Age Pension deeming rules from 1 January 2015 (see above) for untaxed superannuation income generated by various account-based pensions and annuities, regarding them as financial investments. That is, various long-term financial assets which produce an income stream will be counted as financial investments, and subject to the income deeming rules (see [18 032]) for the purposes of the CSHC income test from 1 January 2015. All superannuation account-based pensions and annuities purchased before 1 January 2015 by existing CSHC cardholders are exempt from the new arrangements and will be grandfathered under the existing rules. If a person held a CSHC immediately before 1 January 2015, and a relevant long-term financial asset was being provided to the person immediately before 1 January 2015, then that asset will not be included in the CSHC income test, if it would otherwise be caught by the test.

The Social Services and Other Legislation Amendment (2014 Budget Measures No 6) Act 2014 has also extended from 6 to 19 weeks the portability period for CSHC cardholders from 1 January 2015. The extension will also apply where a person leaves Australia before 1 January 2015, and returns after 1 January 2015, having been continuously absent in the intervening period, provided the person was absent for fewer than 19 weeks in total.
[19 225] Private trusts and private companies

Rules were introduced from 1 January 2002 to assess interests in private trusts and private companies under both the income and assets tests. Private trusts include family trusts, testamentary trusts and fixed trusts with less than 50 members.

A person will be attributed with the income and assets of a private trust or private company based on a source test and a control test. The source test applies where a person transfers assets to a private trust or private company and does not receive adequate consideration for those assets. The control test relates to who has effective control of the private trust or private company. The effective control of a private trust generally rests with the appointer, principal or guardian.

When a person is attributed with the control of a private trust or company, the net income and net market value of assets of that trust or company will be attributed to that person. The amount of income and assets attributed will be in the same proportion as the control attributed to that person.

[19 230] Changes to rates and entitlements

Regular movements in the CPI influence Centrelink entitlements. Three times a year there are changes to rates and entitlements. During March and September each year, the movements in CPI determine new rates of payments. These in turn also change the disqualifying limits under both the income and assets test. In July each year, due to indexation increases, changes to the qualifying limits for pensions and allowances occur influencing the amount of payment made available to pensioners and allowees. At this time, there are usually changes to the valuations of certain assets such as real estate (vacant land, holiday homes, farms and rental properties) being updated on Centrelink records.

While there may be increases to allowable assets and extensions to disqualifying limits, a pensioner may, for example, receive a reduction in entitlements due to an increased valuation on their real estate assets (excluding the home in which they reside).

Conversely, a Centrelink recipient’s entitlement to pensions, benefits or allowances may be influenced by CPI increases to private or government superannuation pensions. Indexation increases on complying pensions, movements in account-based pension minimum payments and a myriad of other changes to either income or assets (eg buying/selling a motor vehicle) may change entitlements.

While there may be no change to the asset values due to the additional funds to acquire a motor vehicle, for example, being withdrawn from a bank account, there can be a change to the “deemed” income under the income test providing a person with an increase in their entitlements.

Add to these types of “automatic” changes the annual Federal Government Budget which sets the scene for the Government of the day to announce changes, add new initiatives, revise current ones, or even abolish current ones – a recipient of a Centrelink or Veteran’s Affairs entitlement could run the gauntlet of having their regular pension entitlements altered not only in a positive sense but also a negative sense. It is therefore important that people contact qualified...
people such as their financial planner or FIS officers to ensure they know they are receiving their correct entitlements. “Political risk” can mean the passage or non-passage of a vital piece of legislation does or does not get through all stages of Parliament to become law. As such, one must be fully aware of their entitlements these days.

Failure to notify Centrelink of changes to circumstances may result in an incorrect entitlement existing. Certainly, with reduced assets or income, one would expect an increase in entitlement. However, without notifying Centrelink, there will be no increases in entitlements. If notification is not made promptly, a person can miss out on the increased entitlements over a long period of time.

**TIP**

It is prudent to regularly monitor assets with the view to keeping Centrelink informed particularly where investments are held in volatile assets.

Again, if there are increases in income or assets and these are not notified to Centrelink, then a recipient will receive excess payments. If these are not notified within the notification period (usually 7 to 14 days), then at some given point in time down the track (this can be years later), when Centrelink becomes aware of the information, the person can be certain of being found to have been overpaid. The excess payment is required by law to be repaid to Centrelink. Furthermore, if deception, fraud or misleading practices are detected, prosecution action leading to jail may occur.

It is important that an inquirer contact Centrelink to ensure the correct entitlements, rates, eligibility criteria and other matters relevant to a case are outlined. It is also important to ensure that any changes to legislation, rates or eligibility criteria are known. Due to the ever-changing legislative environment, contact with Centrelink staff or FIS officers will ensure the correct information is obtained.

Much of what is stated in this section applies equally for those receiving DVA Service Pensions (as opposed to income/asset-test free disability, war or other types of payments).

**[19 235] Contacting Centrelink**

- Employment Services 132 850;
- To report when income or circumstances change 133 276;
- Youth Allowance 132 490;
- Austudy Payment 132 490;
- ABSTUDY Payment 1800 132 317;
- Pensioner Education Supplement (PES) 132 490;
- Assistance for Isolated Children (AIC) Scheme 132 318;
- Older Australians 132 300;
- Aged Care 1800 200 422;
- Disability, Sickness and Carers 132 717;
- Family Assistance Office 136 150;
For information in languages other than English 131 202;
For information on Social Security Agreements with other countries, payment of Australian pensions overseas or claiming overseas pensions 131 673;
If calling from overseas (reverse charges) +61 3 6222 3455;
Customer Relations Freecall(tm) 1800 132 468 for complaints, compliments or feedback;
TTY payment inquiries Freecall(tm) 1800 810 586 – this is only for people who are deaf or who have a hearing or speech impairment. A TTY phone is required to use this service;
TTY customer relations Freecall(tm) 1800 000 567 – this is for complaints, compliments or feedback. Only for people who are deaf or who have a hearing or speech impairment. A TTY phone is required to use this service.

Information on payment rates is also available on the Centrelink website at http://www.humanservices.gov.au/customer/dhs/centrelink. Calls to 13 numbers are charged at a fixed rate depending upon telephone service providers from anywhere within Australia. Calls to 1800 numbers are free of charge. Calls from public pay phones or mobile phones may be charged at a higher rate.

AGED CARE CONSIDERATIONS

Health issues

As we grow older (or age graciously), there are usually signs of deterioration in our bodies (commonly caused by the ageing process, by being involved in some traumatic accident, or by becoming ill). Falls within one’s home have surfaced as one of the most significant issues for the elderly as they grow older. Falls often result in fractures, breakages of the pelvis, hips, legs and wrists, with painful rehabilitation. In many instances it is the “beginning of the end” to one’s independence and carefree lifestyle, with a relocation into another facility where constant supervision may be required. Sometimes the deterioration may take place over a period of years and be difficult to diagnose earlier (eg dementia, Alzheimer’s Disease, Parkinson’s Disease or Motor Neurone Disease) or it may take place rapidly (eg due to a stroke or heart attack).

Ailing health issues can create problems with being able to continue living an independent lifestyle in our homes. Having a partner who is capable of taking on a role as a carer (and usually with the assistance of medical professionals such as a local GP, district nursing services, and local council domestic services, or adult children who may live close by) greatly enhances an aged person’s ability to continue living a reasonable lifestyle in their own home.

Where there is no partner due to bereavement, separation, or divorce or because the partner is already in an aged care facility, then usually the weight of the responsibility falls onto remaining family members. In many cases, due to distances, work commitments, or other family commitments with children, it may not always be possible for a child to care for their unwell parent. For the financial planner, some understanding of the client’s health position would be of assistance in planning their needs.
Memory impairment

Another significant issue is memory impairment which causes much anxiety not only to the patient but all those close family members taking care of the affected person, not to mention the financial planner trying to help his or her client. A financial planner may need the assistance of family members where a client exhibits memory loss issues. Documentation of issues affecting the financial affairs of the client is vital. Also, details of enduring powers of attorney plus AML identification is essential on the financial planner’s client file to support financial decisions undertaken by the appointed attorney, be they for a child, relative, friend or neighbour or other professional.

Carer Allowance

Additional financial assistance such as the Carer Allowance is available to the carer. As it is a tax-free and non-income/asset-assessed payment, it does not cause any problems with other payments such as the Age Pension or Carer Payment entitlements. Details of these entitlements are covered in Chapter 18 at [18 100]. It is quite common to find that the elderly are unaware of such an entitlement and thus making them “aware” can be a great relief to them from an additional financial perspective.

There are a number of hoops to jump through in applying for this allowance, and the application form is lengthy. The allowance is a valuable financial assist to someone caring for a person with a disability or medical condition.

My Aged Care website

Where care from family members or a spouse is not possible, the elderly are able to seek help through Australia’s subsidised aged care system. As there are many different types of help available to a person, the Government has developed a website aimed at assisting people navigate through the system.

The My Aged Care website can be used to help the elderly understand the different types of care available and to identify the right type of care that is best suited to their situation. For example, those who can still manage on their own but need help with some daily tasks such as mowing the lawn or preparing meals may find that a home care package is most suitable for them. Those who are unable to manage on their own and need more extensive care may find that a residential aged care facility is better suited.

Once a type of care has been found, the website can then be used to help the person locate services around their area that provide the care they require. It should be noted that to access subsidised care, a person would first need to be assessed and approved by a member of an Aged Care Assessment Team (ACAT). This team is known as Aged Care Assessment Service (ACAS) in Victoria. This involves speaking to a member of the ACAT about the care needs of the person and how they are managing in their day-to-day life.
Granny flats

A granny flat is usually a self-contained unit within or attached to a family home, or detached and located in the backyard. They are often established to enable elderly people to live near family members at a time when they need more physical and emotional support.

A granny flat arrangement can include various types of living situations that help people to care for elderly family members which if set up correctly, do not affect Centrelink entitlements. In some cases, pensioners may even enhance their Centrelink entitlements by using a granny flat strategy.

Creating a life interest

Centrelink considers a granny flat arrangement as one where a person:

- "pays" for a life interest or right to accommodation for life; and
- the life interest or right to accommodation for life is in a private residence that is to be the person’s principal home.

Granny flat rules enable a person to transfer assets over the allowable gifting limits to another person in exchange for a right of occupancy for life in a residential property, without being subject to any deprivation: see [19 205].

Valuing a life interest

There is no market value for granny flat interests as they are generally private family arrangements. In most cases, the value of the granny flat interest is the same as the amount paid for the interest or value of the asset transferred. There are some circumstances where the Social Security Act allows the granny flat interest to be valued at a different amount known as the "reasonableness test" amount rather than the paid amount. Examples of where the "reasonable test" amount is used include:

- A person transfers title to their home and additional assets to another person.
- A person pays the cost of construction for accommodation on another person’s property and transfers additional assets.
- A person purchases a property in another person’s name and transfers additional assets.


Reasonableness test = combined annual married pension rate x conversion factor

Where:

- the combined annual partnered pension rate is used irrespective of the person’s marital status. As at 1 July 2017, the combined annual partnered pension rate is $34,819.20; and
the conversion factor applied is based on the person’s age next birthday. For married couples, the age of the youngest member of the couple is used.

A person can pay more than the “reasonableness test” amount. However, any additional value paid or transferred will be assessed under the deprivation rules.

**EXAMPLE [19 360.10] Calculating “reasonableness test” amount**

Jacqueline is single, age 75 and is widowed. Jacqueline pays her daughter Josephine $400,000 for a life interest in Josephine’s home. Josephine constructs a granny flat at her home for Jacqueline to live in at a cost of $200,000.

Jacqueline has paid for the cost of construction and has transferred additional assets to Josephine, triggering the “reasonableness test”. Jacqueline’s conversion factor is 12.78.

“Reasonableness test” amount: $34,819.20 × 12.78 = $444,989.38.

Jacqueline has paid Josephine less than the “reasonable test” amount. Therefore no amount is assessed under the deprivation rules.

**TIP** Where the “reasonableness test” amount is greater than the amount paid for the granny flat interest or the value of the asset transferred, additional assets can be transferred up to the “reasonable test amount” without the additional assets being subject to any deprivation.

**[19 365] Homeownership rules**

To determine whether someone is a homeowner and eligible for rent assistance in a granny flat, they would need to calculate the difference between the Entry Contribution (EC) and the Extra Allowable Amount (EAA). The EC is the value of the granny flat interest. As at 1 July 2017, the EAA is $203,000, which is the difference between the homeowners and non-homeowners lower assets test thresholds.

<table>
<thead>
<tr>
<th>Homeownership status</th>
<th>EC is less than or equal to the EAA amount</th>
<th>EC is more than the EAA amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent assistance</td>
<td>May be payable</td>
<td>Not payable</td>
</tr>
<tr>
<td>Entry contribution</td>
<td>Assessed as an asset</td>
<td>Not assessed as an asset</td>
</tr>
</tbody>
</table>
Vacating a granny flat

If a person stops living in a granny flat interest less than 5 years after the time the interest was created, the deprivation rules will apply if the reason they left could have been anticipated. As there is no clear definition of what constitutes an unforeseeable event, Centrelink will assess each case individually.

If the reason for leaving the granny flat was to enter a residential aged care facility, the person will be classified as a non-homeowner on entry to the facility unless the person intends to return to the granny flat.

Where one partner of a couple remains in the granny flat, both are still regarded as homeowners if they were originally homeowners when the granny flat was created.

Other factors to consider

There are some other important factors to consider before setting up granny flat arrangements:

- There could be tax implications to the grantor of the granny flat (refer to Tax Ruling 2006/14). It is recommended that specialist tax advice is sought before the life interest is created.
- Amounts received by the grantor of the granny flat may impact their Centrelink and/or individual income tax position.
- Consider estate planning issues where assets are being transferred to only certain children.
- Consider a formal legal agreement be drawn up for the granny flat interest to protect the client from any breakdown in family relations. This can also be used as evidence that the client has security of tenure for Centrelink purposes.
- Ensure there are provisions in the granny flat agreement to handle the situation where the owner of the property decides to sell. It may also be a good idea to specify who is responsible for any upkeep of the property in the granny flat agreement.
- Ensure the elderly person is left with enough assets to last through retirement.

The granny flat provisions may prove to be a good accommodation choice for some elderly clients that are no longer able to live by themselves. It is important, however, to ensure the arrangement is set up correctly, taking into consideration the various factors outlined.
RETIREMENT VILLAGES

Ownership structures

Retirement villages are generally built as a group of units or villas. Entry is usually restricted to people who are over 55 and retired from full-time employment.

The level of care provided by a retirement village can vary greatly. Some units are described as “independent living” or “self-care units” and provide the lowest level of care, although a range of personal services may be available on request. The units normally have fully self-contained facilities including a kitchen to prepare meals.

Other units, described as “assisted living units” or “serviced apartments”, provide higher levels of care, including the regular provision of a range of personal services. These units may not contain the facilities to prepare full meals as residents generally eat in a communal area or have meals delivered to their units.

Confusion can arise when a retirement village also provides residential aged care services. Residential aged care services are partly funded and regulated by the Commonwealth Government and have a different fee structure to retirement village units. It is important to ascertain your client’s level of care as the Centrelink assessment differs greatly between retirement villages and residential aged care facilities.

Fees and charges

Retirement villages can be operated by private for-profit companies or community-based not-for-profit organisations like churches. Both private and not-for-profit villages generally operate on a resident-funded basis where the residents pay the full cost of the buildings, management, maintenance and day-to-day running of the village. However, not-for-profit villages are more likely to offer special deals for people who cannot afford high entry costs. They may also use any surplus funds, such as from property sales, to subsidise other charitable events.

The financial aspects of retirement villages can be very complex. Contracts and legal structures can vary, resulting in different fee structures between retirement villages. The fees, however, can generally be broken down into the following 3 payments.

Entry fee/contribution

To secure residency in a retirement village, the person must generally pay an entry fee known as an entry contribution (EC). The contribution amount is negotiated between the resident and the retirement village and may be in the form of a loan, donation, payment or a combination of these. In some villages, the EC is equivalent to the actual purchase price of a unit, whereas in other villages it is much less. Some villages also have an arrangement where a former resident sells his or her unit and the new resident must pay an amount to both the retirement village operator and the former resident. The total of these payments will be considered as an EC for Centrelink purposes.
There may be cases where the EC is zero, such as where there is only a rental arrangement in place.

**Ongoing costs**

Residents will need to pay ongoing fees and charges for services and facilities such as rates/water, security, gardening and building insurance. These fees and charges are a contribution toward the day-to-day costs of running the village and are set on a cost-recovery basis. Costs will vary, depending on the extent and age of communal facilities and the type of services provided. Additionally, where the tenure arrangement specifies, a resident may be required to pay rent to the retirement village.

**TIP**

It is important for residents to check the ongoing fee arrangement and to understand how often fees need to be paid before signing a contract. From a financial planning perspective, these costs are an important factor to consider, as they may have a detrimental effect on the client’s cost of living.

**Departure fees**

A resident may be asked to pay a departure fee, also known as an exit fee or deferred management fee, when they leave the retirement village. These fees may be calculated in a number of ways and tend to be fairly complex. They should be set out in the initial contract. Departure fees are normally calculated by reference to either the entry price or resale price.

Where the departure fee is calculated by reference to the entry price, the owner pays a set percentage of the entry price (eg 2.5% for the number of years lived in the village), plus a proportion of the capital gain on sale. In some cases, the operator may be entitled to 100% of the capital gain.

Where the departure fee is calculated by reference to the resale price, the fee is based on a percentage of the resale price when the unit is sold, leased or licensed to a new resident. This means the operator is entitled to the accrued percentage of both the entry price and any capital gain accrued.

**EXAMPLE [19 405.10]**

**Calculating departure fees**

Harold is single, age 80 and is living in a retirement village. The entry price was $300,000 and the departure fee is 5% of the entry price per year. Any capital gains on resale are shared equally between the resident and the retirement village.

Harold moves out of the retirement village after 3 years and the resale price is $350,000.

Departure fee: $(300,000 \times 5\% \times 3) + (350,000 - 300,000)/2 = $70,000.

Harold will receive $280,000 when he leaves the retirement village.
Homeownership rules

Retirement villages are defined in the Social Security legislation as “special residences”. If a person is living in a special residence, their former principal home is assessable under the assets test. This means that if a person continues to own their former home, the current market value of their home will be treated as an assessable asset from the date they move into the retirement village, unless they are a member of a couple and their partner remains living there. Any rental income generated by their former home will count towards the income test for Centrelink purposes.

A person’s principal home can be in a retirement village. The amount of EC paid will determine whether or not a person living in a retirement village is considered a homeowner or not and whether they are eligible to receive rent assistance: see [19 365].

The amount the resident is required to pay in order to secure the accommodation is specified in the entry agreement. This is the amount Centrelink assesses as the EC. The EC does not include ongoing fees and charges for services and facilities. If the resident is eligible to receive rent assistance, the ongoing fees and charges (eg general service and maintenance fees) are assessed as rent.

Although the EC counts as an asset for those who pay $203,000 or less, it is not deemed under the income test as the resident does not earn any income on this amount.

Illness-separated pension rate

If a couple live together in a self-care unit in a retirement village, they will be paid an Age Pension based on the partnered rates and thresholds. However, if they live in a serviced unit and are affected by illness, they may be paid the higher “illness-separated rate”. A couple must tell Centrelink if they think they may be entitled to the higher rate for an assessment.

Vacating the retirement village to move into residential aged care

As a person’s health declines, they may need more personal care than the retirement village can provide.

When moving from a retirement village into residential aged care, it is relevant to consider the homeownership rules. There is the opportunity for a person to continue to be treated as a homeowner when they move into an aged care facility from their family home. If a person who was treated as a homeowner in a retirement village moves from the retirement village to an aged care facility, they must usually sell their unit (or share in the village) as soon as possible. A person does not normally have the option to hold onto the share or unit and rent it. This means they will only be treated as a homeowner until their share or unit is sold.

WARNING!

Additionally, if a resident held on to their former home when they moved into the retirement village, that home continues to be assessable when they move into an...
Another consideration is the amount of time before the retirement village share or unit is sold and the sale proceeds are received. Some clients may be relying on the proceeds to pay for lump sum accommodation payments and might need additional cash flow to cover daily accommodation payments while their retirement village is on the market.

It is critical to stress to your clients the importance of seeking expert or legal advice before signing any contracts. It is important for them to understand the tenure arrangement in detail, the possible fees and charges and how their EC will be refunded when they leave the retirement village.

[19 420] Other factors to consider

An important factor that may impact fees and charges is the ownership structure of the retirement village. Some examples of the various ownership structures are outlined below.

- **A loan and licence agreement.** This is offered by many not-for-profit operators and is the most common form of tenure. The resident provides the village with an interest-free loan and in some cases an additional donation. In return, the resident receives a licence to occupy.

- **A leasehold.** This is where the resident leases the unit and contributes to the costs of the common areas. They pay an initial contribution in return for a lease to live in a particular unit.

- **Strata title.** Under this structure the resident owns the unit and contributes to the maintenance of the common areas.

- **A company title.** With this structure, the resident buys a share or number of shares in a company whose articles of association permit them to live in the unit for the rest of their life or as long as they wish.

- **A unit trust.** This is similar to a company title but the person buys units in a trust. The trustee gives the resident the right to occupy the unit for their lifetime or as long as they wish.

- **Rental arrangements.** Some villages set aside a number of units for retirees with little or no assets to rent. The resident signs a lease and pays rent like other tenants.

The different legal structures may have different stamp duty, GST and fee implications.

Some other important factors to be aware of with departure fees are:

- the percentage rate at which the fee accrues per year. This can vary from around 2.5% to 10% of the entry or resale price. For some villages, the rate may be higher in the first year or first couple of years; and

- the percentage fee may be subject to a minimum or maximum. For example, it can be a minimum of 5% or 10% of the relevant amount (regardless of how long the resident stays there) or a maximum of 25% of the relevant amount.
Departure fees may be a trade-off for a lower entry price. It is important to analyse the entire fee structure before moving into a retirement village. As there is no legislation limiting what the retirement village can charge, it is important that clients read their contract carefully and have a solicitor go through all aspects of the fees payable.

In the event of death, the treatment of the EC will generally depend on the ownership structure and the contract signed with the retirement village when entering the village. The EC (or part of) may be held within the retirement village or paid out to the deceased’s estate.

HOME CARE

[19 450] Home Care Packages Program

The Home Care Packages Program provides 4 levels of home care packages.

<table>
<thead>
<tr>
<th>Level</th>
<th>Support provided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home Care Level 1</td>
<td>Basic care needs</td>
</tr>
<tr>
<td>Home Care Level 2</td>
<td>Low level care needs</td>
</tr>
<tr>
<td>Home Care Level 3</td>
<td>Intermediate care needs</td>
</tr>
<tr>
<td>Home Care Level 4</td>
<td>High level care needs</td>
</tr>
</tbody>
</table>

The main difference between the home care levels is the amount of care and services that can be provided rather than the type of care reflected by higher subsidy amounts for higher levels. Personal services, support services and clinical care are available under any level of care. However, comprehensive clinical care is mostly available under the higher levels.

The Home Care Packages Program replaced the Community Packaged Care Programs from 1 August 2013, which comprised:
- Community Aged Care Package (CACP);
- Extended Aged Care at Home (EACH);
- Extended Aged Care at Home Dementia (EACHD).

[19 455] ACAT assessment

Before receiving a home care package, a person must be assessed and approved by a member of an ACAT. ACAT assessments are a free service provided by the Government to determine eligibility for Australian Government Subsidised Care Services.

From 27 February 2017, there were changes to the ACAT assessment for home care packages. ACAT approvals on or after this date will be specific to each package level and a reassessment will be required to move to a higher level.

Before 27 February 2017, ACAT approvals were broadbanded into 2 assessment bands:
1. Home Care Levels 1 and 2;
2. Home Care Levels 3 and 4.

Existing approvals on 27 February 2017 will automatically be approved at the higher level within the assessment band.

ACAT approvals remain valid indefinitely unless the approval was granted for a specific time period.

**[19 460]** Ongoing care costs

**Basic daily fee**

People receiving home care will pay a basic daily fee. There were no changes to the basic daily fee under the aged care reforms, which remains at 17.5% of the basic single Age Pension.

The basic daily fee is indexed on 20 March and 20 September each year in line with the indexation increases to the Age Pension. The basic daily fee as at 1 July 2017 is $10.10 per day.

**Income-tested care fee**

People receiving home care may also be asked to pay an income-tested care fee as a contribution towards the cost of their ongoing care. The income-tested care fee is determined by a recipient’s assessable income.

The income-tested care fee replaced the care recipient fee from 1 July 2014. The care recipient fee was determined by a recipient’s after-tax income.

An income-tested care fee will be payable where the recipient’s assessable income is greater than the income-free area. The income-tested care fee is calculated as follows:

\[
\text{income-tested care fee} = (\text{assessable income} - \text{income free area}) \times 50\%
\]

Assessable income includes income as assessed under Centrelink/DVA rules and Age/Service Pension income (excluding minimum Pension Supplement and Energy Supplement). Assessable income includes:

- deemed income from financial investments, including money in superannuation funds if the person has reached Age Pension age;
- gross employment income, eg wages, salaries, bonuses, penalty rates, and amounts salary sacrificed into superannuation;
- net business income, including from farms;
- distributions or dividends from private trusts and private companies;
- real estate income, including net income or losses from rental property, and income from boarders and lodgers;
- reportable superannuation contributions;
- income from outside Australia, including non-Australian pensions.

The income free areas as at 1 July 2017 are as follows.
Where a person is a member of a couple, half of the combined assessable income of the couple plus their own Age/Service Pension is assessed.

The income-tested care fee will be recalculated quarterly by the Department of Human Services (DHS) or DVA and may change depending on the resident’s income.

A recipient’s income-tested care fee cannot exceed their cost of care which is the sum of the basic subsidy amount and all primary supplements paid by the Government for the recipient. A recipient’s cost of care will be determined by the DHS when the home care provider submits a claim for payment.

The income-tested care fee has separate annual indexed caps for part pensioners and self-funded recipients. When a recipient reaches the annual cap, they will stop paying the income-tested care fee until the next anniversary of their date of entry. The annual caps as at 1 July 2017 are $5,276 for a part pensioner and $10,552 for a self-funded recipient.

The annual caps are pro-rated to daily amounts. The equivalent daily amounts are $14.49 for a part pensioner and $28.98 for a self-funded recipient.

<table>
<thead>
<tr>
<th>Assessable income (single)</th>
<th>Income-tested care fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td></td>
</tr>
<tr>
<td>Less than 26,177</td>
<td>Nil</td>
</tr>
<tr>
<td>26,177 – 50,560</td>
<td>Lesser of:</td>
</tr>
<tr>
<td></td>
<td>• (Assessable income – $26,177) × 50%</td>
</tr>
<tr>
<td></td>
<td>• Basic subsidy amount + primary supplements</td>
</tr>
<tr>
<td></td>
<td>• $5,276 (part pensioner cap)</td>
</tr>
<tr>
<td>50,560+</td>
<td>Lesser of:</td>
</tr>
<tr>
<td></td>
<td>• (Assessable income – $50,560) × 50% + $5,276</td>
</tr>
<tr>
<td></td>
<td>• Basic subsidy amount + primary supplements</td>
</tr>
<tr>
<td></td>
<td>• $10,552 (self-funded cap)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assessable income (couple each)</th>
<th>Income-tested care fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td></td>
</tr>
<tr>
<td>Less than 20,340</td>
<td>Nil</td>
</tr>
<tr>
<td>20,340 – 38,719</td>
<td>Lesser of:</td>
</tr>
<tr>
<td></td>
<td>• (Assessable income – $20,340) × 50%</td>
</tr>
<tr>
<td></td>
<td>• Basic subsidy amount + primary supplements</td>
</tr>
<tr>
<td></td>
<td>• $5,276 (part pensioner cap)</td>
</tr>
<tr>
<td>38,719+</td>
<td>Lesser of:</td>
</tr>
<tr>
<td></td>
<td>• (Assessable income – $38,719) × 50% + $5,276</td>
</tr>
<tr>
<td></td>
<td>• Basic subsidy amount + primary supplements</td>
</tr>
<tr>
<td></td>
<td>• $10,552 (self-funded cap)</td>
</tr>
</tbody>
</table>
In addition to the annual cap, the income-tested care fee has a lifetime indexed cap. When a recipient reaches the lifetime cap, they will no longer pay the income-tested care fee. Where a recipient moves from home care to residential aged care, income-tested care fees paid for home care will be added to means-tested care fees paid in residential aged care and count towards the lifetime cap. The lifetime cap as at 1 July 2017 is $63,313.

**TIP**
The lifetime cap is not set at the date of entry and therefore a recipient will continue to pay the income-tested care fee until they reach the cap at the time.

**EXAMPLE [19 460.10]**

**Calculating income-tested care fees**

Geoff receives a level 2 home care package and his cost of care is $40.65 per day. He is a homeowner and has $250,000 in a bank account. He is eligible for a part Age Pension of $21,594 per annum.

Geoff has assessable income of $7,372 per annum of deemed income and $20,307 per annum of Age Pension income less minimum Pension Supplement and Energy Supplement.

Income-tested care fee will be the lesser of:

- \(\frac{(7,372 + 20,307 - 26,177) \times 50\%}{364} = \$2.06\) per day;
- $40.65 per day;
- $5,276 / 364 = $14.49 per day.

Geoff’s income-tested care fee will be $2.06 per day in the first quarter.

**[19 465]** Income assessment process

A person’s income will be assessed by the DHS or DVA where they complete the aged care fees income assessment form.

It is not compulsory to have an income assessment. However, a recipient may pay higher ongoing care costs where it is not completed.

Where a person is receiving Centrelink/DVA benefits, they only need to complete their contact details and sign the form to have an income assessment.

**RESIDENTIAL AGED CARE**

**[19 500]** ACAT assessment

Before entering a subsidised aged care facility, a person must be assessed and approved by a member of an ACAT. ACAT assessments are a free service provided by the Government to determine eligibility for Australian Government Subsidised Care Services.
ACAT approvals remain valid indefinitely unless the approval was granted for a specific time period.

Under the previous rules, ACAT approvals restricted care to either low level or high level with low level approvals automatically lapsing after 12 months if a person did not enter residential aged care.

The distinction between low level and high level care was removed from 1 July 2014 with any existing valid low level approvals becoming unrestricted and valid indefinitely.

**Means testing residents**

The aged care reforms introduced a means-tested amount from 1 July 2014 which uses both a resident’s assets and income to determine how much they pay for their accommodation (accommodation payments and contributions) and contribute towards the cost of their ongoing care (means-tested care fee). The means-tested amount is calculated as follows:

\[
\text{means tested amount} = \text{income-tested amount} + \text{asset-tested amount}
\]

Under the previous rules, a resident’s assets were used to determine how much they paid for their accommodation (accommodation bond and charge) (see [19 555]) and their income was used to determine how much they contributed towards the cost of their ongoing care (income-tested fee): see [19 560].

**Income-tested amount**

The income-tested amount is calculated as follows:

\[
\text{income-tested amount} = (\text{assessable income} - \text{income free area}) \times 50\%
\]

Assessable income includes Centrelink/DVA assessed income and Age/Service Pension income (excluding minimum Pension Supplement and Energy Supplement).

Where a person is a member of a couple, half of the combined assessable income of the couple plus their own Age/Service Pension is assessed.

The income free areas as at 1 July 2017 are as follows.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>$26,177 per annum</td>
</tr>
<tr>
<td>Couples (each)</td>
<td>$25,709 per annum</td>
</tr>
</tbody>
</table>

**Asset-tested amount**

The asset-tested amount is calculated as a percentage of assessable assets at increasing thresholds. The assets test thresholds as at 1 July 2017 are as follows.
17.5% per annum of assets between $47,500 and $162,087
1% per annum of assets between $162,087 and $391,262
2% per annum of assets above $391,262

Assessable assets include Centrelink/DVA assessed assets with the following included assets:

- the family home up to a cap of $162,087 where it is not occupied by a protected person: see [19 515]; and
- the refundable accommodation contribution (RAC)/refundable accommodation deposit (RAD) balance: see [19 520].

Where a person is a member of a couple, half of the combined assessable assets of the couple are assessed. If the family home is assessed, the home cap is applied to 50% of the total value of the home for each member of the couple.

A resident’s means-tested amount is compared to the maximum accommodation supplement to determine if they are a “low means” or an accommodation payment resident. The maximum accommodation supplement as at 1 July 2017 is $55.09 per day.

“Low means” resident

A “low means” resident has a means-tested amount less than the maximum accommodation supplement at the time of entry.

A “low means” resident will pay an accommodation contribution and the cost of their accommodation will be partially subsidised by the Government where they have a means-tested amount that is greater than zero but less than the maximum accommodation supplement: see [19 520].

A “low means” resident will not pay an accommodation contribution and the cost of their accommodation will be fully subsidised by the Government where they have a means-tested amount equal to zero.

A “low means” resident will pay the basic daily fee and any extra service fees but no means-tested care fee where their means-tested amount remains less than the maximum accommodation supplement: see [19 525].

Accommodation payment resident

An “accommodation payment” resident has a means-tested amount greater than or equal to the maximum accommodation supplement at the time of entry.

An “accommodation payment” resident will pay an accommodation payment and the cost of their accommodation will not be subsidised by the Government: see [19 520]. They will pay the basic daily fee, any extra service fees and a means-tested care fee where their means-tested amount remains greater than the maximum accommodation supplement: see [19 525].

[19 510] Assets and income assessment process

A person’s assets and income will be assessed by the DHS or DVA where they complete the residential aged care combined assets and income assessment form.
It is not compulsory to have an assets and income assessment. However, a resident may pay higher accommodation and ongoing care costs where it is not completed.

The assets and income assessment will determine:
- if the resident is eligible for any Government subsidy towards the cost of their accommodation: see [19 520];
- the resident’s means-tested care fee payable towards the cost of their ongoing care: see [19 525].

A person receiving Centrelink/DVA benefits will still need to complete the form to have an assets and income assessment. However, only parts of the form will need to be completed.

If a person’s means change before they enter an aged care facility, they may complete another assets and income assessment.

The family home – keep or sell?

Many people about to enter residential aged care worry that they will be forced to sell the family home to fund the accommodation costs. This decision is often made by the family of the person entering aged care.

What a lot of people don’t realise is that there can be advantages to keeping the home when it comes to aged care and Centrelink/DVA.

The following factors should be considered when deciding what to do with the family home:
- the amount of money required (if any) to bring the home up to rental standard;
- the commitment in time and funds for ongoing maintenance and repairs – family will most likely look after the home;
- possible capital gains tax consequences if the home is rented for more than 6 years;
- any land tax payable if the home is rented (determined by the state); and
- tax payable if the home is rented – there are various tax offsets that may be available including the low income, seniors and pensioners and net medical expenses tax offsets (although this offset is now very limited) to reduce tax payable.

Aged care assessment of the family home

The introduction of the means-tested amount (see [19 505]) under the aged care reforms has seen a significant change to the way the family home is assessed for aged care purposes from 1 July 2014.

The family home will be exempt for the purposes of the asset-tested amount where it is occupied by a protected person.

A protected person includes a:
- spouse or dependent child;
- carer eligible for an income support payment who has been living in the home for the past 2 years; or
• close relative eligible for an income support payment who has been living in the home for the past 5 years.

Where the family home is not occupied by a protected person, the home will be assessed up to the home cap. The home cap is $162,087 as at 1 July 2017.

From 1 January 2016, there were further changes to the assessment of the family home. People who entered residential aged care on or after this date will have rental income assessed for the purposes of the income-tested amount. This assessment is independent to how the rental income is assessed for Centrelink/DVA purposes.

People who entered residential aged care before 1 January 2016 will not have rental income assessed where the indefinite exemption conditions for the purposes of Centrelink/DVA (see below) are met.

**Centrelink/DVA assessment of the family home**

A person’s family home is exempt for Centrelink/DVA purposes while they live in it. Where a person moves into residential aged care and keeps the family home, it will automatically be exempt under the assets test for 2 years from the date they leave.

For couples, the family home will be exempt for as long as one member of the couple continues to live in it. The family home will automatically be exempt under the assets test for 2 years from the date the last member of the couple leaves it.

From 1 January 2017, the assessment of the family home for Centrelink/DVA purposes was aligned with the assessment for aged care purposes. People who entered residential aged care on or after this date will have rental income assessed under the income test.

People who entered residential aged care before 1 January 2017 can extend the automatic 2-year exemption under the assets test to an indefinite exemption where the following conditions are met:

- the resident is accruing a liability to pay a daily accommodation contribution (DAC) or daily accommodation payment (DAP): see [19 520]; and
- the family home is rented out.

Where these conditions are met, any rental income will not be assessed under the income test.

While the family home is exempt, the person or couple will be considered a homeowner under the assets test.

**TIP**

The family home may be rented to a family member for an amount that is below the market rate and still meet the conditions for the indefinite exemption under the assets and income test. Note there may be tax implications for receiving below market-rate rent.

**Moving from a retirement village**

Planning opportunities are more limited when a person moves from a retirement village to an aged care facility as they generally need to sell the unit
and cannot take advantage of the Centrelink/DVA exemption rules that apply when keeping and renting the family home. Even if a person has kept their home after moving into a retirement village, the home cannot receive the exemption unless they live in the home right before moving into the facility. This means that the proceeds from the sale of the retirement village unit are counted as an asset when they are received and the resident will be considered a non-homeowner.

**Moving from a granny flat**

For Centrelink/DVA and aged care purposes, a granny flat right or interest is a formal or informal arrangement that provides a person with a life interest in accommodation, or a right to accommodation for life, upon the transfer of the legal title to their home. The granny flat rules enable a person to transfer assets without exceeding the gifting limits: see [19 205].

A key requirement of a granny flat arrangement is that the person with the life interest must not have any legal ownership over their home. This means if they eventually move into an aged care facility, the value of the home will not be included as an asset for aged care purposes.

An exception to this is if the person moves to an aged care facility within 5 years of creating the interest as Centrelink/DVA will apply the gifting rules if they believe the move could have been anticipated. If a person is in good health when they create the granny flat interest, the gifting rules are unlikely to apply regardless of the 5-year rule.

**[19 520] Accommodation costs**

A person may have to pay an accommodation contribution or payment when they enter an aged care facility. Accommodation contributions and payments are determined by a resident’s assessable assets and income calculated by the means-tested amount.

Accommodation contributions and payments replaced accommodation bonds and charges from 1 July 2014: see [19 555]. Up until then, accommodation bonds and charges were determined solely by a resident’s assessable assets.

Whether a resident pays an accommodation contribution or payment will be determined by their means at the time of entry.

A resident’s means will be determined by comparing their means-tested amount to the maximum accommodation supplement. The maximum accommodation supplement as at 1 July 2017 is $55.09 per day.

**Accommodation contribution**

An accommodation contribution will be payable by a “low means resident” who is eligible for a partial Government subsidy towards the cost of their accommodation: see [19 505].

A “low means resident” has a mean-tested amount less than the maximum accommodation supplement at the time of entry.

A resident’s accommodation contribution will be the lesser of:

• the resident’s means-tested amount; and
• the accommodation supplement payable to the aged care facility.
The means-tested amount will be recalculated quarterly by the DHS or DVA and therefore a resident’s accommodation contribution may change over time depending on their means.

The maximum accommodation supplement of $55.09 per day will apply to aged care facilities which were built or significantly refurbished on or after 20 April 2012. A lower accommodation supplement of $35.90 per day will apply to non-refurbished facilities which meet building requirements.

An accommodation contribution will not be payable by a “low means” resident where their means-tested amount is equal to zero.

**Accommodation payment**

An accommodation payment will be payable by an “accommodation payment” resident or where a resident chooses not to disclose their assets and income: see [19 505]. These residents will not be eligible for any Government subsidy towards the cost of their accommodation.

An “accommodation payment” resident has a means-tested amount greater than or equal to the maximum accommodation supplement at the time of entry.

A resident’s accommodation payment will be determined by negotiation with the aged care facility and cannot exceed the amount published by the facility.

**What are the payment options?**

Residents have up to 28 days after entry to decide how to pay for their accommodation. A low means resident has the option of paying their accommodation contribution as:

- a fully refundable lump sum referred to as a refundable accommodation contribution (RAC);
- periodic payments referred to as a daily accommodation contribution (DAC); or
- a combination of lump sum and periodic payment.

An accommodation payment resident has the option of paying their accommodation payment as:

- a fully refundable lump sum referred to as a refundable accommodation deposit (RAD);
- periodic payments referred to as a daily accommodation payment (DAP); or
- a combination of lump sum and periodic payment.

The lump sum will be converted to the equivalent periodic payment using the maximum permissible interest rate (MPIR). The MPIR as at 1 July 2017 is 5.73% per annum. The interest rate is set at the date of entry and will not change while the person is a resident. The periodic payment equivalent of a lump sum is calculated as follows:

\[ \text{periodic payment} = \frac{(\text{lump sum} \times \text{MPIR})}{365} \]

Where a resident decides to pay for their accommodation as a RAC/RAD, they will have 6 months to make the payment. While the RAC/RAD remains unpaid, the resident must pay for their accommodation as a DAC/DAP.
Where the resident decides to pay for their accommodation as a combination of RAC/RAD and DAC/DAP, the DAC/DAP can be deducted from the RAC/RAD. In this case, the facility can increase the DAC/DAP to compensate for the reduction in the RAC/RAD balance.

Facilities cannot accept a RAC/RAD that will leave the resident with less than the minimum permissible asset amount. The minimum permissible asset amount as at 1 July 2017 is $47,500.

**TIP**

The minimum permissible asset amount only applies where a resident decides to pay for their accommodation as a RAC/RAD within 28 days after entry. If a resident decides to pay for their accommodation entirely as a DAC/DAP within 28 days of entry, they can subsequently pay a RAC/RAD after 28 days without the minimum permissible asset amount applying.

Facilities must refund the RAC/RAD balance:

- if the resident dies, within 14 days after the facility is shown the grant of probate or letters of administration;
- if the resident leaves the facility, within 14 days after they leave; or
- if the resident moves to another aged care facility:
  - on the day the resident leaves the facility where they have provided more than 14 days notice;
  - within 14 days of providing notice where the resident leaves the facility within this period; or
  - within 14 days after the resident leaves facility where no notice is provided.

Facilities are required to pay interest on the RAC/RAD balance at the base interest rate (BIR) from the date the resident leaves the facility to the date RAC/RAD is refunded. The BIR as at 1 July 2017 is 3.75%. If the facility is late in refunding the RAC/RAD, it is required to pay interest on the RAC/RAD balance at the MPIR after the last day of the refund period.

The RAC/RAD balance will not be assessed for Centrelink/DVA purposes under the assets test and not deemed under the income test as is the case for accommodation bonds under the previous rules: see [19 555]. However, the RAC/RAD balance will be assessed as an asset for aged care purposes but not deemed to determine the means-tested care fee: see [19 525].

The Government guarantees the repayment of the RAC/RAD if the facility becomes bankrupt or insolvent as is the case for accommodation bonds under the previous rules.

There will be no retention amounts deducted from the RAC/RAD. However, they will continue to be deducted from accommodation bonds paid before 1 July 2014.
EXAMPLE [19 520.10]

Paying a combination of RAD and DAP

John enters an aged care facility on 1 July 2017 with an accommodation payment of $400,000. He decides to pay $200,000 as an RAD and $200,000 as a DAP deducted from the RAD every month. John’s DAP will be $31.40 per day ($200,000 × 5.73%/365) in the first month.

At the start of the second month, John’s RAD balance has reduced by $942 ($31.40 × 30) to $199,058. The amount he will now pay as a DAP is $200,942 ($400,000 – $199,058). John’s DAP will increase to $31.55 per day ($200,942 × 5.73%/365) in the second month.

Published prices

Facilities are required to publish maximum accommodation prices for available rooms showing the RAD and the equivalent DAP and at least one example of a combination of RAD and DAP.

Published prices must be available on the Government’s website http://www.myagedcare.gov.au, the facility’s own website and on any written documents provided to prospective residents.

Facilities cannot charge an accommodation payment that exceeds the published price.

Where a facility wishes to charge an RAD or equivalent DAP greater than $550,000, the facility will need to apply and obtain approval from the Aged Care Pricing Commissioner.

Accommodation agreements

If a resident has to pay an accommodation payment or contribution, they will need to make an accommodation agreement with the aged care facility. This can be included as part of the resident agreement or it may be separate.

The accommodation agreement should include:

- the agreed accommodation price;
- details on the 3 payment options the resident can choose from;
- other conditions of the accommodation payment or contribution;
- the refund amount if the resident leaves or dies;
- any extra services provided at additional cost;
- the specific accommodation provided;
- any services that the accommodation payment entitles the resident to receive; and
- conditions relating to changing rooms.

The accommodation agreement must be signed within 28 days after entry when the resident has decided how to pay for their accommodation.
Ongoing care costs

As well as considering accommodation costs, your client will need to know their ongoing care costs and how they will meet them. It is important to understand how these costs are determined and how they can be reduced with the right strategies.

Basic daily fee

The basic daily fee is payable by all residents for the cost of daily living such as meals, power and laundry. There were no changes to the basic daily fee under the aged care reforms, and it remains at 85% of the basic single Age Pension.

The basic daily fee is indexed on 20 March and 20 September each year in line with the indexation increases to the Age Pension. The basic daily fee as at 1 July 2017 is $49.07 per day.

Means-tested care fee

Residents may be asked to pay a means-tested care fee as a contribution towards the cost of their ongoing care. The means-tested care fee is determined by a resident’s assessable assets and income calculated by the means-tested amount.

The means-tested care fee replaced the income-tested fee from 1 July 2014. The income-tested fee was determined solely by a resident’s assessable income: see [19 560]. A means-tested care fee will be payable where a resident’s means-tested amount is greater than the maximum accommodation supplement or where a resident chooses not to disclose their assets and income: see [19 505].

A resident’s means-tested care fee is calculated by deducting the maximum accommodation supplement from their means-tested amount. The maximum accommodation supplement as at 1 July 2017 is $55.09 per day. The means-tested care fee will be recalculated quarterly by the DHS or DVA and may change over time depending on the resident’s means. The means-tested care fee is calculated as follows:

\[
\text{means-tested care fee} = \text{means-tested amount} - \text{maximum accommodation supplement}
\]

A resident’s means-tested care fee cannot exceed their cost of care which is the sum of the basic subsidy amount and all primary supplements paid by the Government for the resident. Where a resident chooses not to disclose their assets and income, their means-tested care fee will equal their cost of care. A resident’s cost of care will be determined by the DHS when the aged care facility submits a claim for payment.

The means-tested care fee has an annual indexed cap. When a resident reaches the annual cap, they will stop paying the means-tested care fee until the next anniversary of their date of entry. The annual cap as at 1 July 2017 is $26,381.

In addition to the annual cap, the means-tested care fee has a lifetime indexed cap. When a resident reaches the lifetime cap, they will no longer pay the means-tested care fee. Where a resident was previously paying an
income-tested fee for home care under the aged care reforms, the amount paid will also count towards the lifetime cap. The lifetime cap as at 1 July 2017 is $63,313.

**TIP**
The lifetime cap is not set at the date of entry and therefore a resident will continue to pay the means-tested care fee until they reach the cap at the time.

**EXAMPLE [19 525.10]**

**Calculating means-tested care fees**

Annabelle enters an aged care facility with an accommodation payment of $400,000. She is a non-homeowner and has $300,000 in a bank account after paying the accommodation payment as an RAD. She is eligible for a part Age Pension of $20,781 per annum.

Annabelle has assessable income of $8,997 per annum of deemed income and $19,494 per annum of Age Pension income less minimum Pension Supplement and Energy Supplement. Annabelle has assessable assets of $300,000 in a bank account and $400,000 in an RAD.

Income-tested amount: ($8,997 + $19,494 – $26,177) × 50% = $1,157 per annum.

Asset-test amount: ($162,087 – $47,500) × 17.5% + ($391,262 – $162,087) × 1% + ($700,000 – $391,262) × 2% = $28,519 per annum.

Means-tested amount: ($1,157 + $28,519) / 364 = $81.53 per day.

Annabelle’s means-tested care fee will be $26.44 per day ($81.53 – $55.09) in the first quarter.

**Extra service fees**

Residents will pay extra service fees where they choose a higher standard of accommodation or additional services. Facilities may offer rooms with dedicated extra services or rooms where additional services can be purchased separately.

A resident’s extra service fees will be determined by the aged care facility. Facilities are required to publish extra service fees for available rooms with dedicated extra services.

**TRANSITIONAL RESIDENTIAL AGED CARE**

**[19 550] Grandfathered residents**

A person who was already in residential aged care before 1 July 2014 will have the previous rules grandfathered.

Grandfathering will cease and the new rules will apply for a person who:

- does not receive residential aged care for a period of more than 28 days; or
- changes facilities and decides to have the new rules apply to them.
Accommodation costs

Accommodation bonds and charges were replaced by accommodation payments and contributions from 1 July 2014: see [19 520].

An accommodation bond was payable by a person entering either a low level care facility or a high level care facility with extra services.

An accommodation charge was payable by a person entering a high level care facility without extra services.

Accommodation bond

If a person chose to have an asset assessment, the maximum bond was determined by their assessable assets at the time of entry.

Facilities could not accept an accommodation bond that would leave the resident with less than the minimum permissible asset amount. The minimum permissible asset amount as at 1 July 2017 is $47,500.

The accommodation bond was negotiated with the aged care facility at the time of entry subject to the maximum bond.

Where a person chose not to have an asset assessment, the accommodation bond was determined by negotiation alone with no maximum amount.

What were the payment options?

The accommodation bond could be paid as a lump sum, periodic payments, or a combination of both.

Where a resident paid for their accommodation bond as a lump sum, the aged care facility could keep any income earned on the bond and deduct a retention amount for up to 5 years.

The maximum retention amount that the facility could deduct was determined by the accommodation bond paid and the maximum retention amount allowable. There were 2 bond threshold amounts that impacted the maximum retention amount.

The maximum retention amounts as at 1 July 2017 are as follows.

<table>
<thead>
<tr>
<th>Accommodation bond paid</th>
<th>Maximum annual retention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds above $42,840</td>
<td>$4,284</td>
</tr>
<tr>
<td>Bonds up to $22,200</td>
<td>$2,220</td>
</tr>
</tbody>
</table>

Where the accommodation bond was between the 2 thresholds, the maximum retention amount was calculated as 10% of the bond.

Where a resident moves to another aged care facility, they may be able to transfer the accommodation bond and should not be asked to pay a bond greater than the refund given by the previous facility. The balance of the 5-year retention amount period should carry over to the new facility.

Facilities must refund the accommodation bond balance:

- if the resident dies, within 14 days after the facility is shown the grant of probate or letters of administration;
- if the resident leaves the facility, within 14 days after they leave; or
• if the resident moves to another aged care facility:
  – on the day the resident leaves the facility where they have provided more than 14 days notice;
  – within 14 days of providing notice where the resident leaves the facility within this period; or
  – within 14 days after the resident leaves facility where no notice is provided.

The accommodation bond balance is not assessed for Centrelink/DVA purposes under the assets test and is not deemed under the income test.

The Government guarantees the repayment of the accommodation bond (less retention amounts) if the facility becomes bankrupt or insolvent.

Where a resident paid for their accommodation bond as a periodic payment, the aged care facility would charge interest on the outstanding bond amount up to the MPIR. The MPIR as at 1 July 2017 is 5.73% per annum. The interest rate was set at the date of entry and would not change while the person was a resident.

**Accommodation charge**

As with the accommodation bond, if a person chose to have an asset assessment, the maximum accommodation charge was determined by their assessable assets at the time of entry. The maximum accommodation charge as at 1 July 2017 is calculated as follows.

<table>
<thead>
<tr>
<th>Assessable assets $</th>
<th>Maximum daily charge $</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 – 47,500</td>
<td>Nil</td>
</tr>
<tr>
<td>$47,500 – $122,172</td>
<td>(Assessable assets – 47,500) / 2,080</td>
</tr>
<tr>
<td>$122,172+</td>
<td>35.90</td>
</tr>
</tbody>
</table>

The accommodation charge was set at the date of entry and would not change while the person was a resident even if their assessable assets changed.

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**[19 560] Ongoing care costs**

**Basic daily fee**

The basic daily fee was payable by all residents for the cost of daily living such as meals, power and laundry. There were no changes to the basic daily fee under the aged care reforms, so it remains at 85% of the basic single Age Pension.

The basic daily fee is indexed on 20 March and 20 September each year in line with the indexation increases to the Age Pension. The basic daily fee as at 1 July 2017 is $49.07 per day.

**Income-tested fee**

The income-tested fee was replaced by the means-tested care fee from 1 July 2014: see [19 525].
Residents may have been asked to pay an income-tested fee as a contribution towards the cost of their ongoing care. The income-tested fee was determined by a resident’s assessable income. The income-tested fee was calculated as follows.

\[ \text{income-tested fee} = (\text{assessable income} - \text{income free area}) \times \frac{5}{12} \]

Assessable income includes Centrelink/DVA assessed income and Age/Service Pension income (excluding minimum Pension Supplement and Energy Supplement).

The income free areas as at 1 July 2017 are as follows.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>$26,177 per annum</td>
</tr>
<tr>
<td>Couples (each)</td>
<td>$25,709 per annum</td>
</tr>
</tbody>
</table>

Where a person is a member of a couple, half of the combined assessable income of the couple plus their own Age/Service Pension is assessed.

The income-tested fee will be recalculated quarterly by the DHS or DVA and may change depending on the resident’s income.

A resident’s income-tested fee cannot exceed their cost of care which is the sum of the basic subsidy amount and all primary supplements paid by the Government for the resident.

The income-tested fee has a daily indexed cap. The daily indexed cap as at 1 July 2017 is $77.94.

**Extra service fees**

Residents would pay extra service fees where they chose a room with a higher standard of accommodation or dedicated additional services. There were minor changes to extra service fees under the aged care reforms with facilities able to offer rooms where additional services can be purchased separately from 1 July 2014.

A resident’s extra service fees were determined by the aged care facility.

**OTHER ISSUES**

**Net medical expenses tax offset**

The Government also provides financial assistance to the elderly through the provision of the net medical expenses tax offset (NMETO). The NMETO allows Australian residents to annually claim a tax rebate to offset out-of-pocket medical expenses incurred above a certain threshold.

In the 2013-14 Federal Budget, the Government announced it would phase out the NMETO from 1 July 2013 with transitional rules for those receiving aged care. The NMETO will continue to be available for out-of-pocket medical expenses relating to disability aids, attendant care or aged care until 1 July 2019.
The NMETO is worked out as 20% of net medical expenses above $2,299 (2016-17) for taxpayers who have adjusted taxable income up to $90,000 ($180,000 for couples). Taxpayers who have adjusted taxable income above these thresholds can claim a tax offset of 10% for net medical expenses above $5,423 (2016-17). There is no upper limit on how much can be claimed.

[19 610] Safety net concessions

Certain pensioners entering aged care residences may receive concessions due to the inability to pay higher costs. These pensioners usually receive a full pension, do not own a home and have assets below $162,087. They are classified as “low means” residents and are not required to pay a means-tested care fee.

Those suffering hardship are also considered, especially if pensioners are left with less than 15% of their pension after paying their basic daily fees or pensioners with real estate that cannot be sold. This is due to the maximum charge being set at 85% of the maximum single pension rate effective from 1 July 2012.

Those needing respite care enter aged care facilities for short periods of time to provide carers with a break. The duration of stay may be as little as a week to a month. In these circumstances, most aged care facilities may set aside a bed or 2 specifically for this purpose. The respite care resident pays a basic daily fee but not an accommodation payment or means-tested care fees. The maximum period a carer or cared for person can obtain “respite” is 63 days per year.

[19 630] Special disability trusts

Legislation passed in 2006 provides for the establishment of a special disability trust (SDT). Parents or immediate family members were able to place up to $500,000 into such a trust for the future care of their child with a disability, without being subject to the gifting rules.

A SDT must meet certain requirements. For example, it must:

- be “protective” in nature;
- have only one principal beneficiary (ie the person for whom the trust is established);
- provide only for the accommodation and care needs of the principal beneficiary;
- have a trust deed that contains the clauses as set out in the model trust deed;
- have an independent trustee;
- provide annual financial statements and conduct independent audits.

The disabled person in question must meet the definition of “severe disability” in order to be eligible to be a principal beneficiary.

All trust income and trust assets up to the value of $657,250 as at 1 July 2017 (indexed each year) will not affect the family member’s social security payments or payments to a person under the Veterans’ Entitlements Act 1986. In addition, as there are limits under the Social Security law and the Act to the assets a person can give away, gifts to the trust (up to a total of $500,000) from parents or immediate family members (ie natural parents, legal guardians, adoptive
parents, step-parents, grandparents, and siblings) will not affect the donor’s social security payment or payments to a person under the Act.

SDTs also have a role to play in estate planning: see [15 100].

In the 2009-10 Federal Budget, the Government announced it would ensure that the unexpended income of a SDT is taxed at the relevant beneficiary’s personal income tax rate, rather than automatically at the top personal tax rate plus Medicare Levy, with effect from the 2008-09 income year. That change has now been legislated.

The Government also announced that it would extend the CGT main residence exemption to include a residence that is owned by a SDT and used by the principal beneficiary of the trust as their main residence, with effect from the 2009-10 income year. In the 2011-12 Federal Budget, the Government announced it would extend the 2009-10 Budget measure that provides a CGT main residence exemption to SDTs. In particular, the measures would:

- backdate the CGT main residence exemption for SDTs to apply to CGT events happening in the 2006-07 income year and later years;
- allow the trustee of an SDT to disregard any capital gain or loss on the principal beneficiary’s main residence, to the extent that the principal beneficiary would have been able to do so had they owned the main residence directly and not used it to produce assessable income. This will be achieved by treating the trustee of the SDT as holding the asset personally and using it in the same way as the principal beneficiary on each day the trust is an SDT. Furthermore, where the trustee is not an individual, they are treated as if they were an individual. In addition, a trustee of an SDT will be able to access all the concessions that extend the main residence exemption to the extent the principal beneficiary could access them if they owned the dwelling directly (eg the “absence” concession);
- ensure that a recipient of the principal beneficiary’s main residence (or proceeds from its sale) can disregard any capital gain or loss on the principal beneficiary’s main residence, if the recipient’s ownership interest ends within 2 years of the principal beneficiary’s death. Specifically, the trustee will access a full or partial main residence exemption, based on the use of the dwelling by the principal beneficiary, subject to satisfying certain conditions;
- provide equivalent tax treatment among SDTs established under either the Veterans’ Entitlements Act 1986 and Social Security Act 1991; and
- provide a CGT exemption for assets transferred into a SDT for no consideration and give a market value cost base for testamentary transfers.

These changes have been legislated by the Tax Laws Amendment (2011 Measures No 7) Act 2011.

The Families, Housing, Community Services and Indigenous Affairs and Other Legislation Amendment (Budget and Other Measures) Act 2011 has amended the SDT provisions in the Social Security and Veterans’ Entitlements legislation to relax the purpose and work capacity tests in relation to these trusts, and give trustees greater flexibility to meet costs relating to the beneficiary’s health, wellbeing, recreation, independence and social inclusion. The changes have applied from 1 January 2011.
The changes are:

- The definition of a beneficiary has been expanded to include people with a disability who can work up to 7 hours per week at or above the relevant minimum wage (excluding work in an Australian Disability Enterprise).

- The trust can pay for the beneficiary’s medical expenses, including private health fund membership, and the maintenance expenses of the trust’s property.

- Section 1209N(1) of the Social Security Act 1991 previously provided that the primary purpose, during the beneficiary’s lifetime, must be to meet the beneficiary’s reasonable care and accommodation needs. The amendments now made give trustees greater flexibility to meet costs relating to the beneficiary’s health, wellbeing, recreation, independence and social inclusion. The reasonable care and accommodation needs of a beneficiary of a SDT must be decided in accordance with any guidelines made under new s 1209N(4) of the Social Security Act 1991. Purposes that are for the primary benefit of the principal beneficiary of a SDT must be decided in accordance with any such guidelines. The Secretary to the Department of Social Security will have a discretionary power to make guidelines, by legislative instrument, for deciding what are, or are not, reasonable care and accommodation needs, and what are, or are not, purposes that are primarily for the benefit of the principal beneficiary. New s 1209RA of the Social Security Act 1991 sets out the trust expenditure requirements that a trust must meet to be considered a SDT. Broadly: (i) if the Secretary determines the total value of income and assets of a SDT that may be applied in a specified financial year for purposes; and (ii) the trust has one or more purposes, other than its primary purpose, that are primarily for the benefit of the principal beneficiary, then the total value of the income and assets of the trust applied for those other purposes in a financial year must not exceed the value specified in the determination for that year. The Trust can spend up to $11,750 as at 1 July 2017 (indexed each year) on discretionary items not related to the care and accommodation needs of the beneficiary of the trust, ie for items relating to a beneficiary’s health, wellbeing, recreation, independence and social inclusion.

- Another amendment provides that the primary purpose, during the beneficiary’s lifetime, must be to meet the beneficiary’s reasonable care and accommodation needs. This amendment is a relaxation of the previous strict “sole” purpose test and provides that a trust can still meet the criteria for a SDT, even if it has purposes other than meeting the reasonable care and accommodation needs of the beneficiary, provided that remains the primary purpose of the trust.

Any SDTs created before 1 July 2011 need to be varied to reflect these legislative measures that came into effect on 1 January 2011 and in accordance with the Trust Deed, Reporting and Audit Requirements Determination 2011.

Note that the Social Security (Special Disability Trust – Trust Deed, Reporting and Audit Requirements) (FaHCSIA) Determination 2013, registered on 17 June 2013, made a number of technical amendments to the Social Security (Special Disability Trust – Trust Deed, Reporting and Audit Requirements) (FaHCSIA)


Determination 2011. The Determination commenced on 1 July 2013 and the amendments concern the form and provisions to be used in a trust deed for it to qualify as a SDT, financial statements and auditing, and included:

- For the purposes of para 1209P(2)(a) of the Act, a trust deed for a SDT must be in the form of the “model trust deed”. Generally, this means that a trust deed must have the same structure and order as the “model trust deed”, but does not need to be exactly the same as it.

- A list of provisions, as set out in the “model trust deed”, must be included in a trust deed for a SDT. These provisions must be used in the form set out in the “model trust deed”.

- For the purposes of para 1209P(2)(d) of the Act, a trust deed of a SDT cannot contain any clause that is inconsistent, or overrides, the operation of any of the clauses listed in the table in s 2.2(1).

- The financial statements of an SDT must be prepared by a person who is a member of CPA Australia, the Institute of Chartered Accountants Australia or the Institute of Public Accountants, or is an employee of a trustee corporation and who is engaged to work as an accountant or financial planner.

- The financial statements about the trust must include, for the relevant financial year, a profit and loss statement, a balance sheet (with applicable notes) and, if necessary, a depreciation schedule for each class of assets held by the trust.

- When the Secretary is provided with the trust’s financial statements each year, a certified copy of the trust’s income tax return, in relation to this same period, must also be provided. However, a certified copy of the trust’s income tax return is not required, if s 95AB of the ITAA 1936 applies to the trust’s income (which deems a beneficiary to be presently entitled to the income but under a legal disability, so the trust income is taxed in the hands of the trustee).

It is noted that the State Revenue Legislation Amendment Act 2011 (NSW) has amended the Duties Act 1997 (NSW) to extend a provision that exempts from duty instruments establishing, or transferring property to, SDTs within the meaning of the Social Security Act 1991. The amendments also extend a provision that specifies that duty of $50 is chargeable in respect of a transfer of dutiable property to a trustee of a SDT within the meaning of that Act. The amendment also extends these provisions to SDTs within the meaning of the Veterans’ Entitlements Act 1986. These amendments commenced on the day the Bill received Royal Assent ie on 25 October 2011.

CASE STUDIES

Case studies – disclaimer

Case studies have been constructed by the author and bear no connection to any person(s) living or deceased and are intended for education purposes only to assist those interested to understand aged care and the workings of Centrelink rules which are subject to legislative change at any point in time. In addition,
there are rules for recipients of DVA benefits which in many instances are distinctly different between how each Federal Department operates. Readers are asked to inquire with the specific Federal Department.

Case studies are intended for educational purposes only. There are numerous methods available to financial planners for rearranging a person’s financial affairs that can be as equally beneficial to pensioners or non-pensioners. The strategies adopted are for illustrative and educational purposes. They should not be relied upon by readers for their own or others’ own personal financial matters. Consultation about a person’s own personal financial matters should always be sought from skilled and qualified professionals.

[19 655] Case study 1 – creating a life interest

Joan is single, age 75 and is widowed. She owns her home worth $500,000 and has $500,000 in a bank account which she inherited when her husband died.

Joan is currently eligible for a part Age Pension of $3,888 per annum. Her Age Pension is reduced as a result of the assets test.

Her daughter, Michelle, is concerned that she is lonely and would like her mother to live with her family. Michelle sells her home and purchases a much larger home worth $800,000 with a self-contained living area.

Joan sells her home and contributes $700,000 to the purchase of Michelle’s home in exchange for a life interest with Michelle. This is not treated as a gift as she has not paid more than the purchase price of the house. She is still considered a homeowner as she has paid more than $200,000 for the life interest.

By creating a life interest with Michelle, Joan has reduced her assessable assets for Age Pension purposes by $200,000. Under the assets test, the Age Pension increases by $3 per fortnight for every $1,000 reduction in assessable assets.

<table>
<thead>
<tr>
<th>Live on her own</th>
<th>Life interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age Pension entitlement</td>
<td>$3,888</td>
</tr>
<tr>
<td>Benefit</td>
<td>$15,600</td>
</tr>
</tbody>
</table>

Joan is able to increase her Age Pension entitlement by $15,600 in the first year by creating a life interest with Michelle.

[19 660] Case study 2 – reducing home care fees

George is single, age 80 and is receiving a level 2 home care package. He owns his home and has $250,000 in his bank account.

George is currently eligible for a part Age Pension of $21,594 per annum. His Age Pension is reduced as a result of the income test. He is paying a basic daily fee of $3,687 per annum and an income-tested care fee of $753 per annum.

George would like to increase his Age Pension entitlement and reduce his home care fees. An annuity could provide efficient Age Pension and aged care outcomes in his situation.
Challenger CarePlus provides regular payments for life and the option to pay a lump sum in the event of death. CarePlus is comprised of a lifetime annuity (CarePlus Annuity) and an insurance policy (CarePlus Insurance).

CarePlus Annuity has a deduction amount for Age Pension and aged care purposes. The deduction amount reduces the assessable income from the annuity every year and reduces the assessable asset value every six months.

CarePlus Insurance has no assessable income unless surrendered and the voluntary surrender value is the asset value for Age Pension and aged care purposes.

George withdraws $150,000 from his bank account and purchases Challenger CarePlus of which $12,982 is allocated to CarePlus Annuity and $137,018 is allocated to CarePlus Insurance. His CarePlus Annuity pays $4,643 per annum fixed for life and his CarePlus Insurance will pay $150,000 in the event of his death.

The deduction amount for George’s CarePlus Annuity is calculated as the purchase price divided by his life expectancy.

Deduction amount: $12,982 / 8.6 = $1,510 per annum.
Assessable income: $4,643 – $1,510 = $3,133 per annum.

If $150,000 remained in George’s bank account, it would have been subject to the deeming provisions with 3.25% per annum assessed as income for Age Pension and aged care purposes.

Deemed income: $150,000 × 3.25% = $4,875 per annum.

By purchasing Challenger CarePlus, George has reduced his assessable income for Age Pension and aged care purposes by $1,742 in the first year.

The surrender value for George’s CarePlus Insurance is $108,616. If $150,000 remained in his bank account, the full amount would have been assessed as an asset for Age Pension and aged care purposes.

By purchasing Challenger CarePlus, George has reduced his assessable assets for Age Pension and aged care purposes by $28,403 in the first year.

<table>
<thead>
<tr>
<th></th>
<th>Bank account $</th>
<th>Challenger CarePlus $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age Pension entitlement</td>
<td>21,594</td>
<td>22,464</td>
</tr>
<tr>
<td>Basic daily fee</td>
<td>3,687</td>
<td>3,687</td>
</tr>
<tr>
<td>Income-tested care fee</td>
<td>753</td>
<td>0</td>
</tr>
<tr>
<td>Benefit</td>
<td>1,623</td>
<td></td>
</tr>
</tbody>
</table>

George is able to increase his Age Pension entitlement by $870 and reduce his home care fees by $753 in the first year. His overall benefit is $1,623 in the first year by purchasing Challenger CarePlus.

1 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
2 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
3 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
4 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
5 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
**[19 665] Case study 3 – keeping or selling the family home**

Shirley is age 85, single and has been approved for residential aged care. She owns her home worth $800,000 and has $200,000 in a bank account earning 3% per annum.

Shirley has found an aged care facility she would like to move into with an advertised accommodation payment of $400,000. She is deciding if she should sell or keep her home.

If Shirley sells her home, the entire proceeds would be assessable for Age Pension and aged care purposes. She considers selling her home and paying the entire accommodation payment as an RAD.

If Shirley keeps her home, the asset value will be exempt for 2 years for Age Pension purposes and capped at $162,087 for aged care purposes. However, any rental income will be immediately assessed for Age Pension and aged care purposes. She considers keeping and renting her home for $500 per week and paying the accommodation payment as $150,000 RAD and $250,000 DAP.

### Sell home $ | Keep home $
---|---
Age Pension entitlement 11,922 | 11,842
Interest 18,000 | 27,500
Basic daily fee 17,911 | 17,911
Means-tested care fee 16,115 | 7,647
DAP 0 | 14,325
Benefit 3,201 |

Shirley is able to reduce her means-tested care fee by keeping her home. However, she has to pay part of her accommodation payment as a DAP. She receives rental income which offsets the DAP and her overall benefit is $3,201 in the first year by keeping her home.

**[19 670] Case study 4 – reducing residential aged care fees**

Sandra is aged 87, single and has moved into residential aged care. She recently sold her home and has $400,000 in her bank account after paying a $600,000 RAD.

Sandra is currently eligible for a part Age Pension of $19,156 per annum. Her Age Pension is reduced as a result of the income test. She is paying a basic daily fee of $17,911 per annum and a means-tested care fee of $16,480 per annum.
Sandra would like to increase her Age Pension entitlement and reduce her residential aged care fees. An annuity could provide efficient Age Pension and aged care outcomes in her situation.

Challenger CarePlus provides regular payments for life and the option to pay a lump sum in the event of death. CarePlus is comprised of a lifetime annuity (CarePlus Annuity) and an insurance policy (CarePlus Insurance).

CarePlus Annuity has a deduction amount for Age Pension and aged care purposes. The deduction amount reduces the assessable income from the annuity every year and reduces the assessable asset value every six months.

CarePlus Insurance has no assessable income unless surrendered and the voluntary surrender value is the asset value for Age Pension and aged care purposes.

Sandra withdraws $250,000 from her bank account and purchases Challenger CarePlus of which $27,588 is allocated to CarePlus Annuity and $222,412 is allocated to CarePlus Insurance. Her CarePlus Annuity pays $7,837 per annum fixed for life and her CarePlus Insurance will pay $250,000 in the event of her death.

The deduction amount for Sandra’s CarePlus Annuity is calculated as the purchase price divided by her life expectancy.

Deduction amount: $27,588 / 6.11 = $4,515 per annum.
Assessable income: $7,837 – $4,515 = $3,322 per annum.

If $250,000 remained in Sandra’s bank account, it would have been subject to the deeming provisions with 3.25% per annum assessed as income for Age Pension and aged care purposes.

Deemed income: $250,000 × 3.25% = $8,125 per annum.

By purchasing Challenger CarePlus, Sandra has reduced her assessable income for Age Pension and aged care purposes by $4,803 in the first year.

The surrender value for Sandra’s CarePlus Insurance is $188,980. If $250,000 remained in her bank account, the full amount would have been assessed as an asset for Age Pension and aged care purposes.

By purchasing Challenger CarePlus, Sandra has reduced her assessable assets for Age Pension and aged care purposes by $33,432 in the first year.

<table>
<thead>
<tr>
<th></th>
<th>Bank account $</th>
<th>Challenger CarePlus $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age Pension entitlement</td>
<td>19,156</td>
<td>21,558</td>
</tr>
<tr>
<td>Basic daily fee</td>
<td>17,911</td>
<td>17,911</td>
</tr>
<tr>
<td>Means-tested care fee</td>
<td>16,480</td>
<td>14,600</td>
</tr>
<tr>
<td>Benefit</td>
<td></td>
<td>4,282</td>
</tr>
</tbody>
</table>

Sandra is able to increase her Age Pension entitlement by $2,402 and reduce her means-tested care fees by $1,880 in the first year. Her overall benefit is $4,282 in the first year by purchasing Challenger CarePlus.

1 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
2 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
3 Challenger CarePlus quote 1 July 2017, monthly payments, nil adviser fees.
PITFALLS – AGED CARE PLANNING

[19 700] The former home

One of the main decisions for a person moving into residential aged care is whether to keep or sell the former home. There are situations where keeping the home makes more sense for Centrelink/DVA purposes, especially where it is significant in value.

Where a person keeps their former home, it will automatically be exempt under the assets test for Centrelink/DVA purposes for 2 years from the date they leave. However, where the person entered residential aged care on or after 1 January 2017, the indefinite exemption (see [19 515]) under the assets test is no longer available. In addition, any rental income will be assessed immediately under the income test.

Consideration needs to be given to the impact on Centrelink/DVA benefits of keeping the former home when it becomes assessable under the assets test after 2 years. Although the resident will be classified as a non-homeowner at this time, they may still lose their Centrelink/DVA benefits.

[19 705] Help from family members

Family members often support aged care residents with the cost of receiving care. The 2 most common ways are to provide support with ongoing care costs and to fund (in full or in part) lump sum accommodation costs, with the latter being more common where the resident retains their former home.

If a family member pays a lump sum payment on behalf of the aged care resident, the lump sum paid will count towards the assets of the resident when calculating their means-tested care fee. This is regardless of whether a formal loan agreement has been drafted between the resident and the family member. While support is being provided, the parties involved need to be mindful of any impact on the resident’s cash flow due to a change in the means-tested care fee.

Apart from the impact on the aged care resident’s means-tested care fee, family members will also need to be aware that the lump sum accommodation payment is generally paid to the estate of the resident and therefore distributed according to their will. It is therefore important that the will is updated to reflect contributions made by each family member.

In addition, where the aged care resident has chosen to have their ongoing care costs deducted from the lump sum accommodation payment, the amount paid back to the estate of the resident is likely to be much lower than the initial amount paid. The will needs to be worded carefully to ensure family members are left with the intended amount on death of the resident.

[19 710] The protected person

At times a former carer or family member of the aged care resident remains living in their former home and qualifies as a protected person: see [19 515]. The
FURTHER INFORMATION

Further information on social security and aged care

Further information on subject matter relevant to this chapter can be found in:

- http://www.myagedcare.gov.au/, provided by the Department of Social Services;
- Thomson Reuters’ Australian Tax Handbook 2017 by Deutsch, Friezer, Fullerton, Hanley and Snape, especially [7 100] and [100 150];
- Thomson Reuters’ Law of Investments, 3rd edition, by John McLaren, Melissa Simpson and Mary Toohey. This book brings together legal principles in relation to various investments including equities, derivatives, shares and property. It also explains the relevant tax laws attracted by various investments and analyses the application of tax law to participants in the investment industry. It includes chapters on corporate governance and directors’ duties, corporate insolvency, insider trading, company takeovers, superannuation and personal bankruptcy.

Programs and organisations

- National Respite for Carers Program;
- National Aged Care Advocacy Program;
- Alzheimer’s Australia;
- COTA Australia;
- National Seniors Australia;
- Your Life Choices.