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Technical guide: Challenger Term annuities

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challenger

Contents

Introduction

Term annuities are a secure source of income providing a regular, guaranteed cash flow for the investment term, regardless of how investment markets perform. Whether used on its own or with other investments like account-based pensions, this cash flow certainty provides your clients with peace of mind.

Challenger Guaranteed Annuity (Fixed Term)

In this guide, we explore the technical aspect of Challenger Guaranteed Annuity (Fixed Term) (the Annuity) for individuals who are tax residents of Australia, including how the Annuity is assessed for Centrelink under the income and assets tests, how regular payments and withdrawals are taxed and how they are assessed for the transfer balance cap. The guide also discusses implications of term annuities for non-residents and self-managed superannuation funds.

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The Challenger Tech team provides specialist technical resources, support and training to financial advisers on retirement and aged care.

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Product features

Figure 1 provides a summary of the main features which apply to the Annuity. Please refer to the Challenger Guaranteed Annuity (Fixed Term) Product Disclosure Statement (PDS) for further details.

Figure 1: The Annuity at a glance

Investment term	1 to 50 years (in whole years)[i].
Minimum investment	$10,000
Capital repayment	The investor can choose to have all of their capital repaid at the end of the investment term, or they can choose to have some or all of their capital repaid (as part of their regular payments) throughout the investment term. Any capital that remains at the end of the term is called the residual capital value (RCV).
Payment indexation[ii]	If: • the investor's chosen investment term is at least two years, and • they choose to have all their capital returned to them as part of their regular payments throughout the term, then they can choose to have their regular payments increased annually. The annual increase can be in line with increases in the Consumer Price Index (CPI) or a fixed whole percentage rate of up to 5%.
Payment frequency	Monthly, quarterly, half-yearly or yearly[iii].
Voluntary withdrawals	The investor can withdraw before the end of the investment term (in part or in full). However, the Annuity is designed to be held until the end of the investment term so they might not receive the benefits they would have, had they not withdrawn, and they might receive back less than they invested.
Nominating beneficiaries	Generally, an investor can elect for an individual (or individuals) to receive the remaining benefit of their Annuity if they die. If the Annuity is bought with money rolled over within the superannuation system, and the beneficiary is not the investor's dependant at the time of the investor's death, the benefit will be paid to their estate.
Upfront and ongoing adviser service fee	Where the client has provided their authorisation, an agreed dollar amount can be charged.

i For super investments where all of the initial investment is repaid as part of your clients regular payments, super rules restrict the maximum term they can select – it cannot be greater than the number of whole years until they turn age 100.

ii From time to time some indexation options may not be available due to market conditions. Please check Challenger eQuote to confirm which indexation options are available.

iii If an investor chooses a 1-year fixed term, they cannot choose to receive yearly payments.

Centrelink treatment

How the Annuity is assessed for the Age Pension

The following assessments apply to the Annuity bought with either superannuation or non-superannuation money. The Age/Service Pension income assessment of the Annuity will depend on whether it is classified as long-term or short-term. The following assessment also applies for the Low Income Health Care Card.

Long-term annuities

A long-term annuity is an annuity with:

- a term of greater than five years, or
- a term of five years or less and is equal to or greater than the person's life expectancy.

The Centrelink assessment under the assets test and income test for a long-term annuity is as follows:

Income assessment	Assets assessment
Annual payment less annual deduction amount	Purchase price less (deduction amount multiplied by term elapsed)[i]

i The amount of the purchase price that is assessed by Centrelink will reduce over the term of the annuity to the residual capital value. Where regular payments are paid more frequently than yearly (e.g. monthly), the purchase price will reduce every six months by half the deduction amount. If regular payments are paid yearly, the purchase price will reduce every 12 months by the deduction amount.

Short-term annuities

A short-term annuity is an annuity with a term of five years or less and is not otherwise defined as a long-term annuity. Centrelink treats a short-term annuity as a financial investment. The Centrelink assessment under the assets test and income test for a long-term annuity is as follows:

Income assessment	Assets assessment
Subject to deeming rules based on current Centrelink asset value (refer to Challenger Fast Facts for latest rates and thresholds)	Purchase price less (deduction amount multiplied by term elapsed)[i]

i The calculation is the same as for a long-term annuity.

Deduction amount

The deduction amount generally represents the return of capital over the term of the annuity. To calculate the deduction amount for the Annuity, divide the purchase price (less withdrawals and residual capital value) by the nominated term at commencement.

Example: Long-term annuity with nil RCV

Bruce and Wendy are both 67 years old and invested in the Annuity for $100,000 as part of their retirement plan. The Annuity has a 10-year term with no residual capital value and they receive an annual payment of $10,979[1].

The annual deduction amount for Bruce and Wendy's Annuity will be:

($100,000 – $0 – $0) / 10 = $10,000 per annum

The Centrelink assessable income for Bruce and Wendy's Annuity will be:

$10,979 – $10,000 = $979

The Centrelink assessable asset value for Bruce and Wendy, assuming they do not make any withdrawals from their Annuity, will reduce uniformly as in Figure 2.

Figure 2: Centrelink assessment of Bruce and Wendy's Annuity

Start of year	Asset assessment	Income assessment
1	$100,000	$979
2	$90,000	$979
3	$80,000	$979
4	$70,000	$979
5	$60,000	$979
6	$50,000	$979
7	$40,000	$979
8	$30,000	$979
9	$20,000	$979
10	$10,000	$979
11	$0	$979

1 Based on a Challenger Guaranteed Annuity quote as at 25 January 2021 for a 10-year term annuity with no residual capital value, nil adviser fees and income paid monthly with no indexation.

Example: Short-term annuity with 100% RCV

Leonard and Ida are both 70 years old and invested in the Annuity for $100,000 as part of their retirement plan. The Annuity has a five-year term with a 100% residual capital value.

The annual deduction amount for the asset assessment of Leonard and Ida's Annuity will be:

($100,000 – $0 – $100,000) / 5 = $0

The Centrelink assessable income for Leonard and Ida's Annuity in year one, assuming they have no other financial assets, will be $490 based on the Centrelink deeming rules[2].

The Centrelink assessable asset value for Leonard and Ida, assuming they do not make any withdrawals from their Annuity, will remain constant as in Figure 3.

Figure 3: Centrelink assessment of Leonard and Ida's Annuity

Start of year	Asset assessment	Income assessment[i]
1	$100,000	$490
2	$100,000	$490
3	$100,000	$490
4	$100,000	$490
5	$100,000	$490

i Assuming Leonard and Ida have no other financial assets. If the RCV was less than 100%, deemed income would reduce over the term of the annuity as the Asset assessment reduces.

Treatment of lump sum withdrawals

Centrelink/Department of Veterans Affairs (DVA) treats full and partial withdrawals from the Annuity as a return of capital, and does not assess them under the income test. How the withdrawn funds are subsequently invested will determine how they will be assessed under the assets and income tests. For example, if the withdrawn funds are invested in a term deposit, Centrelink/DVA will assess the value of the term deposit as a financial asset and deem it under the income test.

Where a partial withdraw is made, Centrelink will recalculate the assessable asset value of the Annuity.

For example, if Bruce and Wendy withdrew $10,000 from their Annuity at the end of the second year, the deduction amount going forward would be:

= (Purchase price less residual capital value) divided by the nominated term at commencement. Where Purchase price = Original purchase price less withdrawals

= ($100,000 – $10,000) – $0) / 10 = $9,000 per annum

Their assessable asset value after the withdrawal would be:

= Purchase price less (deduction amount multiplied by term elapsed)

= ($100,000 – $10,000) – ($9,000 x 2)

= $72,000

Splitting income

Where the Annuity is owned jointly by two investors (non-superannuation money only), the regular payment can be split according to a nominated proportion. This proportion will also be used to split the deduction amount and assessable asset value across the two investors for Centrelink purposes.

Beneficiaries and joint policies

On death of the primary owner, where payments continue to a beneficiary, they will inherit the deduction amount and assessable asset value of the primary owner.

For joint policies, the full deduction amount and asset value are applied to the surviving owner's Income and Assets Test assessments.

Adviser fees

Upfront adviser fees

Where an upfront adviser service fee has been negotiated, the Annuity's regular payments are reduced to reflect the amount of the fee.

However, this fee does not reduce the purchase price used to calculate the deduction amount.

2 Based on Centrelink rates and thresholds as at 1 January 2021 ($100,000 – $88,000) x 2.25% + $88,000 x 0.25% = $490.

Ongoing adviser service fee

Your client can agree to the payment of an ongoing adviser service fee, which can be deducted from their regular payments. Where an ongoing service fee is charged, the regular payments are reduced by the amount of the fee and the net amount credited to the client's nominated account. Centrelink does not reduce the assessable income of the Annuity by the amount of this fee.

How the Annuity is assessed for the Commonwealth Seniors Health Card

The Commonwealth Seniors Health Card income test

Centrelink uses adjusted taxable income plus deemed income from non-grandfathered account-based pensions to assess eligibility for the Commonwealth Seniors Health Card (CSHC).

Adjusted taxable income is assessed from a client's reference tax year, which is usually the tax year immediately preceding the current tax year. If a client has not received their tax notice of assessment for the tax year immediately preceding the current tax year, then the tax year immediately preceding the previous tax year will be the reference tax year.

For example, for a client who applies for the CSHC in February 2021, the current tax year is 2020/21, therefore they must provide a tax notice of assessment for 2019/20. If this is not available, then this client should provide a tax notice of assessment for the 2018/19 tax year, which will be their reference tax year.

For non-grandfathered account-based pensions, it is the current account balance of that pension which is used to calculate deemed income. Clients can reduce their CSHC assessable income immediately by reducing their deemed account-based pension balances.

From 20 September 2020 until 19 September 2021, the CSHC income threshold for singles is $55,808 and the CSHC income threshold for couples is $89,290.

Assessment of regular payments

The taxable income (if any) from the Annuity will be assessed for the CSHC. The taxation of Annuity regular payments is discussed in detail on page 6.

At a high level, payments from an Annuity investment made with superannuation money are tax free, and therefore have no assessable income for the CSHC.

Payments from an Annuity investment made with non-superannuation money may have assessable income, which is generally equal to the payments less the deduction amount.

Assessment upon withdrawal (voluntary)

The taxable income (if any) from a voluntary withdrawal from an Annuity will be assessed for the CSHC. The taxation of voluntary withdrawals from the Annuity are discussed in detail from page 8.

At a high level, where an Annuity investment made with superannuation money is withdrawn voluntarily and taken as a lump sum, the withdrawal value is generally tax free for people aged 60 and over, and therefore not assessed for the CSHC income test.

Where an Annuity investment made with non-superannuation money is withdrawn voluntarily, the withdrawal value above the reduced purchase price (if any) is taxable income.

Taxation treatment

This information applies to individual Australian tax residents only and is based on our understanding of current taxation legislation as at the date of this document.

Taxation upon investment

No tax is deducted from the initial amount used to invest in the Annuity using non-superannuation money.

However, where money is rolled over from an untaxed superannuation fund to commence the Annuity, 15% tax will be deducted from the 'taxable component – untaxed element' (up to the untaxed plan cap of $1.565 million for FY 2020/21) on receipt and prior to commencement.

Note: Where superannuation money is being used to commence the Annuity, it can only be purchased with superannuation benefits that are classified as unrestricted non-preserved.

Taxation of regular payments

The tax treatment of the Annuity's regular payments is different for annuities purchased with non-superannuation and superannuation money.

Non-superannuation money

For an Annuity purchased with non-superannuation money, the regular payments are split into two components:

Deductible amount

The deductible amount is the amount of each regular payment that broadly represents the return of part of the original investment capital. This amount is tax free. The deductible amount of the term annuity is calculated as follows:

Deductible amount = (Purchase price – Residual capital value) divided by Term of the annuity

Assessable amount

The assessable amount is the amount of the regular payment that is greater than the deductible amount (including any excess deductible amount carried forward from a previous financial year). This amount is assessable for tax purposes. The assessable amount is the amount (if any) of each regular payment that notionally represents earnings.

Depending on the investor's personal circumstances, this amount may be subject to Pay As You Go (PAYG) withholding tax.

Note: PAYG is not a final tax and a greater or lesser amount of the tax may apply on assessment of your client's annual income tax return.

Where income paid from the Annuity is less than the deductible amount, there is no assessable income for taxation purposes. The excess deductible amount does not reduce other assessable income of the individual. The excess deductible amount is carried forward and may be used to offset assessable income from the Annuity in future years (if any).

Joint policies

Challenger allows policy owners to select the regular payment amount to be paid to each owner. For example, one owner can be allocated 30% of the regular payments and the second owner the remaining 70%. In these cases, the deductible and assessable amounts for tax purposes will also be split in these proportions.

On death of one of the owners, the full regular payment will be paid, and the full deductible amount will be allocated, to the surviving owner.

Reversionary beneficiaries

Where a reversionary beneficiary is nominated, regular payments will continue to be paid to the reversionary and taxed in their name. Note that the deductible amount does not get recalculated and the assessable amount (if any) will be the income payment in excess of the deductible amount.

Superannuation money

Generally, regular payments from the Annuity purchased with superannuation money for those aged 60 and above are tax free. On death of the original owner, the income paid to the reversionary (if applicable) will also be tax free if the original owner or the reversionary was aged 60 or over at the time of death.

An Annuity purchased with superannuation money requires minimum income payments to be paid from the annuity. If the term annuity has an RCV, the term annuity's regular payments will need to meet minimum standards each year. If the term annuity has no RCV, a minimum payment requirement must only be met in the first year.

For example, let's assume Glen who is 65 years old, purchases a 15-year Annuity with a 100% RCV and with money rolled over from his superannuation fund. The Annuity will need to meet minimum payments of 5% per annum for the first 10 years (while Glen is below 75) and then 6% per annum for the remaining five years when Glen is 75 and over.

Where minimum regular payments cannot be met, Challenger's quote software – eQuote – will require a reduced residual capital value or a shorter term to be selected so that each year's regular payment can be increased.

Note: Challenger only offers superannuation annuities to people with unrestricted non-preserved benefits who are entitled to receive tax-free payments. On death, if there is a nominated reversionary beneficiary and they are eligible, regular payments will continue to be paid to the beneficiary.

Taxation upon withdrawal (death)

Non-superannuation money

Upon death, any amount payable will comprise an amount that represents a return of remaining capital (called the reduced purchase price) and income. The income component of the amount paid will be assessable to the estate/beneficiary(ies) and, depending on the respective tax circumstances, subject to tax.

Calculating the reduced purchase price

The reduced purchase price is worked out by reducing the purchase price by the deductible amount used each year.

Reduced purchase price = Purchase Price
– (Deductible amount x Term elapsed)
+ Unused Deductible amount (if any)

If the payments from the Annuity for a particular year were less than or equal to the deductible amount (including any unused deductible amounts carried forward from prior years), the purchase price is reduced by the income paid for that year (and any excess deductible amount carried forward into a future financial year).

Where the regular payments were greater than the deductible amount then the purchase price is reduced by the deductible amount (and any excess deductible amount from a prior year added back).

For example, Bruce and Wendy's 10-year Annuity will have the following reduced purchase price at the end of the first year:

Deductible amount: $10,000 (($100,000 – $0) / 10)

Annuity payment received: $10,979[3]

Unused deductible amount = Nil (as the payment amount of $10,979 is greater than $10,000)

End of year one reduced purchase price = $90,000 ($100,000 – ($10,000 x 1) + $0).

For the reduced purchase prices for future years for Bruce and Wendy, see Figure 5.

In Bruce and Wendy's case, if their Annuity of $100,000 was purchased using non-superannuation money, then in the event that both died and the estate of the last surviving partner chooses to withdraw a lump sum, the estate will have the following assessable income upon receiving the withdrawal payment. The income component is calculated the same way if a beneficiary is to receive the payment, however, it may be split if there are multiple beneficiaries.

3 Based on a Challenger Guaranteed Annuity quote as at 25 January 2021 for a 10-year term annuity with no residual capital value, nil adviser fees and income paid monthly with no indexation.

Figure 4: Tax components of the withdrawal value on Bruce and Wendy's deaths

End of year	Withdrawal value[i]	Reduced purchase price[ii]	Income component (assessable)
1	$86,549	$90,000	$0
2	$77,938	$80,000	$0
3	$69,091	$70,000	$0
4	$60,001	$60,000	$1
5	$50,664	$50,000	$664
6	$41,070	$40,000	$1,070
7	$31,215	$30,000	$1,215
8	$21,089	$20,000	$1,089
9	$10,687	$10,000	$687
10	$0	$0	$0

i. Based on Challenger Guaranteed Annuity and bank bill swap rates effective 25 January 2021.

ii. Based on a Challenger Guaranteed Annuity quote as at 25 January 2021 for a 10-year term annuity with no residual capital value, nil adviser fees and income paid monthly with no indexation.

Superannuation money

Term annuities purchased with superannuation money are generally made up of a taxable and a tax-free component. The proportion of these components is set at the start of the term annuity and remains fixed for the term of the annuity. On death, lump sum amounts paid to tax dependants (directly or through the estate) are not subject to tax regardless of the components.

However, if the lump sum is paid to a non-tax dependant, the taxable component is subject to tax at a maximum rate of 15% (Government levies may also apply).

In summary, tax dependants are:

- a spouse or ex-spouse
- a child under age 18 (or otherwise a financial dependant)
- someone who is a financial depandant
- someone with whom an interdependency relationship existed.

Taxation upon withdrawal (voluntary)

Non-superannuation money

If the Annuity is withdrawn before the end of the term, the withdrawal value can comprise an amount that represents a return of remaining capital (the reduced purchase price) and income. The income component of the withdrawal will be assessable to the investor and, depending on personal tax circumstances, subject to tax.

For example, Bruce and Wendy's Annuity will have the following assessable income component upon a voluntary full withdrawal:

Figure 5: Tax components of the voluntary withdrawal value for Bruce and Wendy

End of year	Withdrawal value[i]	Reduced purchase price[ii]	Income component (assessable)
1	$78,051	$90,000	$0
2	$71,379	$80,000	$0
3	$64,133	$70,000	$0
4	$56,525	$60,000	$0
5	$48,328	$50,000	$0
6	$39,613	$40,000	$0
7	$30,405	$30,000	$405
8	$20,678	$20,000	$678
9	$10,552	$10,000	$552
10	$0	$0	$0

i. Based on Challenger Guaranteed Annuity and bank bill swap rates effective 25 January 2021.

ii. Based on a Challenger Guaranteed Annuity quote as at 25 January 2021 for a 10-year term annuity with no residual capital value, nil adviser fees and income paid monthly with no indexation.

With a partial withdrawal, the withdrawn amount will generally be classified as a return of capital and will not be taxed. The deductible amount applied to future regular payments will be recalculated to reflect the partial withdrawal.

Partial withdrawals

If a partial withdrawal is made from the term annuity, then the deductible amount can reduce. This is because the amount of capital which is returned to the investor throughout the term of the policy cannot be more than the original purchase price. The deductible amount after a withdrawal would be:

(Unused purchase price – Residual capital value) / Remaining term

Where:

Unused purchase price = Reduced purchase price – Partial withdrawals

Note: The deduction amount cannot be less than zero.

For example, if Bruce and Wendy withdrew $10,000 at the end of the first year, the deductible amount that would apply going forward would be:

- Unused purchase price = $80,000 ($90,000 - $10,000)
- Deductible amount (after partial withdrawal) = $8,888.88 per annum (($80,000 - $0) / 9)

This is different to the calculation for the deduction amount for Centrelink purposes which does not consider deduction amounts previously used.

Superannuation money

Where the Annuity purchased with superannuation money is withdrawn, the withdrawn amount can generally be paid as a lump sum, rolled back to accumulation or used to start another superannuation income stream. Amounts taken as a lump sum are generally tax free for people aged 60 and over.

Other considerations

Transfer balance cap

The transfer balance cap will generally limit the amount of assets a person can transfer to tax-free superannuation retirement phase income streams including term annuities purchased with superannuation money.

The general transfer balance cap is $1.6 million for FY 2020/21 and will index to $1.7 million for FY 2021/22.

As a result, superannuation annuities will generally not be able to be purchased for more than $1.6 million in FY 2020/21 nor more than $1.7 million in FY 2021/22.

The transfer balance account

A person commences to have a transfer balance account on the later of 1 July 2017 and when they start a superannuation retirement phase income stream. The transfer balance account will track the net amount a person has transferred into the tax-free retirement phase of superannuation.

Certain transactions will be recorded as credits or debits to a personal transfer balance account.

How is a term annuity assessed for the transfer balance cap

Non-superannuation money

The purchase of the Annuity with non-superannuation money is not credited to a person's transfer balance account. Likewise, withdrawals from a non-superannuation Annuity are not debited to a person's transfer balance account.

Superannuation money

The credit value for the Annuity purchased before 1 July 2017 is the identifiable lump sum. The identifiable lump sum is defined as an amount equal to purchase price.

From 1 July 2017, the credit value for the Annuity is purchase price.

The purchase price of the Annuity will count towards a person's transfer balance account regardless of the product features chosen. For example, irrespective whether the residual capital value (RCV) of the Annuity is 0%, 100% or in between, the amount credited to the person's transfer balance account is purchase price.

For the purpose of the transfer balance cap, a Challenger Guaranteed Annuity (Fixed Term) is not a 'Capped Defined Benefit Income Stream'. For more details regarding the treatment of a 'Capped Defined Benefit Income Stream' including how the a Challenger Guaranteed Annuity (Complying) is assessed please contact Challenger Tech.

Commutations

If a person commutes the Annuity then a debit will be created against their personal account balance equal to the withdrawal value.

Residual capital value (RCV)

If the Annuity with an RCV reaches the end of the term, a debit will be created against the person's personal transfer balance account equal to the RCV. If a new Annuity is then purchased with superannuation money, the amount credited to the person's transfer balance account is the new purchase price.

Death benefits

Where a superannuation death benefit is paid to an eligible dependant as a superannuation Annuity, it will generally be credited to the dependant's transfer balance account on the day the dependant becomes entitled to the income stream. The credit will equal the original purchase price of the Term annuity less any partial commutations which were made.

Where the Annuity reverts to a beneficiary following the death of the original recipient, a credit will arise in the beneficiary's transfer balance account 12 months after the original recipient's date of death. The credit will equal the original purchase price of the Annuity less any partial commutations which were made.

In these cases, a death benefit beneficiary will need to manage their affairs to ensure they do not exceed the transfer balance cap.

Excess amounts

Where a person's transfer balance account exceeds their personal transfer balance cap, they will generally be required to reduce their transfer account balance below their personal transfer balance cap.

They may be able to do this by commuting the excess (equal to the excess transfer balance plus a notional earnings amount) from one or more superannuation retirement phase income streams (subject to any commutation restrictions which may apply to certain income streams). The excess amount commuted could generally be transferred to an accumulation superannuation account or withdrawn from the superannuation system altogether.

They will also generally be liable for an excess transfer balance tax, which is a tax on the accrued transfer balance earnings of 15% for the first breach and 30% for subsequent breaches.

Individuals who are not tax residents of Australia

The Annuity can be purchased by non-residents, however they must receive information about the Annuity and sign the application form in Australia.

Taxation treatment

Non-residents are generally taxed in Australia on all Australian-sourced income. This includes Australian sourced pensions or annuities unless an exemption is available under an applicable treaty.

Australia has entered into double tax agreements (DTAs) with more than 40 countries of which one of the aims is to reduce or eliminate double taxation. The majority of DTAs state that pension and annuity income is taxed in the country in which an individual is a resident, as opposed to where the income is sourced.

Note: If Australia does not have a DTA with the country of which your client is a resident, or the DTA does not contain the relevant exemption, the assessable income portion of the annuity payments is taxable in Australia at non-resident tax rates.

Countries that have a DTA with Australia

We have listed below a few of the countries that have a DTA with Australia where the Annuity's income would not be taxed in Australia under the current agreement. The full list of countries that have a DTA with Australia can be found on the Australian Government treasury website www.treasury.gov.au.

India	Philippines	United Kingdom
Japan	Singapore	United States
Korea	Taipei	Vietnam
Malaysia	Thailand	

Tax information

We cannot provide you or your clients with taxation advice that takes into account your clients' personal circumstances. If your clients have further questions about the tax treatment of their annuity payment we recommend they seek their own tax advice.

Self-managed superannuation funds

The Annuity may be suitable for Self-managed super funds (SMSFs) which:

- are looking for a fixed term investment that will provide them with a secure income at competitive rates, and;
- and want to ensure essential cashflow needs are met, in particular minimum pension payments so the fund can claim tax-exempt income.

Valuing a term annuity

Annuities within an SMSF are generally an investment of the fund. SMSFs are required to use market value reporting for their financial accounts and statements.

For the purpose of valuing the Annuity in the SMSF, the fund accountant and trustee will need to satisfy themselves that an appropriate valuation methodology has been used that satisfies the Australian Tax Office (ATO) requirements of market value based on objective and supportable data.

The Annuity may be valued based on a number of approaches such as:

- The withdrawal value of the fixed term annuity;
- An actuarial calculation of the present value of future payments.

It is recommended that trustees of an SMSF discuss an appropriate method with the fund's accountant/auditor.

Centrelink treatment

For Centrelink purposes an Annuity owned by an SMSF will generally be treated like any other asset of the fund. The Centrelink assessment of the member's interest in the SMSF will be determined by the characteristics of that interest (accumulation, account-based pension or other) and the usual Centrelink assessment of Annuities will generally not apply.

Taxation treatment

An Annuity owned by an SMSF will generally be taxed under the Taxation of Financial Arrangements (TOFA) provisions. As we are not tax agents the following is provided as general information to help illustrate how the Annuity payments may be assessed. We recommend qualified tax advice is sought.

Where TOFA applies, the overall gain from a fixed term annuity will be included in the SMSF's assessable income applying an accruals basis over the term of the Annuity. Broadly, the accruals method allocates gains and losses from a financial arrangement to income years over the term based on calculated internal rate of return, which takes into consideration the investment term and the future payments to be received.

The ATO website offers a 'Guide to the taxation of financial arrangements' which specifies how to calculate the assessable income under the TOFA provisions, including the default accruals method.

Case study

Tony and Helen are a 66-year-old couple who have recently retired. They own their own home, have no debts and $550,000 each in account-based pensions. Additionally, they have $50,000 in the bank as a cash reserve and personal assets of $20,000.

Tony and Helen want to enjoy the active years of their retirement after many hard years of work. To them, this means $15,000 per year for holidays for the next 10 years, on top of the regular income they currently receive.

Tony and Helen would like those funds to be invested so they are not affected by share market volatility. They visit their financial adviser to find a solution.

The financial adviser's recommendation

Tony and Helen's financial adviser recommends they each use part of their account-based pension to purchase a new investment which can provide them with the guaranteed payments of $15,000 (indexed by 2% p.a. each year) for the required 10-year period.

This strategy is designed to give Tony and Helen the confidence to enjoy their annual holiday knowing they will receive payments for their chosen timeframe regardless of how investments markets perform.

The investment recommended is a 10-year nil residual capital value (RCV) Challenger Guaranteed Annuity (Fixed Term) for an amount of $74,569 each.

This recommended income stream is a secure investment which provides a series of regular payments consisting of capital and interest that match the 10-year timeframe they are planning for their holidays.

A total combined amount of $950,862 will be retained in Tony and Helen's account-based pensions. This income stream allows them to choose from a range of investments, to meet their risk and investment objectives, and provide them with flexibility to select the income they draw (subject to Government minimum payment requirements) to meet their regular cashflow requirements until it runs out.

After speaking with their adviser, Tony and Helen's $1,100,000 superannuation balance would be invested as follows:

- **$74,569[4] each in a 10-year Challenger Guaranteed Annuity (Fixed Term) with nil residual capital value which gives them $15,000 in the first year with payments indexed by 2% p.a.,**
- **$475,431 each retained in an account-based pensions to meet their current regular income requirements.**

Strategy outcomes

By investing in the Annuity purchased with superannuation money, Tony and Helen have:

- Regular payments that cover their holiday expenses for the next 10 years which is unaffected by share market volatility.
- Certainty with the regular payments they will receive each year and indexed by 2% p.a. to help keep up with inflation.
- Regular payments that will be tax-free as the money used to purchase the Annuity was superannuation money and they are age 60 or over.
- Less Commonwealth Seniors Health Card assessable income due to rolling over from their deemed account-based pensions to the Annuity.
- only $43 Centrelink assessable income ($7,500 income – $7,457 deduction amount) from each Annuity in the first year. Rolling over from their deemed account-based pensions to the Annuity therefore reduces their Low Income Health Care Card assessable income.

4 Based on a Challenger Guaranteed Annuity quote as at 25 January 2021 for a 10-year term annuity with no residual capital value, nil adviser fees and income paid monthly ($15,000 p.a.) indexed by 2% p.a.

We're always ready to support you

Challenger has a wide range of tools and resources to help you with retirement income planning; including our Retirement Illustrator, webcasts, videos and case studies. To access these or find out more:

- Log in, or register for AdviserOnline at **adviseronlineportal.com.au**
- Speak to your **Challenger BDM**
- Call Adviser Services on **1800 621 009** or Challenger Tech on **1800 176 486**

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