



# Client Fact Sheet

July 2009



## Understanding Term Allocated Pensions

A term allocated pension is a tax-effective, fixed-term retirement income stream, which is paid from superannuation monies.

Once commenced, funds invested into a term allocated pension are generally no longer accessible.

Term allocated pensions offer a choice of investment options, and as such the investment returns of the investment options selected will dictate the level of income provided each year. The income payment is based on the account balance and a "payment factor" at commencement and at 1 July each year. The annual income is fixed at this amount for the full financial year.

Term allocated pensions are no longer able to be purchased after 19 September 2007.

### You have an Existing Term Allocated Pension

Term allocated pensions can only be purchased with superannuation money.

Once you satisfy certain criteria (for example retirement or reaching age 65), you may gain access to your superannuation monies. You may withdraw a lump sum amount, use the money to purchase product/s to provide you with a regular income stream (such as a term allocated pension) or a combination of both. There are different taxation implications for lump sum superannuation payments and payments received from regular income stream products.

As term allocated pensions may only be purchased with superannuation money, this does not allow for income splitting through joint ownership. A superannuation benefit can only be paid to the member.

Although the pension payments themselves are taxable in the hands of the recipient, term allocated pension recipients between the ages of 55 and 60 may, subject to individual circumstances, be eligible for a tax-free component, as well as a 15% tax rebate based on the taxable portion of the annual pension. For persons over 60 years of age the pension payments will be tax free. Fund earnings and realised capital gains within a term allocated pension fund are untaxed.

### Options

- **Payment frequency** – the pension can usually be paid monthly, quarterly, half-yearly or on an annual basis.
- **Investment options** – depending on the product you choose you can select from a number of underlying investment options, and can generally switch between options if the need arises.
- **Provision for spouse** – you can elect to have reversionary pension payments continue to your spouse. Reversionary pension payments continue to pay a surviving reversionary pensioner upon the death of the owner of the term allocated pension.

### Complying pensions

"Complying pensions" refer to Term Allocated Pensions which have met certain conditions. Depending upon which conditions have been met these complying pensions will be either 50% or 100% exempt from the Assets Test by Centrelink.

No new Term Allocated Pensions or complying pensions have been available since 20 September 2007.

## Income payments

Payments must be made at least annually. The amount a person must receive in a year is calculated in accordance with a schedule of payment factors (PFs) which are determined by the remaining term of the pension.

The income payment each year will be determined by dividing the account balance as at 1 July by the PF for the remaining term.

At the owners discretion, the annual income paid can vary between plus or minus 10 per cent of the income determined by the applicable Pension Factor.

In the first year, the income payment will be pro-rated according to the date of commencement of the term allocated pension. If commenced on or after 1 June, no payment is required in that financial year. In the last year of the set term, the entire remaining balance will be paid as an income payment.

## Tax concessions available

### Tax Free Amount

For persons over 60 the income will be tax free. For persons under 60 the tax free amount is the percentage of the income payment from the term allocated pension that is not subject to tax. The tax free percentage is calculated by using the following formula:

$$\text{Tax Free Percentage} = \frac{\text{Tax Free component}}{\text{Balance of investment at commencement of pension}}$$

$$\text{Tax Free Amount} = \text{Tax free percentage} \times \text{pension payment}$$

$$\text{Tax Free Component} = \text{non-concessional contributions} + \text{amounts which represent the portion of a superannuation benefit that accrued before 1 July 1983} + \text{Invalidity Component} + \text{CGT Component.}$$

### 15% tax rebate

If you are under age 60 a rebate of 15% is applied to the taxable income drawn from your term allocated pension. The taxable income is the pension amount drawn less the tax free amount as outlined above. To qualify the income recipient must be over 55 years of age.

The calculation to determine the amount of the rebate is listed below:

$$\text{Rebate} = \text{Annual Income Payments less Tax Free Amount} \times 15\%$$

## Centrelink treatment

Where a term allocated pension is complying (ie. meets the requirements outlined above), it receives concessional treatment under the Centrelink Assets Test.

Under the Assets Test, depending upon the conditions met there are two exemptions available:-

- A full exemption is generally available for complying pensions purchased prior to 20 September 2004, or
- A 50% exemption is available for complying pensions purchased between 20 September 2004 and 20 September 2007. The market value of the income stream is re-assessed by Centrelink on a bi-annual basis (unless income is paid annually, where the value is only re-assessed once a year) and then the 50% discount is applied.

## Risks associated with term allocated pensions

### Taxation and Legislative Risk

Our advice is based on the current practices of government bodies such as the Australian Taxation Office as well as existing legislation. As with most financially related matters there is always the risk that the relevant legislation or current government practices may be amended.

### Liquidity and Access to Capital Risk

Liquidity is the ability of an investment to be easily converted to cash with little or no loss of capital and minimum delay.

As mentioned above, in the case of term allocated pensions, access to your capital is very restricted.

### Outliving Capital Risk

As the length of the term allocated pension is based upon the recipient's life expectancy, the income payments will cease when the term has expired.

### Stability of Income Risk

Payments are not stable, as the income will depend on the annual performance of the underlying assets. This means that the income level is not guaranteed and will vary from year to year.

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