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Revisiting grandfathered account-based pensions

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From 1 January 2015, the income test assessment (the assets test assessment remained unchanged) for account-based pensions (ABPs) changed to be treated under the deeming provisions for entitlements such as the Age Pension and Commonwealth Seniors Health Card (CSHC). When the rules changed, existing ABPs were grandfathered and retained their existing assessment if certain rules were met.

The rules to retain grandfathering meant that certain strategies could not be considered for grandfathered ABPs after 1 January 2015. Strategies such as switching providers to save on fees, a re-contribution strategy and adding a reversionary beneficiary were largely not possible without losing the grandfathering status.

While the income test assessment for ABPs purchased prior to 1 January 2015 can be more favourable compared to deeming, it might be worth revisiting whether this still holds true for clients in light of recent changes, like:

- reduced deeming rates
- reduced minimum drawdown rates for 2020/21
- a reduction in balances due to the impact of COVID-19.

Recap of grandfathering rules for ABPs

ABPs that commenced prior to 1 January 2015 are grandfathered and assessed using the deduction method if certain rules are met. It should be noted that the grandfathering rules for income support payments are different to the grandfathering rules for the CSHC. For instance, if an ABP is grandfathered for Age Pension purposes, it does not mean that it is automatically grandfathered for the CSHC and vice versa.

Grandfathering rules for income support payments

The income test assessment for ABPs that are grandfathered for income support payment purposes are based on the deduction rules. Income from these ABPs is assessed as follows:

Annual payment less deduction amount

*Where deduction amount = (purchase price less commutations) / relevant number.**

*Life expectancy of the person at commencement of the ABP. Where a reversionary beneficiary exists, the longer of the two life expectancies is used.

To be grandfathered (and to retain the grandfathered status):

- the ABP had to be commenced before 1 January 2015, and
- the client was in receipt of an income support payment before 1 January 2015 and continuously thereafter.

If the grandfathered status is lost, then the ABP is assessed under the deeming provisions from that day and grandfathering cannot be reobtained. Generally, clients can lose the grandfathering status in two common scenarios:

- An ABP is commuted and restarted (e.g. where the client changes the fund or a product, restarts a pension after a recontribution strategy or adding a reversionary, merges two or more pensions and starts a new income stream).
- The client has lost their income support payment entitlement (even for a day) and is not in continuous receipt of any other income support payment (e.g. loss of Age Pension entitlement during 1 January 2017 assets test changes).

Grandfathering rules for the CSHC

The CSHC's income test prior to 1 January 2015 was based on adjusted taxable income.*

*Includes taxable income (excluding assessable First Home Super Saver Scheme released amount), fringe benefits, target foreign income, total net investment loss and reportable superannuation contributions.

This changed on 1 January 2015 to include deemed income from ABPs (unless the ABP was grandfathered). An ABP is grandfathered for the purposes of the CSHC income test if:

- the ABP was commenced prior to 1 January 2015, and
- the client held a CSHC before 1 January 2015 and continuously held the card thereafter.

Similar to the grandfathering rules of ABPs for the purposes of income support payments, if the grandfathered status is lost, deemed income from the ABP will be included in the CSHC's income test from that day, and grandfathered status cannot be reobtained.

What has changed?

The COVID-19 pandemic has resulted in significant market fluctuations as well as the introduction of many stimulus measures.

Deeming rates reduced

On 1 May 2020, the deeming rates reduced to a historic low of 0.25% and 2.25% (see Table 1 in the Appendix for deeming rates and thresholds).

Those who may have retained the grandfathering status as a result of getting a more favourable income test assessment may want to reassess the situation, given the significant reduction to the deeming rates since 1 January 2015. The review can be worthwhile for clients who have made large commutations in previous years and as a result have had their deduction amount recalculated and reduced over time. For these clients, deemed income from their ABP may produce lower assessable income compared to the deduction rules, particularly if their income drawdowns exceed their reduced deduction amount.

As a guide, Figure 1 shows the new income and asset test strategy zones using Centrelink rates and thresholds as at 1 January 2021. These zones highlight which test a client might be assessed under if we use the assumption that the client only has deemed financial assets.

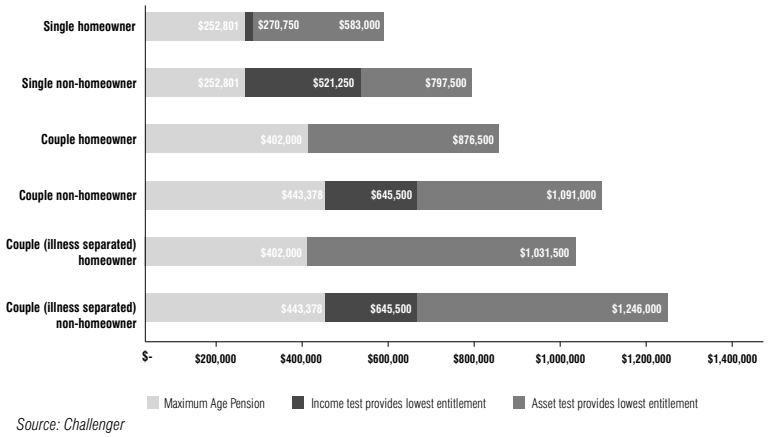
For instance, couple non-homeowners are full pensioners up to $443,378, at which point they become income tested and remain so up to $645,500, then they are asset tested up to $1,091,000, where they lose Age Pension entitlements. Note that the non-homeowner asset cut-out may be higher if eligible for rent assistance.

Figure 1 shows that there is now no income zone for couple homeowners and a much-reduced income zone for single homeowners. For these clients, having an ABP that is subject to deeming will have little or no impact on their entitlement compared to an ABP assessed under the deduction method. In some cases, particularly where clients are drawing a level of income that is significantly higher than their deduction amount, the deeming rules can provide a better Age Pension outcome. However, this assumes that deeming rates stay constant. Increases in deeming rates in the future can change this outcome.

Example 1. Grandfathering for the Age Pension

Katherine, a 77-year-old single homeowner, has a grandfathered ABP with a current balance of $300,000 and a deduction amount of $15,000. Her home and contents are worth $10,000. She needs to draw $30,000 annually from the ABP to fund her retirement. Under the grandfathered rules, the total assessable income from the ABP would be $15,000, and her Age Pension would be $19,366 p.a. If her ABP was subject to deeming, her total assessable income would be $5,690, and her Age Pension would increase to $21,276 p.a.

Figure 1. Strategy zones



Source: Challenger

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Consideration for the loss of grandfathering not only includes comparing which income test assessment provides a better entitlement, but also the overall impact of the strategy.

Minimum pension drawdown rates halved

The minimum pension drawdown rates have been halved for 2020/21. This means clients can get their pension payments reduced (based on the cash flow requirement) to the new minimums.

Although this can help income-tested pensioners with grandfathered ABPs to achieve a higher rate of pension due to reduced assessable income, it is important to note that this change is temporary. The minimums are expected to revert to the original rates from July 2021.

However, in some cases, clients may need to maintain a high-income drawdown to fund their retirement. As a result, these clients may continue to be impacted from an income test perspective, unless lump sum withdrawals are used as a strategy. In these cases, it is important to note that future deduction amounts will be recalculated to a reduced amount.

Reduction in balances

Account balance reductions due to market fluctuations triggered by COVID-19 is also another consideration. The minimum drawdowns are based on balances on 1 July of the relevant financial year, with the deduction amount based on the purchase price (less any commutations) and the relevant number at commencement.

Although the reduced superannuation minimums can assist with reducing assessable income, the lower balances have the effect of reduced deemed income, particularly when coupled with lower deeming rates.

Advice considerations

With lower deeming rates and likely lower balances due to market volatility, some clients may achieve a higher rate of Age Pension if their ABP is assessed under the deeming provisions instead of being grandfathered under the deduction method.

Clients whose Age Pension is unaffected under the deeming rules or the deduction method can consider strategies that they were not able to implement previously due to unfavourable Age Pension outcomes under the deeming rules. These can include:

- moving funds to save on fees
- moving funds to access more appropriate investment options or specialist options in line with the client's investment goals
- refreshing the pension to include accumulation monies from contributions such as downsizer contributions
- implementing re-contribution strategies
- consolidating multiple ABP accounts
- adding a reversionary beneficiary where a product provider requires the restarting of an existing pension to add the beneficiary, or
- where the client wants the convenience of maintaining a high-income payment to fund their retirement without regularly taking lump sum withdrawals.

However, it is important to note that once grandfathering is lost, it cannot be regained. Immediate benefits with having a deemed ABP instead of retaining grandfathering (including the ability to implement strategies previously mentioned) should be weighed against any future impacts in the longer term, such as the potential for higher deeming rates. Consideration for the loss of grandfathering not only includes comparing which income test assessment provides a better entitlement, but also the overall impact of the strategy. For instance, if any gain in the savings of fees or tax outweighs any loss in an existing entitlement.

The impact of losing the grandfathering may not only be limited to income-tested clients. Asset-tested clients, especially non-homeowners, may need to consider the impact of the loss of grandfathering. For instance, they could become income tested on the loss of grandfathering and may be adversely impacted.

In the case of the CSHC, losing the grandfathered status could mean losing the card if the client's adjusted taxable income plus the deemed income from ABPs is above the income test threshold. However, in many cases, deeming may not even impact their CSHC entitlement as the income cut-off is quite high. A client can have an ABP balance (assuming adjusted taxable income of nil) of up to $2,527,467(singles) or $4,046,667(couple combined) before they exceed the income test threshold and lose their CSHC (see Table 2 for the CSHC income test thresholds in the Appendix).

Example 2. Grandfathering for the CSHC

Caroline is a single homeowner and holds an ABP valued at $650,000 and grandfathered for the purposes of her CSHC. She also has accumulation money of $200,000 which includes a downsizer contribution she made recently. Caroline currently works part-time and earns a taxable income of $30,000 a year. Her adviser wishes to implement a pension refresh and combine her accumulation money with her existing funds in pension phase for tax efficiency. They also want to explore a different product provider that offers more appropriate investment options and lower ongoing costs.

If Caroline loses the grandfathering on her ABP, she would still continue to be eligible for the CSHC. This is because deeming on her ABP balance of $850,000 ($18,065) plus her employment income ($35,000) is still under the CSHC income test threshold of $55,808.

As a result, Caroline is able to access a cheaper and a more appropriate ABP product, increase the amount she has in pension phase without having multiple pension accounts, and can retain her CSHC. Although there can be potential future increases in the deeming rates, the client may still be able to retain the card due to reducing account balances and indexation of the CSHC income test threshold. **FS**

Appendix

Table 1. Deeming rates

Threshold for singles	Threshold for couples	Applicable deeming rate
Up to $53,000	Up to $88,000	0.25%
Amount above $53,000	Amount above $88,000	2.25%

Source: Challenger

Table 2. Income test thresholds for the CSHC

Relationship status	Annual income limit
Single	$55,808
Couples	$89,290
Illness-separated couples	$111,616

Source: Challenger

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