TECHNICAL ARTICLE

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Providing advice on grandfathered account-based pensions

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It is important to consider the impact of potential advice recommendations on the assessment of grandfathered account-based pensions.

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Background

On 1 January 2015, changes to the income-test assessment of account-based pensions (ABPs) came into effect. Specifically, the assessment changed for determining entitlement to:

- income support payments from Centrelink and DVA (see Appendix A), and
- the Commonwealth Seniors Health Card (CSHC) (see Appendix B).

Income from ABPs commenced from this date is determined under the deeming rules for both income support and CSHC entitlements. However, where certain conditions are met, grandfathering applies to some ABPs that were originally commenced before this date.

ABPs that are grandfathered:

- may have no or very little income assessed for income support means-testing purposes, and
- where the ABP is paid from a taxed super fund to a person aged 60+, there will be no income assessment for the CSHC.

The question then arises, what impact will a loss of grandfathering have on social security outcomes? Could there ever be an instance where a loss of grandfathering could be beneficial?

Where a potential advice recommendation would in fact lead to a loss of grandfathering, it is often asked, 'how do I work through the possible implications of this and what do I need to consider to help determine whether this recommendation is appropriate for the client?'

Impact of losing grandfathering

It is important to consider not only the immediate impact of a loss of grandfathering, but also any future implications, where for example, the person's asset and income position changes, or where their partner passes away.

Depending on the circumstances, a loss of grandfathering <u>for income support purposes</u> could:

- negatively impact the client under the income test
- have no immediate or future impact
- have no immediate impact, but may have future implications, or
- increase income support entitlement under the income test.

☑ **Advice tip:**

Where a person is receiving home care or aged care services, fees may also be impacted. This is because broadly, fees are calculated based on income and assets of the person as per social security rules. For more information, see **'Guide to Aged Care Fees and Rules'** on the **Technical** section of MLC Adviser Online.

For CSHC purposes, grandfathered ABPs (paid from a taxed fund) are not assessed under the income test. This is because the income test for the card is based on adjusted taxable income.[1]

A loss of grandfathering, will result in the full balance of the ABP being subject to deeming, with deemed income (only from the ABP) being added to other ATI to determine entitlement to the card. This assessment will also apply where an ABP doesn't qualify for grandfathering. Therefore, the implications for CSHC purposes of losing the grandfathering may be that the person loses entitlement to the card under the income test, if the person (or couples) ATI from other sources, plus deemed income from ABPs exceeds the income test threshold.

Note: The key purpose of this article is to outline some of the key considerations when providing advice on grandfathered ABPs. For a more detailed explanation of the pre and post 1 January 2015 income test assessment rules, see Appendix A and B.

Causes of loss of grandfathering

Broadly, grandfathering is lost where an existing pension ceases and a new pension is commenced. The table below summarises the most common scenarios where grandfathering will and won't be lost.

Grandfathering lost	Doesn't result in loss of grandfathering
Pension refresh (**regardless** of whether the same account number applies to new pension)	Partial commutations[2] and additional pension payments
Voluntarily switching pension products (including where within same trustee structure)	Switching underlying investments within the same pension product and certain involuntary product switches/upgrades[3]
Adding/removing a reversionary death benefit nomination **where trustee requires** a new pension to be commenced	Adding/removing a reversionary death benefit nomination where trustee **does not require** a new pension to be commenced[2]
Original pension owner passes away and beneficiary elects to commence a death benefit pension (either as a result of a non-binding or binding nomination)	Original pension owner (grandfathered) passes away with an automatic reversionary nomination in place and beneficiary is entitled to an income support payment/CSHC at that time.
Person fails to be in 'continuous receipt' of an income support payment or ceases to be eligible for the CSHC for a period	Person transitions directly from one income support payment to another (eg a person receiving Carer Payment transfers to Age Pension when they reach Age Pension age).

☑ **FAQ:**

If my client has a grandfathered ABP, holds the CSHC but becomes eligible for Age Pension in the future, will their ABP continue to be grandfathered when determining their Age Pension entitlement?

Answer:

No. Grandfathering is determined separately for CSHC and income support purposes, under two different pieces of legislation. Each requires the individual to have been in receipt of an income support payment (or a CSHC cardholder) both as at 1 January 2015 and to have been in continuous receipt of an income support payment or CSHC (depending on which they were qualified for as at 1 January 2015) since this date. The effective result is that where a person transitions between entitlement to the CSHC and Age Pension (or vice versa), the grandfathering is lost.

1 Income streams paid from an untaxed fund do impact assessment under the income test. This is because these income streams have a taxable untaxed component, and therefore impact ATI.

2 While grandfathering is not lost in these circumstances, it is important to consider the impact on both the deductible amount and income test assessment going forward if the reversionary's life expectancy is used to calculate the DA.

3 The provider will need to seek approval and confirmation from DHS to confirm that grandfathering will not be lost.

Key advice considerations

An adviser's 'best interest' obligation clearly applies to a recommendation concerning an income stream. Generally, where a recommendation that involves the loss of grandfathering is being contemplated it is the case that the recommendation would be in the client's best interest except, perhaps, for the loss of grandfathering. Given that any benefit from grandfathering may be uncertain and, perhaps only prospective, the decision can be difficult.

A loss of grandfathering won't always lead to negative outcomes. In some cases, there will be a valid reason for making a recommendation that will lead to a loss of grandfathering. However, it is important to work through a number of key considerations before providing advice. It will be crucial to run appropriate projections to determine immediate, future and potential implications of a loss of grandfathering to determine the appropriateness of the recommendation.

Below we provide:

- a list of some of the common reasons that an action resulting in a loss of grandfathering may be considered
- a checklist of some key considerations before providing advice that leads to a loss of grandfathering, and
- a more detailed summary of some of these considerations.

Common strategies that will lead to a loss of grandfathering

Some of the most common scenarios that we come across when discussing with advisers the potential implications of a loss of grandfathering are:

- changing pension products due to fee savings
- adding a reversionary death benefit nomination to an existing pension
- winding up an SMSF and commencing a new pension in a public offer fund
- consolidating pension interests, and
- deliberately triggering a loss of grandfathering to gain an income test advantage.

Checklist – key considerations

Some important things to consider and to model where appropriate, are included below. This list is not exhaustive and care should be taken to ensure all potential implications are considered.

<u>Considerations for income support purposes:</u>

☑ Is the client currently income or assets tested?
☑ If assets tested (and therefore no immediate impact), what is the likelihood they will become income tested in the future? Consider future indexation of the lower assets test threshold (will effectively mean more assets can be held before the assets test takes over the income test).
☑ Does the client anticipate any changes to their circumstances in the future? This might include receipt of an inheritance, disposal of their main residence, a change in the income received from another source, significant expenses or an adjustment to the income drawn (or commutations required) from their ABP.
☑ What impact would a future increase in deeming rates have?
☑ Together with potential deeming rate increases, what impact would an increase in the pension account balance have under both income tests?
☑ Where members of a couple, what would be the future impact on a surviving spouse if grandfathering was lost?
☑ Is the client currently drawing above their deductible amount? If so, would income assessment reduce under deeming? This should be worked through with consideration of any future changes to the client's income needs and financial position. It would also be worthwhile considering on an ongoing basis whether or not a better income test outcome could be achieved under deeming.

Considerations for CSHC purposes:

- ☑ What income does the client have from other sources?
- ☑ If the ABP was subject to deeming, how close would the client (couple) be to the income test thresholds?
- ☑ Does the client (or their partner) anticipate any future change to their ATI? Consider things such as future redemptions of investments, which may mean that capital gains become a regular source of income, future employment intentions.
- ☑ What would the impact be if deeming rates increased in the future? Also consider the implications of an increasing account value of the ABP.
- ☑ If advising members of a couple, consider the implications where one member of a couple passes away.4

Client is assets tested – income support purposes

Where the client is assets tested, and based on their asset levels and circumstances, it is likely that they always will be assets tested, it may be the case that they won't actually be impacted by a loss of grandfathering. It is important to consider the client's circumstances not only at the time of providing advice, but also what this might look like in the future.

It is important to consider things such as:

- other sources of income that the client has
- any anticipated future change in the client's income or asset position (for example, an increase or reduction in income from other sources, or significant expenses that may reduce the client's assets and push them into income-tested territory), and
- the impact of the death of one member of a couple on the survivor's position and entitlement.

Where thorough consideration and research indicates that it is unlikely that the client/s would ever become income tested, then a loss of grandfathering may be considered immaterial.

The tables below show the levels of assets at which the assets test takes over the income test in reducing entitlement. These figures are based on the rates and thresholds current as at the date of publication and levels of income and assets at specified levels.

Broadly, the greater a client's total income from other sources, the higher their asset holdings may be before the assets test takes over, based on current deeming rates and asset and income test thresholds.

Table 1: Assuming nil other income and only financial investments held

Relationship status	Point at which assets test takes over (homeowner)	Point at which assets test takes over (non-homeowner)
Single	$281,000	$543,000
Couple combined	$412,000	$672,000

Table 2: Assuming other income of $10,000 and non-deemed assets of $50,000

Relationship status	Point at which assets test takes over (homeowner)	Point at which assets test takes over (non-homeowner)
Single	$300,000	$560,000
Couple combined	$441,000	$690,000

Table 3: Assuming other income of $30,000 and non-deemed assets of $100,000

Relationship status	Point at which assets test takes over (homeowner)	Point at which assets test takes over (non-homeowner)
Single	$397,000	$657,000
Couple combined	$526,000	$787,000

4 Grandfathering will be extended to the reversionary beneficiary where certain conditions are met. See Appendix B.

Future deeming rates and account balance – income support and CSHC purposes

Deeming rates are currently at a historic low. Even if modelling confirms that a loss of grandfathering will not cause an immediate reduction in entitlement under the income test, it is important to consider any future impact of a loss of grandfathering with consideration of variables such as:

- future increases to deeming rates
- fluctuation in the ABP balance and other financial investments, at both current and potentially increased future deeming rates, and
- future increases to income from other sources, which may exacerbate any impact of future deeming rate increases.

Table 4: Deeming rates effective from 1 July 2019

Deeming rate	Single	Couple (includes illness separated)
1%	First $51,800	First $86,200
3%	Above $51,800	Above $86,200

The below table identifies the deemed income from an ABP across different account balances and deeming rates. This is reflected for a situation where:

- both deeming rate and account balances are increasing, and
- where deeming rates increase only, holding steady account balances (to isolate the impact of increasing deeming rates).

Table 5: Deemed income across different account balances and deeming rates

Relationship status	Deeming rates	Total ABP balances	Deemed income	Income from other sources before income tested out[5]
Single	Lower 1% Upper 3%	**$170,000**	$4,064	$48,996
Couple		**$350,000**	$8,776	$72,396
Single	Lower 2% Upper 3.5%	**$170,000**	$5,173	$47,887
Couple		**$350,000**	$10,957	$70,215
Single	Lower 3% Upper 5%	**$170,000**	$7,464	$45,596
Couple		**$350,000**	$15,776	$65,396
Single	Lower 5% Upper 7%[6]	**$170,000**	$10,864	$26,096
Couple		**$350,000**	$22,776	$58,396

5 Ignores Work Bonus, which exempts the first $300 pf of 'Work Bonus income' (income from physical exertion)
6 Historically, these rates are the highest that the deeming rates have been since 1996.

CSHC

Currently, eligibility for the CSHC is determined where income (for CSHC purposes) is less than[7]:

- $55,808 for an individual
- $89,290 for couples, and
- $111,616 for illness separated couples.

The below table provides the amount that could be held in a deemed ABP, at various levels of ATI, without losing entitlement to the CSHC. Remembering that *income is not deemed from any other investments for this purpose,* the table demonstrates that significant amounts may be held in non-grandfathered ABPs before eligibility for the CSHC is lost.

Table 6: Max. amount that could be held in deemed ABP to retain CSHC at different levels of ATI

Relationship status	Deeming rates	Nil ATI	$20,000 ATI	$50,000 ATI	$60,000 ATI
Single	Lower 1% Upper 3%	$1,894,797	$1,228,133	$228,132	N/A
Couple		$3,033,801	$2,367,133	$1,367,133	$1,033,800
Single	Lower 2% Upper 3.5%	$1,616,715	$1,045,286	$188,143	N/A
Couple		$2,588,086	$2,016,657	$1,159,514	$873,800
Single	Lower 3% Upper 5%	$1,136,881	$736,880	$136,880	N/A
Couple		$1,820,281	$1,420,280	$820,280	$620,280
Single	Lower 5% Upper 7%[8]	$812,057	$526,343	$97,771	N/A
Couple		$1,300,200	$1,014,486	$585,913	$443,057

Consider the deductible amount – income support purposes

When providing advice to a client with a grandfathered ABP, it is worth considering whether or not income assessment under the deeming rules would actually provide a more favourable entitlement. This should be considered on an ongoing basis as circumstances change.

In some cases, a client may be drawing an amount from a grandfathered pension that is above the deductible amount. Depending on a range of variables and the individual's circumstances, income assessment for income support means-testing may actually be lower under deeming.

Example 1:

Eliza has an ABP with a current account balance of $150,000 and a DA of $15,000. She also has a defined benefit pension, with assessable income (for Centrelink purposes) of $10,000 pa. She is currently drawing $27,000 pa in income payments. This means that her current income for means-testing purposes is $22,000. This is a total of:

- the assessable income of $10,000 from the defined benefit pension, and
- $12,000 pa attributable to the ABP (being the gross annual income payment in excess of the DA - see Appendix B).

As a result, Eliza is income tested and receives a reduced Age Pension entitlement.

If Eliza's ABP was instead subject to deeming (assuming no other financial investments for simplicity), the deemed annual income from the pension would only be $3,464. This is the amount that would be assessed as income under the income test and the actual annual income payment received would be disregarded. When added to the $10,000 income from the defined benefit pension, her Age Pension entitlement would increase by approximately $4,268 pa (based on rates and thresholds as at the date of publication).

7 Thresholds apply from 20 September 2019 to19 March 2020.

8 Historically, these rates are the highest that the deeming rates have been since 1996.

Example2:
Let's say that Eliza from the previous case study had been drawing more than the annual minimum pension payment for the past couple of years to assist with some medical bills and that her intention is to reduce her annual income payments to $9,000 next financial year. In this case her Age Pension entitlement would be approximately $1,732 higher if the ABP retained the grandfathering assessment. This is because given the DA is $12,000 and the annual income payment would be less than this amount, no income would be assessed from the ABP.

☑ **Advice tip:**
It is not possible to 'opt in' to deeming. Where the deeming rules provide a more favourable outcome for an existing pension, a new pension will need to be commenced (ie a refresh will need to occur).

Net benefit of strategy

As discussed, when providing advice that will lead to a loss of grandfathering, there are a broad range of considerations. Depending on the client's circumstances, modelling is likely to be required to support the recommendation.

While in some cases there may be reasons to support a change in product, or otherwise the commencement of a new pension, it is always important to consider the net benefits of the proposed strategy. Where it is determined that there will be no immediate reduction in entitlements, but that there *could be* an impact in the future, it will be important to weigh up immediate benefits against the likelihood of potential loss of benefits in the future.

For example, where a cheaper pension product is available, but the recommendation would lead to a loss of grandfathering, it will be important to consider whether the fee savings outweigh any loss of entitlement as a result of the loss of grandfathering.

Similarly, when considering the amendment of a reversionary nomination where the provider requires a new pension to be commenced, it is important to weigh up the impact of *not adding* a reversionary nomination, with any loss of benefits.

Case study

John (72) visits his financial adviser for his annual review. His adviser is considering transferring him to a cheaper ABP product. The overall fee is 0.25% less in the new product, otherwise the products are very similar. His adviser needs to consider the implications of a loss of grandfathering for John. The details of his account-based pension are below:

Commencement value	$250,000
Current balance [9]	$314,000
Annual pension payments	$15,700
Deductible amount [10]	$13,007
Annual income assessed for Age Pension	$2,603

9 Assuming that this was also the balance at the prior 1 July for minimum payment standard purposes.
10 It has been assumed that there have not been any commutations from the pension and that the relevant number is 19.22.

The only other assets John owns are a car and home contents, collectively worth $30,000 and a term deposit valued at $30,000. John's fortnightly income for Age Pension purposes is $115.12, which leads to a nil reduction under the income test. The reduction under the asset test is $332.25 pf and therefore John is assets tested.

If John changes products, the:

- income under the income test would be $357.08 pf and the reduction would be $91.54 pf, and
- reduction under the assets test would be unchanged, at $332.25 pf.

Therefore, loss of grandfathering wouldn't have an immediate impact on the client's entitlement. The fee savings available on the other product are currently $30.19 pf (ignoring advice fees). Even if deeming rates increased to 3% and 5% (assuming no indexation of the thresholds for simplicity) deemed income would rise to $619.77 pf and the reduction under the income test would be $222.88 pf.

It seems in this case, assuming no reasonably foreseeable changes to the client's circumstances, the asset test will likely always be the determinant. Also the fee reduction is an ongoing actual benefit whereas any possible negative outcome is both uncertain, in the future, and small.

Contact details

For further information, please contact MLC Technical Services on **1800 645 597.**

Appendix A: Pre and post 1 January 2015 income test assessment of ABP for income support payments

There are two ways an ABP may be assessed under the income test for income support purposes.

Post 1 January 2015

Since 1 January 2015, ABPs have their income determined under the deeming rules. The full account value is added to the value of other financial investments of the person (or couple), with income determined based on the prevailing deeming rates.

Where income is deemed, the actual annual pension payments received by the person are disregarded.

The full value of the account is assessed as an asset.

Pre-1 January 2015 rules and grandfathered accounts

The way in which assessable income (for income support purposes) is determined is based on the 'gross annual income payment', relative to the 'deductible amount' (DA). The DA operates like an income free area.

Where the pre-1 January 2015 rules apply, only actual income payments from the pension that are in excess of the deductible amount are assessed as income for income support purposes. Where actual income payments are less than the deductible amount, then no income is assessed from the ABP.

As is the case for deemed pensions, the actual account value is assessed as an asset under the assets test.

The DA is calculated as follows:

PP – Commutations ÷ RN

Where:

PP = purchase price

Commutations = total commutations over the life of the account

RN = Relevant Number which is life expectancy at the commencement of the pension.[11]

When does grandfathering apply for income support payment purposes?

For a pension to qualify for grandfathering, the:

- pension must have commenced prior to 1 January 2015, and
- person must have been in continuous receipt of an income support payment since that time.

Note that <u>both</u> conditions must be met, meaning that it is not enough for the ABP to have commenced prior to that date.

<u>Reversionary death benefit pensions</u>

Where:

- an automatic reversionary death benefit nomination exists, and
- the original member qualifies for grandfathering, and
- at the time of the death of the original member, the reversionary beneficiary is also in receipt of an income payment

the grandfathering assessment of the pension will continue in the hands of the deceased.

11 Where a reversionary nomination exists, the RN used is the life expectancy of the younger person. Care should be taken when adding a reversionary beneficiary (where a new ABP need not be started) as this may impact the DA.

Appendix B: Pre and post 1 January 2015 assessment of ABPs for CSHC

Pre-1 January 2015 income test assessment and grandfathered ABPs

Income test

Eligibility for the CSHC is based on an income test only. No assets test applies. The income test for the card is based on **adjusted taxable income** (ATI). As cardholders need to be Age Pension age, this means that grandfathered ABPs paid from a taxed fund don't generate ATI and are therefore exempt from the income test. To qualify for grandfathering, the person:

- must have commenced the ABP prior to 1 January 2015, and
- have been a CSHC holder at this date.

A loss of entitlement to the card after this date will cause a loss of grandfathering, even if entitlement to the card is regained in the future. Similarly, a new pension commenced after this date will be ineligible for grandfathering.

FAQ:

Will grandfathering continue to apply where a person has a CSHC and a grandfathered pension, and becomes eligible for Age Pension?

Answer:

No. Where a person's eligibility shifts to or from the CSHC to an income support payment, any grandfathering will be lost.

Post-1 January 2015 assessment

Where a pension is not grandfathered, deemed income from the pension will be added to any ATI. Deemed income will ONLY be calculated on any non-grandfathered ABPs. Other investments that are considered to be 'financial investments' for income support payment purposes are not deemed for this purpose.

FAQ:

Where one member of a couple is a CSHC holder, and their younger spouse is not yet eligible for the card due to age, how is the ABP of the younger spouse assessed when determining eligibility for the older member of the couple?

Answer:

Grandfathering status is determined based on the account holder's entitlement to the CSHC. That is, if the younger member of a couple had an ABP on 1 January 2015, but only the older member of the couple was a cardholder on this date, the younger partner's ABP will not be grandfathered and would be subject to deeming.

However, if the younger member of the couple is aged <60, the pension would already be captured under the income test under the ATI definition (as the taxable component of ABP payments results in assessable income). Once the younger member of the couple reaches 60, the ABP would be subject to deeming.

FAQ:

Should I recommend commuting an ABP back to accumulation to avoid assessment for the CSHC?

Answer*:*

Super accumulation accounts will not impact entitlement to the CSHC. This is because account earnings are not included as ATI for the individual[12], and they are not subject to deeming. However, tax is payable on investment earnings at up to 15%, compared to a retirement phase ABP, where income within the fund is tax free.

It is very difficult – if not impossible – to accurately quantify in dollar terms, the financial benefit of holding the CSHC. Particularly given the nature of the concessions provided, the financial benefit of holding the card in any year may vary (for example as medical expenses fluctuate).

12 Care should be taken when making lump sum withdrawals from accumulation where one member of the couple is aged <60 as this will impact the ATI of that member of the couple (where the lump sum comprises of a taxable component, even where the low rate cap is utilised).

Appendix C: Definitions

Income support payment means a:

- social security benefit or social security pension (see below)
- job search allowance
- youth training allowance
- service pension, or
- income support supplement.

Social security benefit includes:

- Widow Allowance
- Youth Allowance
- Austudy Payment
- Newstart Allowance
- Sickness Allowance
- Special Benefit
- Partner Allowance
- Partner Parenting Payment, and
- Parenting Allowance.

Social security pension includes:

- Age Pension
- Disability Support Pension
- Wife Pension
- Carer Payment
- Single Parenting Payment
- Bereavement Allowance
- Widow B Pension, and
- Special Needs Pension.