Understanding account-based pensions

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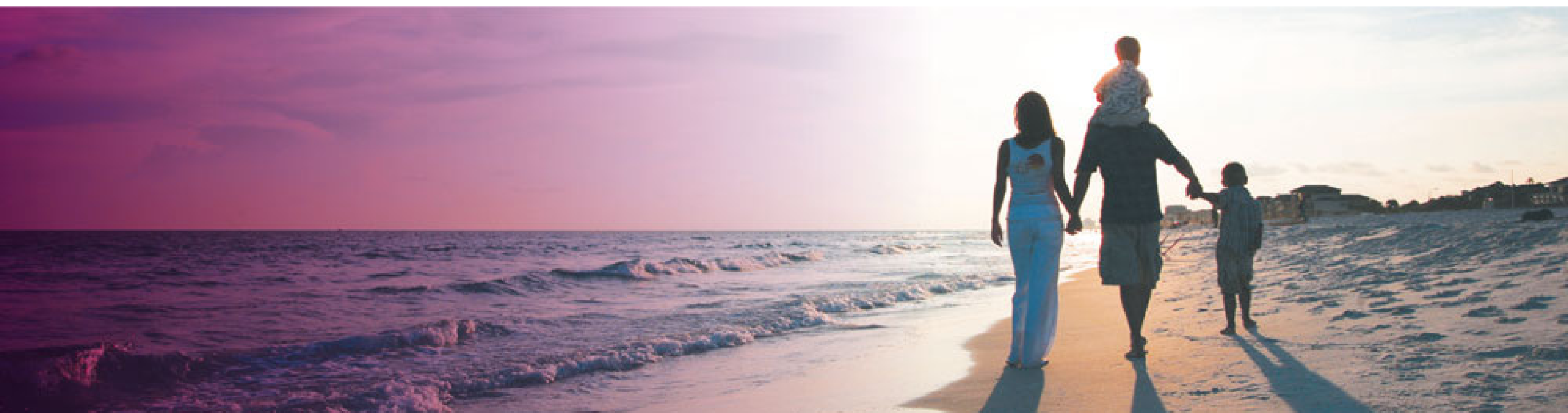

An account-based pension is a flexible tax-effective retirement income stream that represents the income phase of superannuation.

Account-based pensions provide flexible income payments and the choice of investment options. The value of the pension depends upon the investment returns of the investment options selected and the amount of income withdrawn each year. As a result, there are no guarantees of how long your account-based pension will last.

How to purchase an account based pension

Account-based pensions can only be purchased with superannuation money upon meeting a condition of release. The superannuation fund provides you with money which can be used to provide you with a regular income stream and the option of lump sum withdrawals (if allowable).

Taking an income stream from your superannuation fund generates tax benefits over the life of the pension. For persons age 60 or older, the income payments will be tax-free. For persons under age 60, a portion of the income payments will be tax free according to the amount of tax-free component, with a 15% tax rebate available to partially/wholly offset tax on the taxable portion of the income payment. Fund earnings and realised capital gains in an account-based pension fund are not taxed.

Features

Account-based pensions provide the investor with various options. These include income levels that can be varied from year to year. A minimum percentage is required to be drawn down (dependent upon your age).

The table below shows the minimum factors for account-based pensions.

Age of beneficiary	Minimum drawdown percentage
Under 65	4%
65 – 74	5%
75 – 79	6%
80 – 84	7%
85 – 89	9%
90 – 94	11%
95 and over	14%

Other features of an account-based pension are:

- 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 investment options available, and can switch between options if the need arises; lump sum withdrawals are generally possible (unless a transition to retirement account-based pension) although these may attract lump sum tax for persons under age 60

- Provision for dependants – on your death you can have the account-based pension account balance paid to your dependants or estate. Alternatively, you can elect (at commencement) to have reversionary pension payments continue to a dependant (generally your spouse). Reversionary pensions continue to pay a surviving reversionary pensioner upon the death of the original pensioner.

Transition to retirement option

A transition to retirement pension (TTR pension) allows older workers to transition into retirement by accessing a superannuation pension.

It is possible for people who have reached their superannuation preservation age (currently 55) to access benefits in the form of a restricted income stream (no lump sum withdrawals allowed) before a full condition of release is met.

The minimum annual pension payable from a TTR pension is 4% of the account balance with the maximum payment being 10%. The minimum and maximum pension limits are calculated at the beginning of the financial year (or when the pension commenced if in the first year).

Once a full condition of release has been met, no maximum pension limit applies and lump sum withdrawals are allowed.

All other characteristics of a TTR account-based pension remain the same as a regular account-based pension.

Tax concessions available

Deferral of lump sum tax

Some lump sum withdrawals for individuals under age 60 will incur lump sum tax. If you are able to defer taking a lump sum (by receiving pension payments instead) until you reach age 60, no lump sum tax is payable at that time.

Tax-free amount

For persons aged 60 or older, the income will be tax-free. For persons under age 60, the tax-free amount is the percentage of the income payment from the account-based pension that is not subject to tax. The tax-free percentage is calculated by using the following formula:

$$\text{Tax-free percentage} = \frac{\text{tax-free component at commencement of the pension}}{\text{total balance at commencement of pension}}$$

Tax-free amount = tax-free percentage x pension payment

15% tax rebate

A rebate of 15% is applied to the taxable income drawn from your account based pension if you are under age 60. The taxable income is the pension amount drawn less the tax-free amount as outlined above. To qualify, the income recipient must be at least age 55 or older.

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

Rebate = (annual income payments less tax-free amount) x 15%

Risks associated with account based pensions

Taxation and legislative risk

Our information is based on legislative practices of the Australian Taxation Office (ATO) and other relevant government bodies as they presently exist. As with most financially related matters, there is always a legislative risk that provisions may be amended.

Investment values and income payments risk

An account-based pension may contain a mix of cash, capital stable, diversified and specialist funds. The value of units in each fund may rise and fall, in line with the value of underlying assets as determined by market conditions.

Account-based pensions do not guarantee your pension payments will last throughout your lifetime. Essentially, the longevity of your account-based pension is determined by your investment earnings, which are determined by your investment strategy, the income you draw and any lump sum withdrawals you may make. Payments will only continue while there is a balance in the account.

Important note

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