The rebalancing of the assets test

One of the key messages from the 2015 Federal Budget was the need to rebalance the assets test to help make access to government pensions fairer. To do this, the Government legislated to increase the assets test thresholds and the assets test taper rate from 1 January 2017. The legislation to implement these changes received assent on 30 June 2015.

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Increase in the assets test thresholds

The first change to the assets test relates to the thresholds above which a pensioner's entitlement will start to reduce. Subject to the income test, the increase in the assets test full pension thresholds from 1 January 2017 will enable approximately 50,000 part-pensioners to qualify for the full Age Pension under the new rules, according to the Federal Government[1]. Indexing the current assets test thresholds to 1 January 2017, the estimated and legislated thresholds would be as follows:

Table 1: Assets test thresholds at 1 January 2017

Client situation	Current assets test full pension thresholds indexed[1]	New assets test full pension thresholds
Single, homeowner	$210,500	$250,000
Single, non-homeowner	$363,000	$450,000
Couple, homeowner	$298,500	$375,000
Couple, non-homeowner	$451,000	$575,000

Under the new rules, certain pensioners may receive higher Age Pension entitlements:

Table 2: Higher Age Pension entitlements for certain pensioners from 1 January 2017

Client situation	Higher Age Pension until assets reach[2]
Single, homeowner	$289,500
Single, non-homeowner	$537,000
Couple, homeowner	$451,500
Couple, non-homeowner	$699,000

Increase in the taper rate

The other change to the assets test increases the current taper rate from $1.50 per $1,000 to $3 per $1,000. This means that the amount of assets a pensioner can have on top of their family home and still receive a part-pension (assets test upper threshold) will be reduced. The estimated upper thresholds under the current and new rules on 1 January 2017 can be found in Graph 1.

1 Based on Government estimates of assets test full pension thresholds at 1 January 2017 without the new rules http://www.liberal.org.au/latest-news/2015/05/07/fairer-access-more-sustainable-pension

2 Based on estimated rates and thresholds from 1 January 2017 with deeming thresholds assumed to be $50,000 for a single, $83,000 for couples and deeming rates remaining at 1.75% and 3.25%. Actual rates and thresholds are subject to change.

The Government will ensure that anyone who is affected by the scaling back of the assets test upper threshold will be guaranteed eligibility for the Commonwealth Seniors Health Card for those who are above Age Pension age or Health Care Card for those under Age Pension age. The Government has not provided grandfathering for the assets test changes, so clients with assets above the new upper thresholds will lose their part-pensions and become self-funded.

It is interesting to note that the higher taper rate affects homeowners more than non-homeowners and is reflected in the larger proportional drop of the assets test upper threshold. For example, the upper threshold for a single homeowner reduces by about 32% compared with a single non-homeowner which reduces by 22%. This suggests that more homeowners are likely to become self-funded once the new rules are applied, and may start to consider strategies that access equity in the home.

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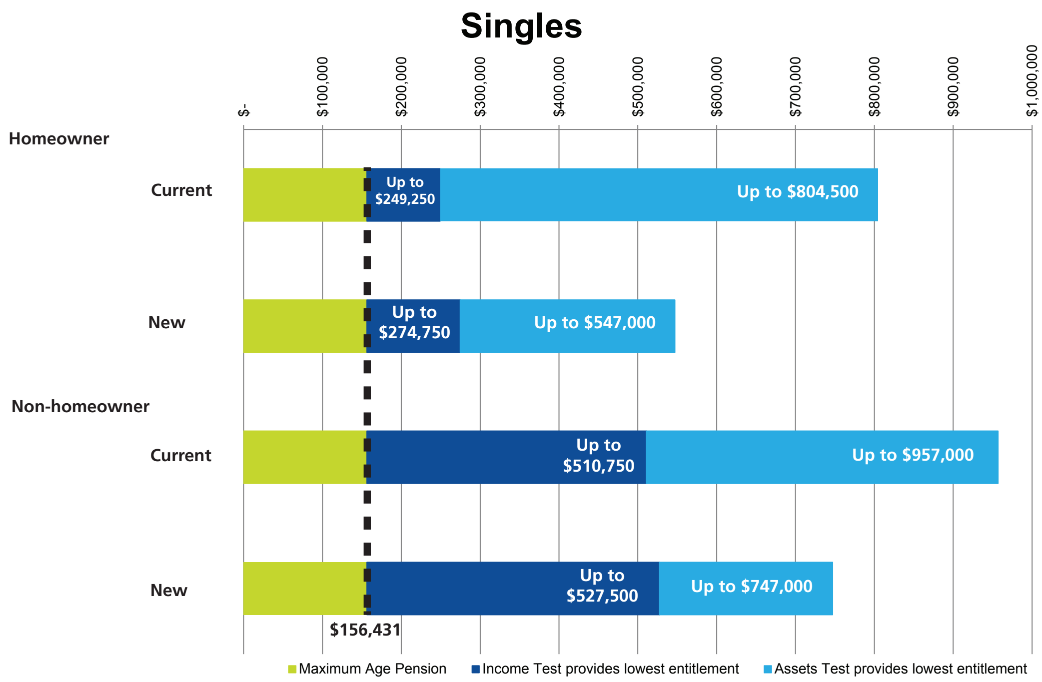
Graph 1: Assets test upper thresholds and assets test crossover points at 1 January 2017[3]



3 Based on estimated rates and thresholds from 1 January 2017 with deeming thresholds assumed to be $50,000 for a single, $83,000 for couples and deeming rates remaining at 1.75% and 3.25%. Actual rates and thresholds are subject to change. All assets are assumed to be deemed financial assets.

Couples

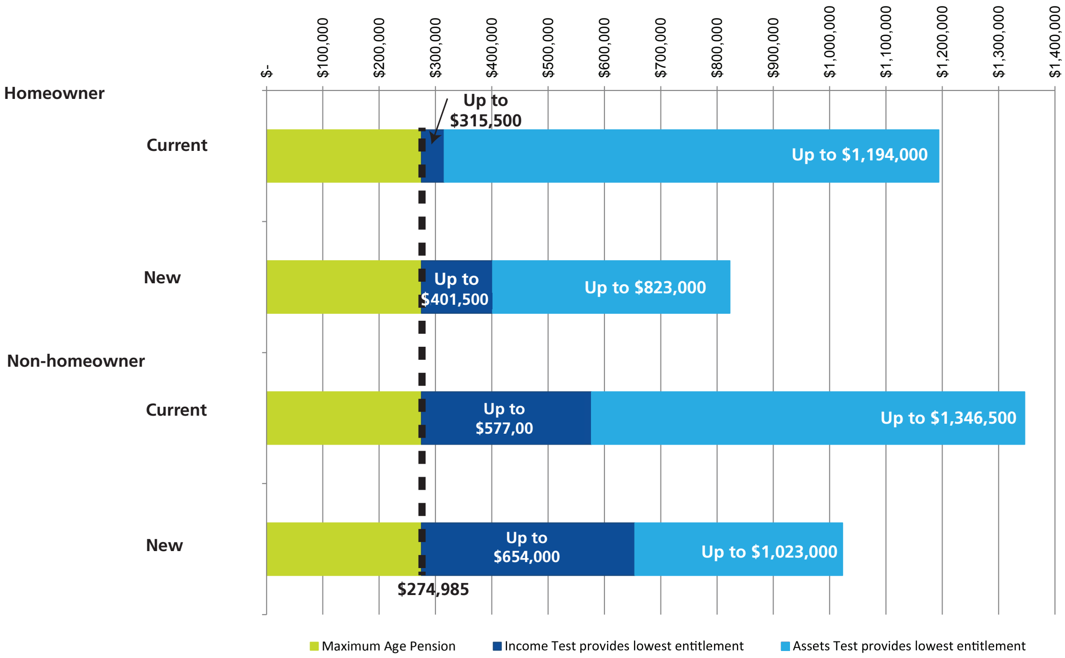


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Table 3: Maximum impact on Age Pension entitlements at 1 January 2017

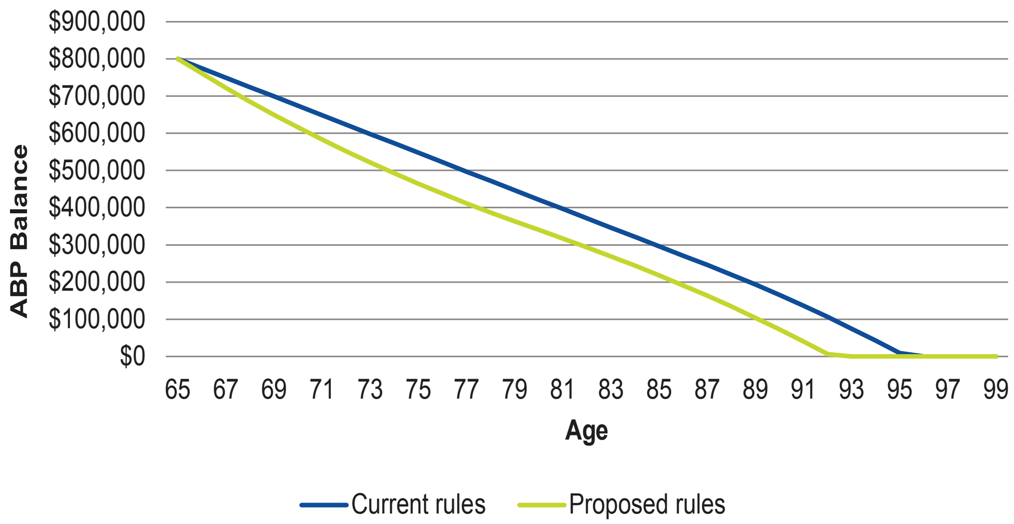
Client situation	Maximum impact on Age Pension
Single, homeowner	$10,042
Single, non-homeowner	$8,190
Couple, homeowner	$14,467
Couple, non-homeowner	$12,615

For example, couple homeowners will be affected the most if they have assets of $823,000 on 1 January 2017. Under the new rules, the couple's Age Pension entitlement at 1 January 2017 would reduce to zero under the assets test. Under the current rules, their Age Pension entitlement at 1 January 2017 would be $14,467[3] per annum. These retirees may need to withdraw more from their retirement capital to maintain their lifestyle.

Case study 1

Sam and Joyce are expecting to retire on 1 January 2017. Between the two of them, they expect to have about $800,000 in superannuation savings and anticipate that they will need income of $70,000 per annum to fund the lifestyle they want. Under the new rules, they would be solely reliant on the Age Pension from age 92 compared to age 95 under the current rules (see Graph 2).

Graph 2: Sam and Joyce's projected account-based pension[4] balances under the current and new rules



Technical impacts

When combined, the changes to the assets test threshold and the assets test taper rate have important technical implications for professionals which are discussed below.

Assets test crossover points

The new rules will change the assets test crossover points from 1 January 2017. The crossover point, which assumes all assets are financial assets, highlights where a pensioner's entitlement changes from being determined by the income test (income tested) to being determined by the assets test (assets tested). Graph 1 summarises the crossover points under the current and new rules, showing a larger change for couples rather than singles.

Widening of the income test zone

The new rules will also widen the income test zone (depicted as the green portion in Graph 1) from 1 January 2017. The income test zone, which assumes all assets are financial assets, highlights where a pensioner's entitlement is determined by the income test. Under the current rules, the gap would be $40,515 ($315,500 - $274,985) for couple homeowners. Under the new rules, the gap will increase to $126,515 ($401,500 - $274,985). This may mean that professionals will see more income tested clients going forward.

4 Assumes Sam's and Joyce's account-based pensions are invested in a 50/50 growth/defensive portfolio that earns 8%/5% net of fees, and inflation is 2.5%. Age Pension calculations are based on estimated rates and thresholds as on 1 January 2017.Assumes $70,000 spend increases annually with inflation and account-based pensions are deemed. Forecast allows for taxation.

Grandfathered account-based pensions

On 1 January this year the Government introduced rules to deem new account-based pensions with grandfathering provisions applying to existing account-based pensions. The assets test changes do not directly impact the grandfathering rules but can still have implications for pensioners who hold a grandfathered income stream. Two important implications for these income streams are:

1. Currently there are situations where it can make sense to have a client's account-based pension deemed instead of retaining its grandfathered status, especially when the client is still asset tested. The widening of the income test zone (see Graph 1) may see some of these clients move from having their Age Pension entitlement determined under the assets test to the income test, potentially reducing their entitlement.

2. The reduced assets test upper threshold may mean that some clients will lose their government pensions and in turn, lose the grandfathered status of their account-based pensions. Although this may not impact those who are asset tested, those who have other income (e.g. defined benefits) and are income tested, may find their Age Pension entitlement affected.

Case study 2

Peter is age 72, single and is a part-pensioner who owns his own home. He has $600,000 in an account-based pension that is not deemed (a grandfathered income stream) for pension purposes and is withdrawing the legislative minimum (with no Centrelink assessable income). He is also receiving a defined benefit from an untaxed scheme of $40,000 per annum (with no deduction amount) and is currently entitled to $4,471 per annum in Age Pension.

Under the new rules, Peter would lose his part-pension as his assets are over the new assets test upper threshold of $547,000. If his circumstances changed and he became eligible for an Age Pension again his account-based pension would then be deemed. For example, if Peter were to spend $100,000 from his account-based pension to renovate his home after 1 January 2017, reducing his assessable assets below the upper threshold, his total assessable income would be $55,500 per annum ($40,000 per annum plus deemed income of $15,500 per annum[5]) which would exceed the income test upper threshold to receive a part-pension.

Helping clients to understand the changes

It is important to consider how the new rules can impact a client, particularly where their Age Pension entitlement is determined under the assets test and/or where they have a grandfathered income stream. For example:

- for every $100,000 over the assets test threshold, a pensioner's entitlement is currently reduced by $3,900 per annum ($100,000/$1,000 x 1.5 x 26), assuming they are assessed under the assets test. Doubling the taper rate will also double the reduction to $7,800 per annum[5] or 7.80%.
- in order to preserve the grandfathered status of an account based income stream, clients must also retain access to the Age Pension. Should this cease then the grandfathered status will be lost.

5 Based on estimated rates and thresholds from 1 January 2017 with deeming thresholds assumed to be $50,000 for a single, $83,000 for couples and deeming rates remaining at 1.75% and 3.25%. Actual rates and thresholds are subject to change.

Where clients are looking at reducing their assets, it is important that this is considered in light of their entire situation and their overall goals. Options they may be considering include:

- gifting within the allowable limits
- purchasing a funeral bond
- superannuation fund contributions on behalf of a spouse who is below the Age Pension age
- bringing forward capital expenditure and home renovations
- purchasing an annuity
- for aged care residents, paying a refundable deposit instead of a daily payment for accommodation

Case study 3

Mary is age 85 and single. She is about to move into an aged care facility that has an advertised accommodation price of $350,000. She has decided to sell her home and after paying the refundable deposit of $350,000, she will have about $650,000 left in the bank. The aged care facility also has a bigger room with better features that has an advertised accommodation price of $450,000. If she decides to pay the additional $100,000 to occupy this room, her assessable assets for Age Pension purposes reduces and her entitlement would increase by $7,800 per annum[5] under the new rules. Depending on the rate of return on any alternative investments for Mary, occupying the bigger room could improve her overall cash flow position as well as providing her with access to additional features that may improve her quality of life. It should be noted that although the changes only affect the assets test, the changes may mean that a larger portion of pensioners will be assessed under the income test. Where this occurs, an option may be to invest in long-term annuities (which are not account-based), which continue to be assessed based on the deduction amount and not deemed.

Conclusion

The potential impact of the changes to the assets test now legislated reaffirm the need for ongoing assistance for SMSF trustees in the years leading up to and during retirement. This article highlights the importance of helping clients understand how the changes can affect them and the impact on their overall retirement objectives. Communicating these changes gives professionals an opportunity to demonstrate the value they can provide clients in retirement.

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