LORREQUER
Wealth & Advisory

Annuities

An annuity is a product that provides you with a guaranteed income for either a set term; your life expectancy or the rest of your life – generally they are a secure option providing a set income irrespective of how investment markets perform. It is possible to nominate the amount of capital to be returned at the end of the fixed term or upon death. This is called the residual capital value (RCV) and cannot exceed the purchase price.

Benefits

- You are paid a guaranteed income regardless of how markets perform.
- Income from annuities purchased with super money are tax free from age 60.
- Annuities purchased with super money before age 60 will have the taxable portion of the income taxed at your marginal tax rate, however, you will receive a 15% offset.
- Only the income component (if any) of an annuity purchased with non-super money is taxable. You don't pay tax on investment earnings.
- Income payments can be set to increase annually at the time the annuity is purchased.

How it works?

You can invest in an annuity from a super fund or life insurance company with a lump sum from your super or other savings. If you're using super money you must have reached your ‘preservation age’ (from age 55 to 60 years depending on your date of birth) and met a ‘condition of release’ such as ceasing employment on or after age 60, or reaching age 65.

How much income will you receive?

The amount of income you receive depends upon two key factors:

1. the initial mount you invest;
2. the amount of interest the annuity is willing to provide – which is determined by an actuary.

The income you will receive is fixed when you purchase the annuity, however it can be indexed each year, either by a fixed percentage or in line with inflation. Income payments can usually be made monthly, quarterly, half-yearly or yearly.

How long do income payments last?

Typically, annuities will be either ‘fixed term’ or ‘lifetime’. Under a ‘fixed term’ annuity, you select the term and payments are for the duration of the term and stop at the end of the term. With a ‘lifetime’ annuity, regular payments are paid for the rest of your life.

What happens to your annuity if you die before the term has finished?

For a fixed term annuity, your estate or beneficiaries generally have the option to either continue to receive payments until the end of the term or withdraw the annuity and

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have it paid as a lump sum however, the withdrawal value may be less than the original amount invested, even after taking into account any payments already received.

If you choose a 'reversionary' option you can nominate a person who will continue to receive all or part of the annuity payments should you die first. You can choose for the reversionary beneficiary to receive a reduced level of income payments from what you received.
For example if you bought an annuity and nominated your spouse as the reversionary beneficiary, they might continue to receive 60% of your income for the rest of their life, after you have passed on.

How are annuities taxed?

When an annuity is bought with money rolled over within the superannuation system by a person aged 60 or over the regular payments are tax free.

For non-superannuation annuities, the regular payments are split into two components:

a. ***Deductible amount***
   The deductible amount is the amount of each annuity payment that is deemed to represent the return of part of the original investment. This amount is tax free. Note: there will be no deductible amount if you have selected a 100% RCV annuity – i.e. where you have elected to receive the full capital value back at the end of the term.

   The deductible amount is calculated based on the gender and age of the investor at the time of investment. It is fixed for the term of the lifetime annuity. If you select a 'reversionary annuity', the annual deductible amount is generally your purchase price, divided by the longer of your or your reversionary beneficiary's life expectancies.

b. ***Assessable amount***
   If annuity payments in the financial year are greater than the deductible amount, the excess amount is called the assessable amount and is assessable for tax purposes. The assessable amount is the amount (if any) of each annuity payment that notionally represents earnings. Depending on the investor's personal circumstances, this amount may be subject to Pay As You Go (PAYG) withholding tax.

How are annuities treated for Centrelink purposes?

The income of an annuity is assessed by the Centrelink and Department of Veteran's Affairs income test as follows:

1. Subject to deeming rates where the term is five years or less, or
2. Total income is reduced by a 'deductible amount' where the term is more than five years.

NOTE: If your life expectancy is equal to or less than five years, the income assessment will be total income reduced by a 'deductible amount'.

The investment amount of an annuity is assessed under the Centrelink and Department of Veteran's Affairs Assets Test. If you choose to receive all of the capital at the end of the selected term, the assessed asset

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value does not change. If you choose to have some of the capital returned as part of the regular payments, the asset value is recalculated every six to 12 months, depending on payment frequency, and reduced by the amount of capital returned up to that time.

Consequences

- If you would like to withdraw capital from your annuity, in some cases you can and you will receive a 'withdrawal value' from your investment but you may receive back less than you invested originally and less than you would have received had you held the annuity for its agreed term.
- With many lifetime annuities, a withdrawal value is only available for a set number of years of the annuity – say for the first 15 years of the annuity term. This is often referred to as a "guarantee period' or 'withdrawal period'. After that, you cannot withdraw your money and, if you pass away after the Guarantee period, there is no return of capital - your money goes to the annuity provider.
- You cannot choose how your money is invested.
- You may not be able to transfer it somewhere else if you change your mind.
- Over the long term, an annuity may pay less than a market-linked investment.
- Inflation will eat into the return from an annuity, which means that each year it will buy less, unless you choose an 'indexed' option.
- If purchased with superannuation money, the reversionary annuitant must be a 'dependant' person.
- For Centrelink purposes the gross income less the return of capital is assessable. If you choose a 'reversionary' annuity,
- Annuities purchased with superannuation money will be counted against the $1.6 million transfer cap. The taxation of payments to you may be impacted if you have superannuation income streams that exceed the transfer balance cap and are unable to lower your superannuation income streams below the cap threshold.
- With an annuity, you are locked in to a specific rate of return for the rest of the term (or life). If interest rates rise, you are not able to take advantage of the higher potential return without incurring penalties.
- Once the annuity is established, the amount and frequency of the income payments cannot be altered.

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