WHAT IS

An annuity?

Annuities are designed to provide a guaranteed regular income for life, or for a chosen investment term, typically during retirement. Long-term annuities can help address longevity risk (the chances of you outliving your savings) and help diversify your portfolio.

How do they work?

An annuity is a contract between you and an insurance company where the lump sum you have invested is converted into guaranteed regular payments.

There are broadly two types of annuities, depending on the payment term chosen.

Lifetime annuity	Term annuity
• Regular payments for your lifetime and/or your spouse's lifetime, if chosen. • Annuity payments can start immediately or, for deferred annuities, on a future date you choose. • Can pay a lump sum death benefit to family or estate within a known withdrawal period.	• Regular payments for a fixed term of your choosing. • You can chose to have your investment repaid at the end of the fixed term or have some or all of it repaid throughout the fixed term as part of your regular payments.

An annuity can be customised with several features, including:

- **Start date** – you can purchase an immediate annuity where payments start right away. You can also choose a deferred annuity where payments start at a specific future date.
- **Payment term** – payments can be made for a set term or your lifetime or that of a reversionary beneficiary you nominate.
- **Payment frequency** – you may be able to choose the frequency of your payments.
- **Access to capital** – if you voluntarily cancel your annuity, you may have access to a portion of your initial capital invested. You can also forego access to capital in return for higher payments.
- **Indexation** – payments can automatically change each year to keep pace with inflation. Some annuities provide market-linked returns where payments automatically increase or decrease in line with the performance

of a basket of investments. Another option is to have your payments linked to the RBA cash rate, where part of your payments automatically increase or decrease in line with the RBA cash rate.

- **Death benefits** – a lump sum may be payable to your estate or nominated beneficiary(ies) depending on the policy terms. Income payments can also automatically continue to be paid a reversionary beneficiary.
- **Withdraw benefits** – some annuities can offer the flexibility to withdraw part of your investment and pay you a lump sum within a specified period
- **Ordinary money / super** – you can use your super or personal savings to purchase an annuity. If you purchase the annuity using super money, payments are tax free if you are age 60 or over.

Your personal goals, objectives and circumstances will determine the type of annuity that is right for you.

Annuities generally appeal to people whose objectives include long-term financial security, stable retirement income, diversification, and in some cases capital preservation.

Taxation

For annuities purchased with super money, payments and lump sum withdrawals are generally tax-free if you are age 60 or over.

For annuities purchased with non-super money, a portion of income payments and lump sum withdrawals may be included in your assessable income for tax purposes and taxed at your marginal tax rate.

If you pass away, a death benefit lump sum (if applicable) can be taxable to beneficiaries, depending on their tax dependant status and whether you purchased your annuity with super or non-super money.

Consider seeking tax advice before purchasing an annuity.

Case study

Amanda is aged 67 and she purchases a $100,000 lifetime annuity using super money rolled over from her accumulation account. As she is over aged 60, her $5,200 annual income payment will be tax free.

For social security, the asset test will assess $60,000 (i.e., 60% of her initial purchase price) until she reaches age 84. Thereafter, $30,000 (30%) will be assessed.

Under the income test, $3,120 (60% of her annual income payment) is assessed in year one. This value will change each year as her regular payments index.

She nominates her daughter, Olivia, as a beneficiary who can receive a death benefit lump sum when she passes away. If Amanda passes away within 10 years, $100,000 is payable as a death benefit lump sum to Olivia. From year 11 onwards, the death benefit lump sum will gradually decrease each year and no death benefit lump sum is payable after year 20.

She has also chosen to index her income payments to the Consumer Price Index (CPI) to ensure her regular payments keep pace with the rising cost of living. As a result, on the anniversary date of when she commenced her annuity, her regular payment will change by CPI.

WHAT IS

An annuity?

Social security assessment

There are limits on the amount of assets you can have to be eligible for the age pension. Limits also apply to the amount of income you can earn to be eligible for the age pension under the income test.

The table below summarises how an annuity can be assessed for social security purposes depending on the type of annuity purchased and the product features chosen.

Social security treatment of an annuity	Short-term	Long-term	Lifetime
Description	A term annuity payable for less than 5 years and does not satisfy the conditions of a 'long term' annuity.	A term annuity that meets any of the following: • payable for 5 years or more, or, • if the term is less than 5 years, that it is greater than your life expectancy, or • an annuity payable for your lifetime, purchased before 1 July 2019. Refer to Australian Government Actuary for life tables.	An annuity payable for your lifetime, purchased after 1 July 2019.
Asset test	A deductible amount reduces the purchase price that is assessed on an ongoing basis.		60% of the purchase price is assessed until age 84, or for at least 5 years. After this, 30% of the purchase price is assessed for the lifetime of the income stream.
Income test	Purchase price after deductible amount is deemed.	Portion of payment above the deductible amount is assessed.	60% of the regular payment is assessed.

The deductible amount will vary depending on the annuity type and features chosen. For more information, visit Services Australia and search 'income streams' at www.servicesaustralia.gov.au

WHAT IS

An annuity?

Things you should know before starting an annuity

- You cannot alter product features of your annuity once it has commenced.
- The amount you can invest in an annuity with super money is limited by the transfer balance cap. Currently the general transfer balance cap is $1.9 million (for 2024/25).Your annuity may not form part of your estate.
- If your annuity is purchased with super money, beneficiaries who are not financially dependent on you at the time of your passing may pay tax on the lump sum they receive when you die.
- These products are designed to be held until maturity.
- Consider your personal circumstances and/or speak to a financial adviser before purchasing an annuity.

Please note, due to indexation the Total Super Balance cap will increase to $2,000,000 from 1 July 2025.

Pros

- Reliable income for a selected term or your lifetime.
- If you are worried about outliving your savings (longevity risk), a lifetime annuity helps to provide a guaranteed income stream for life.
- Income payments are tax free if you invest with super money and are aged 60 or over.
- Only the income component of an annuity purchased with non-super money counts as assessable income for tax purposes.
- You do not pay tax on the underlying investment earnings of an annuity.
- Indexed annuities can help protect you from the rising costs of living.
- A lump sum residual capital value can be paid to you at the end of a fixed term annuity.
- You can nominate a loved one or dependent as a reversionary beneficiary, meaning they will continue to receive income after you pass away.
- The assets and income test assessment of some annuities can improve your social security entitlements.

Cons

- Your money is generally locked away.
- If you cancel your annuity, you may receive less back than you invested, even after taking into account the regular payments you have received.
- Extra features have a cost – opting for indexed payments or a residual value returned to you when the annuity matures at the end of the term could mean the value of your regular payments are initially lower compared to if you had chosen no indexation with no residual value.
- Your beneficiary(ies) may pay tax on the death benefit received.
- The nature of an annuity can mean it is backed by very conservative investments. As a result, the rate of return may be lower compared to riskier investments such as shares.