Appendix 11

Pension income and assets test arrangements

Introduction

1.1 This appendix summarises the provisions of the income test and assets test, and their impact on the availability of the age pension. It is based on Attachment D of the submission of FACS to the inquiry.[1]

The income and asset tests

1.2 Income and assets tests (collectively referred to as the 'means test') work together to target pension payments to those most in need of assistance, and to ensure that the pension system remains affordable for Australian taxpayers. The means test also helps to reinforce the message that people are expected, where possible, to use their own resources before calling on the community for support.

1.3 The rate of pension payable to an individual is calculated under both the income test and the assets test. Payment is made under the test that provides the lower rate of pension.

1.4 People can have substantial income and assets before there is any effect on their pension. These "free areas" are indexed each July in line with cost of living increases.

1.5 Income and assets above these "free areas" reduce pension payments. Reduction rates are set to strike a balance between targeting the pension to those most in need and ensuring that people are better off from self-provision. The following tables set out the income test and assets test free areas and reduction rates as at 1 July 2002.

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1 *Submission* 79, FACS, Attachment D.

Table: The income test

Family situation	Maximum pension is payable under income test if assessed income does not exceed	No pension is payable under income test if assessed income reaches
Single pensioner	$116 per fortnight	$1,185 per fortnight
Pensioner couple (combined)	$204 per fortnight	$1,979 per fortnight
The rate of pension is reduced by 40 cents for every dollar of income over the free area threshold amounts.		

Table: The assets test

Family situation	Maximum pension is payable under assets test if assessable assets do not exceed	No pension is payable under assets test if assessable assets reach
Single homeowner	$145,250	$288,000
Single non-homeowner	$249,750	$392,500
Partnered homeowner (combined)	$206,500	$443,500
Partnered non-homeowner (combined)	$311,000	$548,000
The rate of pension is reduced by $3 per fortnight for every $1,000 of assessable assets above the free area amounts.		

1.6 The maximum amounts of income and assets that people can have and still receive a pension payment have increased substantially in recent years, as a result of indexation arrangements and also the July 2000 one-off liberalisation of the income test and assets test as part of *A New Tax System* arrangements. The July 2000 liberalisation reduced the maximum rate at which pension is withdrawn under the income test from 50 cents per dollar of assessed income to 40 cents per dollar. This meant that from July 2000 there was a substantial increase in the amount of income people could earn and still be paid some pension (for a single person, this amount increased by around $6,000 a year).

1.7 As noted earlier, 33.5 per cent of age pensioners receive a reduced pension because of their income or assets. Of age pensioners granted in the last 12 months, 51.8 per cent received a full rate pension and 48.2 per cent received a part rate pension. This suggests that people recently moving on to the age pension have, on average, higher levels of income and / or assets that the total group of people currently on age pension, some of whom have been receiving the pension for many years.

Means test policy principles

1.8 While the income and assets tests target payments to those most in need, these tests must also provide incentives for self-provision. The means test should encourage pre-retirement accumulation of private savings (including through superannuation), because higher pre-retirement accumulations should translate into increases in retirement incomes. The means test should also encourage people to maximise their total post retirement income (comprising private income and income support) rather than maximise their age pension payments in isolation.

1.9 A number of means test policy settings support the achievement of these outcomes.

a) Firstly, the means test free areas and withdrawal rates ensure that people are better off from self-provision, even if the additional assets or income causes some reduction in pension.

b) Secondly, the assets test is an important measure in encouraging customers to maximise their total income. This is because the assets test reduces the income support paid to customers with substantial assets that produce little or no income. Hence the assets test encourages better utilisation of assets. More broadly, the assets test reflects the principle that customers with non-home assets of high value should not be able to draw on the limited public funds available for social security expenditures.

c) Thirdly, the income test deeming rules further encourage customers to use their savings to produce market-related levels of income. Under these rules, savings placed in financial investments such as bank accounts, term deposits, and shares are deemed to earn market-related rates of income, irrespective of the actual income from the investments. Before the deeming rules were introduced, many pensioners elected to place their savings in no income or low-income investments, in order to maximise their pension. While increasing incentives for self-provision, the deeming rules also considerably simplified the income test.

d) Fourthly, the means test also contains "deprivation" rules that act as a disincentive for customers to gift, or give away, assets that they could use for self-provision. Under these rules amounts gifted in excess of \$10,000 per year (or \$30,000 over 5 years) are taken into account under the income test and the assets test.

Means test treatment of superannuation

1.10 Accumulation phase superannuation (superannuation that has not been drawn on and is not being used to generate an income stream) is exempt from the income test and the assets test until a person is of age pension age. It is then assessed under both the income and assets tests. This reflects the principle that superannuation should be used to provide income in retirement.

1.11 Superannuation can generally be drawn on retirement after age 55, and this means that most people have made decisions about how to draw on their superannuation before they reach age pension age. These decisions determine the extent to which their accumulated superannuation affects their income support entitlements (both before age pension age and from age pension age).

1.12 Superannuation may be taken in lump sum form or via an income stream. The social security means test implications follow:

- the extent to which superannuation taken as a lump sum results in assessable income or assets depends on the way in which the lump sum is used. For example, if the proceeds are invested in assets such as shares and managed investments, then these are assessed under the means test, and pension reductions can result. To the extent that the proceeds are used for expenditure on the home (an exempt asset) or on lifestyle spending (eg travel) there can be no impact on pension entitlements; and
- where superannuation is used to purchase an income stream, the income stream is assessable under the means test. (The form of the means test rules that apply depend upon the characteristics of the income stream.)

1.13 The Government has encouraged greater take-up of income streams by providing an assets test concession where the customer has given up access to capital in return for an income stream payable for life (or for life expectancy).

Assessable income for the income test

1.14 The intention of the social security definition of income is to capture a broad range of incoming amounts. “Income” is defined in the legislation as meaning “an income amount earned, derived or received by the person for the person’s own use or benefit”. The reason for such a broad definition is that social security income support payments are intended as a to assist those in need, which is measured by assessing the resources available to the person for their own support. Consequently, very few types of income are excluded. There are also special rules for assessing income from some sources, for example financial investments. Some of the most common types of assessable income include:

- deemed income from financial investments (refer below for more information);
- gross income from wages and salaries (including fringe benefits);
- net income from rental property and businesses (including farms);
- family trust distributions and dividends from private company shares; and
- income from income stream products such as annuities and allocated products.

1.15 Deeming rules are used to assess a pensioner’s income from financial investments. Under these rules, as at 1 July 2002 a deeming rate of 2.5 per cent applies for the first:

- $34,400 of total financial assets held by a single pensioner; and

- $57,400 of total combined financial assets held by a couple where at least one member is a pensioner.

1.16 A deeming rate of four per cent applies to amounts above these thresholds.

1.17 The actual income from financial investments is not assessed. If a person's financial assets earn higher income than the deemed rates, the extra income earned above the deeming rate is not counted as income.

1.18 Financial investments include bank, building society and credit union accounts, term deposits, loans and debentures, managed investments, listed shares and assets tested income streams (short term). Financial investments also include "accumulation phase" superannuation investments held by social security customers over age pension age.

1.19 These deeming rules were introduced in 1996 after an independent review of the income and assets tests. Consultations with pensioners and pensioner organisations had indicated major concerns about the complexity of the previous income test rules for financial investments, and about the frequent changes they caused to pension payments. The deeming rules are a simple and fair way of assessing income from financial investments, because they treat all types of financial investments in the same way. They also increase incentives for self-provision.

1.20 The deeming thresholds (the maximum amount of financial investments that is assessed at the lower deeming rate) are also indexed to increases in the Consumer Price Index in July each year.

Assessable assets for the assets test

1.21 Some of the most common types of assessable assets are:

- bank, building society or credit union accounts, term deposits, bonds, debentures, shares, property trusts, and managed investments;
- income stream products that do not meet all the characteristics for assets test exemption (refer section on means test treatment of income streams);
- household contents and personal effects;
- motor vehicles, boats and caravans (not used as homes);
- the value of real estate (e.g. a holiday home or a bush block);
- the refundable amount of an accommodation bond paid on entry to an aged care home;
- the value of businesses and farms, including goodwill; and
- superannuation investments from which an income stream has not been drawn (investments such as approved deposit funds) held by social security customers over age pension age.

1.22 The principal home is exempt from the assets test.

1.23 Gifted assets over a $10,000 limit in any year (or over $30,000 over five years) are assessed as an asset for five years from the date of the disposal.

1.24 Pensioners who are assessed under the assets test, and who are in severe financial hardship, may be eligible for extra payment under special hardship provisions if they:

- own an asset that they cannot sell or reasonably be expected to sell; and
- cannot borrow against the asset or reasonably be expected to borrow against it.