

EXPLANATORY STATEMENT

Issued by authority of the Minister for Superannuation, Financial Services and the Digital Economy

Income Tax Assessment Act 1997

Retirement Savings Accounts Act 1997

Superannuation Industry (Supervision) Act 1993

Treasury Laws Amendment (Allowing Commutation of Certain Income Streams) Regulations 2022

The *Income Tax Assessment Act 1997* (Income Tax Act), *Retirement Savings Accounts Act 1997* (Retirement Savings Act), and the *Superannuation Industry (Supervision) Act 1993* (Superannuation Industry Act) provide for the regulation and governance of taxation, retirement savings and superannuation respectively.

Section 909-1 of the Income Tax Act, section 200 of the Retirement Savings Act and section 353 of the Superannuation Industry Act provides that the Governor-General may make regulations prescribing matters required or permitted by those Acts to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to those Acts.

The purpose of the *Treasury Laws Amendment (Allowing Commutation of Certain Income Streams) Regulations 2022* (the Regulations) is to make minor and technical amendments in the Treasury portfolio to laws relating to superannuation.

Minor and technical amendments are periodically made to Treasury legislation to remove anomalies, update references, correct unintended outcomes and improve the quality of laws. The amendments are part of the Government's commitment to the care and maintenance of Treasury portfolio legislation. The process was first supported by a recommendation of the 2008 Tax Design Review Panel, which considered ways to improve the quality of tax law changes. It has since been expanded to all Treasury legislation.

The Regulations amend three Treasury portfolio regulations to make minor and technical changes that address unintended outcomes arising from the inability of recipients of certain non-capped defined benefit income streams (that were commenced on or after 1 July 2017) to address excess transfer balance amounts. These changes ensure that the relevant regulations operate as intended. Details of the Regulations are set out in Attachment A.

The Regulations apply to the *Income Tax Assessment (1997 Act) Regulations 2021*, *Retirement Savings Accounts Regulations 1997*, *Superannuation Industry (Supervision) Regulations 1994* from the day after this instrument is registered.

Public consultation on the Regulations was undertaken from 2 December 2021 to 15 December 2021. Minor and technical changes were made in response to submissions on the Regulations.

The submissions also highlighted the need for further consequential amendments to legislation to ensure commutations that result from these amendments do not result in the loss of asset test exempt status for veterans and social security entitlements, and some other matters outside the scope of these amendments.

The Office of Best Practice Regulation has confirmed that a Regulation Impact Statement is not required. OBPR reference number OBPR ID 44387.

The Authorising Acts specify no conditions that need to be met before the power to make the Regulations may be exercised.

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

The only legal effect of the Regulations is to amend or repeal one or more other legislative instruments without making any application, saving or transitional provisions relating to the amendment or repeal. In accordance with section 48A of the *Legislation Act 2003*, if the Regulations are not disallowed, the Regulations will automatically repeal when the disallowance period ends. For this reason, the sunset regime set out in Part 4 of Chapter 3 of the *Legislation Act 2003* is not relevant in relation to these Regulations.

The Regulations commence the day after registration.

Details of the Treasury Laws Amendment (Allowing Commutation of Certain Income Streams) Regulations 2022

Section 1 – Name of the Regulations

This section provides that the name of the Regulations is the *Treasury Laws Amendment (Allowing Commutation of Certain Income Streams) Regulations 2022* (the Regulations).

Section 2 - Commencement

The Regulations commence on the day after the instrument is registered on the Federal Register of Legislation.

Section 3 - Authority

This section states the Regulations are made under:

- *Income Tax Assessment Act 1997*;
- *Retirement Savings Accounts Act 1997*; and
- *Superannuation Industry (Supervision) Act 1993*.

Section 4 – Schedule

This section provides that each instrument that is specified in the Schedule to this instrument will be amended or repealed as set out in the applicable items in the Schedule, and any other item in the Schedule to this instrument has effect according to its terms.

Schedule 1 – Amendments

Amendments to commutation rules

Commutation is the process of converting a superannuation income stream into a lump sum. Items 3 to 5, 8 to 11 and 14 to 19 add exceptions to the commutation rules in the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) and the *Retirement Savings Account Regulations 1997* (RSA Regulations).

The exceptions allow commutations to occur to comply with commutation authorities. The commutation authorities would require recipients to address excess amounts above the transfer balance cap for certain products specified in the table in subsection 294-130(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) namely, life expectancy pensions, life expectancy annuities, market linked pensions and market linked annuities (affected products). Previously, the exceptions contained in the SIS Regulations and the RSA Regulations did not permit for such commutations to occur. As such, retirement phase recipients of affected products were not able to address any existing excess transfer balance and were therefore unable to comply with transfer balance cap rules.

The exceptions rectify this problem by enabling recipients of affected products that were commenced on or after 1 July 2017 to undertake commutations to resolve excess

transfer balance amounts. Individuals who were previously recipients of a capped defined benefit income stream (including a person who was previously a recipient of a lifetime annuity or lifetime pension) and commuted a lump sum to directly purchase an affected product on or after 1 July 2017 can now commute up to the amount that they are in excess of the transfer balance cap from the commenced income stream. Accordingly, the lump sum that results from commuting the excess transfer balance would reduce a recipient's transfer balance account. Commutation in this instance may only occur in response to a commutation authority that is issued after the Australian Taxation Office has determined the excess transfer balance for the individual.

For the purposes of clarification where a capped defined benefit income stream that was also a lifetime pension or lifetime annuity is commuted into one of the abovementioned affected products the commutation exceptions will apply. However, any conversion of a capped defined benefit income stream into a lifetime pension or annuity will not be covered by these exceptions.

Items 6 to 7 and 12 to 13 provide that total payment amounts to be made in a year to recipients of life expectancy annuities and life expectancy pensions may be varied to allow commutation to address an excess transfer balance. These amendments ensure that funds can reduce annual payment amounts to avoid solvency problems that may arise following commutations which reduce the value of underlying assets which support these income streams.

Item 20 permits the use of a pension valuation factor that exceeds the maximum prescribed in Schedule 1B to the SIS Regulations for a conversion in relation to a commutation to address an excess transfer balance. This amendment ensures that funds can use a higher pension valuation factor to successfully commute a lump sum up to the amount that the member is in excess of the transfer balance cap.

Items 1 and 2 amend the *Income Tax Assessment (1997 Act) Regulations 2021* to ensure that the period in which affected individuals accrue excess transfer balance tax liabilities begins on or after the commencement of the Regulations. This will allow appropriate tax outcomes for these individuals given their prior inability to comply with the transfer balance cap rules.

Specifically, these amendments provide when the transfer balance credit and transfer balance debit arise in relation to calculating the excess transfer balance tax for an individual who commuted from a capped defined benefit income stream and commenced an affected product on or after 1 July 2017. That is:

- An individual's transfer balance credit for a capped defined benefit income stream that they have commuted from normally arises under item 1 in the table in section 294-25(1) of the ITAA 1997 (and this timing is not modified by items 1 or 2 of the Regulations).
- The transfer balance debit, for a commutation from a capped defined benefit income stream, arises immediately after the commencement of Schedule 1 to the Regulations or immediately after the commutation occurs, whichever occurs later. This debit arises prior to the transfer balance credit (for commencing an affected product). The debit value arises once and is determined in accordance with item 1 of the table in subsection 294-80(1) of the ITAA 1997.

- The transfer balance credit, for commencing an affected product, arises after the transfer balance debit (for a full commutation out of a product) so that any excess transfer balance tax liability accrues after the commencement of the Regulations. The credit value arises once and is determined in accordance with item 2 of the table in subsection 294-25(1) of the ITAA 1997.

Example

On 1 July 2018 Steven purchased a market linked pension (the new credit) directly from the underlying account balance lump sum resulting from a commutation of his capped defined benefit income stream (CDBIS) market-linked pension (the debit). As his new market-linked pension commenced after 1 July 2017, it was not classified as a CDBIS for transfer balance cap purposes.

Steven's old market-linked pension was valued on 1 July 2017 at \$2.4 million (this is the old credit, using the transfer balance cap special valuation rules). There was no excess in his transfer balance account at that time because the product was a CDBIS despite a notional excess amount of \$800,000.

Under the Regulations, the debit and credit for this commutation and new commencement will arise in his transfer balance account on the date the Regulations commence. The debit arises prior to the transfer balance credit.

A special value of \$2.1 million is attributed to the commutation of the old CDBIS product for the calculation of Steven's transfer balance account (being the original credit value less total pension payments made before commutation of the old product since 1 July 2017). The underlying account balance when Steven commuted the old CDBIS MLP was \$1.8 million (the new credit).

Steven will then have an excess transfer balance amount that he would have been unable to resolve if it arose before the commencement of the Regulations. This will be \$500,000. This amount uses the old product credit (\$2.4 million) less the commutation debit (\$2.1 million) plus the new product credit (\$1.8 million), less Steven's transfer balance cap of \$1.6 million.

Steven will then receive a determination of his excess transfer balance amount. The excess transfer balance amount on the determination will be the amount that exceeds Steven's personal transfer balance cap and the deemed earnings that accrue after the Regulations commence. Steven will not have accrued any transfer balance credits for deemed earnings between 1 July 2018 and the commencement of the Regulations.

A commutation authority will enable Steven to commute the excess amount as a lump sum from his market-linked pension to an account in the accumulation phase, where it can be retained or be paid out as a lump sum.

For the purposes of clarification these amendments do not apply to CDBIS products subject to a successor fund transfer (SFT). Such products remain a CDBIS for transfer balance cap purposes before and after the SFT, which precludes them from being affected by the excess transfer balance cap issues that are being addressed by these amendments.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Treasury Laws Amendment (Allowing Commutation of Certain Income Streams) Regulations 2022

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The *Treasury Laws Amendment (Allowing Commutation of Certain Income Streams) Regulations 2022* provides for certain income streams to commute for the purposes of meeting the transfer balance cap. The Regulations amend the *Income Tax Assessment (1997 Act) Regulations 2021*, *Retirement Savings Accounts Regulations 1997*, and *Superannuation Industry (Supervision) Regulations 1994* to make minor and technical changes that address unintended outcomes arising from the inability of recipients of certain income streams (that were commenced on or after 1 July 2017) to address excess transfer balance amounts.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.