EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer and Minister for Financial Services

Income Tax Assessment Act 1997

Income Tax Assessment (1997 Act) Regulations 2021

Section 909-1 of the *Income Tax Assessment Act 1997* (the ITAA 1997) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Subsection 294-25(3) of the ITAA 1997 provides that the regulations may provide that an item of the table in subsection (1) does not apply to a class of *superannuation income streams specified in the regulations. Item 5 of the table at subsection 294-25(1) also provides for a transfer balance credit to arise under regulations made for the purpose of the item, of an amount worked out in accordance with the regulations and at the time specified in the regulations.

The purpose of the *Income Tax Assessment Amendment (Superannuation) Regulations 2024* (the Instrument) is to, from commencement, remove the potential for recipients of capped defined benefit income streams (CDBISs) to have their transfer balances impacted by involuntary fund transfers.

Currently, a successor fund transfer (SFT) is the way that most mergers between superannuation funds are undertaken. An SFT involves the transfer of members' superannuation interests from one fund (the transferor fund) to another fund (the successor fund).

Under current provisions, if an individual is a retirement phase recipient of a CDBIS, an SFT results in a debit and a credit to their transfer balance account, as the original superannuation income stream ceases and a new one commences in the successor fund. Currently, the debit and credit could be different amounts, resulting in a net increase or decrease to their transfer balance. In the case of a net increase, this could cause their transfer balance account to exceed their transfer balance cap, which could result in additional taxation or require them to commute funds from a non-CDBIS pension that they hold, or both.

The amendments provide that, when an SFT occurs, the credit that arises in a CDBIS recipient's transfer balance account is equal to the debit that arises. This means that the debit and credit cancel each other out and the SFT has no net impact on the recipient's transfer balance. This puts CDBIS recipients of funds who undergo an SFT in the same net position as if the SFT did not occur.

The amendments apply retrospectively where a CDBIS recipient has been disadvantaged by an SFT that occurred before commencement in relation to their transfer balance. Where a CDBIS recipient has had their transfer balance reduced due to an SFT that occurred

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before commencement, they can retain that benefit and will not be impacted by the amendments in relation to that SFT.

The ITAA 1997 does not specify any conditions that need to be satisfied before the power to make the Regulations may be exercised.

Public consultation occurred over the period from 3 April 2024 to 24 April 2024. Treasury received a total of 20 submissions, including from industry stakeholders and a number of affected individuals. Submissions were highly supportive of the proposed amendments with some concerns raised in relation to the administration of the amendments.

The Instrument is a legislative instrument for the purposes of the *Legislation Act 2003*.

The Instrument is subject to sunsetting.

The Instrument is subject to disallowance.

The Instrument commenced on the day after registration.

While there could theoretically be a reduction in tax receipts from individuals who would otherwise have been pushed up to or beyond their personal transfer balance cap, this reduction in tax receipts is expected to be negligible.

As the amendments are addressing an unintended consequence of the current provisions, by which some CDBIS recipients have been disadvantaged through no action of their own due to an SFT occurring, retrospective application is appropriate. As the amendments can only apply retrospectively to benefit a CDBIS recipient, not to disadvantage a CDBIS recipient, and the amendments do not impose any liability for past actions or omissions, section 12(2) of the *Legislation Act 2003* is not affected.

Details of the Instrument are set out in Attachment A.

A statement of Compatibility with Human Rights is at Attachment B.

The Office of Impact Analysis (OIA) has been consulted (OIA ref: 23-05377) and agreed that an Impact Analysis is not required. The measure is unlikely to have more than a minor impact on compliance costs.

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ATTACHMENT A

Details of the *Income Tax Assessment Amendment (Superannuation) Regulations 2024*

Section 1 – Name

This section provides that the name of the Regulations is the *Income Tax Assessment Amendment (Superannuation) Regulations 2024* (the Instrument).

Section 2 – Commencement

Schedule 1 to the Instrument commenced on the day after the instrument was registered on the Federal Register of Legislation.

Section 3 – Authority

The Instrument is made under the *Income Tax Assessment Act 1997* (the ITAA 1997).

Section 4 – Schedule 1

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

Schedule 1 - Amendments

Current law

Successor fund transfers

Under paragraph 6.29(1) of the Superannuation Industry Supervision Regulations 1994 (SIS Regulations), members' consent is not needed for an SFT. A trustee may only undertake an SFT if the transfer is in the members' best financial interests and the successor fund meets the definition of a 'successor fund' in the SIS Regulations.

A 'successor fund' is defined in subsection 995-1(1) of the ITAA 1997 and subsection 1.03(1) of the SIS Regulations which, in relation to the transfer of a superannuation interest of a member of the transferor fund, requires among other requirements that the successor fund grant equivalent rights to the member that they had with the transferor fund in relation to the interest being transferred.

Capped defined benefit income streams

Capped defined benefit income streams (CDBISs) are defined as those set out in the table in section 294-130 of the ITAA 1997 and those prescribed as CDBISs by the regulations (in 294.130.01 of the Income Tax Assessment (1997 Act) Regulations 2021 (ITAR 2021). Together, this includes certain lifetime pensions, lifetime annuities, life expectancy pensions, life expectancy annuities, market linked pensions, market linked annuities, and market linked pensions for the purposes of the *Retirement Savings Accounts Act 1997* (RSA Act).

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Transfer balance cap

The *Treasury Laws Amendment (Fair and Sustainable Super) Act 2016* introduced a transfer balance cap into the ITAA 1997 applying from 1 July 2017 to limit the amount of superannuation interests supporting an individual's superannuation income streams that are in retirement phase. Section 294-25 of the ITAA 1997 sets out circumstances that result in credits to an individual's transfer balance account, and section 294-80 of the ITAA 1997 sets out when debits arise.

When a recipient's transfer balance cap is exceeded, and they have other non-CDBIS superannuation interests in retirement phase in addition to their CDBIS interests, they may need to commute those other retirement phase interests and pay excess transfer balance tax for any days that their transfer balance cap is exceeded in relation to the non-CDBIS interest.

Credits and debits when an SFT occurs

If an individual is a retirement phase recipient of a superannuation income stream when the fund undertakes an SFT, they will stop receiving benefits from the transferor fund and start receiving benefits from the successor fund. As part of the SFT, because all superannuation income stream benefits cease to be payable from the old stream in the transferor fund, the old stream stops being a superannuation income stream that is in the retirement phase. The recipient will receive a debit into their transfer balance account under Item 6 of the table in subsection 294-80(1) of the ITAA 1997.

When benefits become payable to the recipient under the new income stream from the successor fund, the recipient will start to be the retirement phase recipient of the new superannuation income stream. This means that a transfer balance credit will arise in their transfer balance account under Item 2 of the table in subsection 294-25(1) of the ITAA 1997.

Amount of the debit

The amount of the transfer balance debit that arises as part of an SFT under subsection 294-80(1) of the ITAA 1997 is the value of the superannuation interest just before the stop time as set out in Item 6 of the table in that subsection. For a CDBIS, under subsection 294-145(4) of the ITAA 1997, the value is the debit value set out in subsection 294-145(5) or 294-145(6) depending on the type of pension account.

For transfer balance debits arising under Item 6 of the table in subsection 294-80(1) of the ITAA, both subsections 294-145(5) and 294-145(6) base the debit value on the amount of the transfer balance credit that arose in respect of the commencement of the original income stream, minus amounts for commutations or other relevant debits since that time. If there has been no commutation or relevant debit, the amount of the debit in the transfer balance account will be equal to the amount that was initially credited when the individual became the retirement phase recipient of the superannuation income stream.

For CDBISs that are prescribed by the ITAR 2021, the same calculation is applied through subsection 294-145.01 of the ITAR 2021.

Amount of the credit

The amount of the transfer balance credit that arises as part of an SFT under Item 2 in the table in subsection 294-25(1) of the ITAA 1997 is the value of the superannuation interest that supports the superannuation income stream on the starting day as defined in that item. For a CDBIS, under subsection 294-135(1) of the ITAA 1997, the value is the special

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value of the superannuation interest as set out in subsection 294-135(2) or 294-135(3) of the ITAA 1997, depending on the type of pension account.

Both subsections base the special value on the annual entitlement, which is either multiplied by 16 or multiplied by the remaining term, depending on the pension type. The annual entitlement is based on the amount of the first superannuation income stream benefit the recipient is entitled to receive from the income stream.

For CDBISs that are prescribed by the ITAR 2021, the same calculation is applied through section 294-135.01(1) of the ITAR 2021.

Unintended impacts of SFTs under the current provisions

As set out above, when an SFT occurs, the debit that arises is based on the first payment payable from the income stream in the transferor fund, whereas the credit that arises is based on the first payment payable from the new income stream from the successor fund. Therefore, the credit and debit may be different amounts and the SFT could either increase or reduce the recipient's transfer balance.

For CDBIS recipients who are not subject to an SFT, any increase or decrease to payments over time would usually not affect their transfer balance. On the commencement of a retirement phase superannuation income stream, a transfer balance credit to the value of the income stream is applied to the recipient's transfer balance account. Ordinarily, once a benefit is converted into the retirement phase, there would be no re-assessment of the value of the retirement phase superannuation income stream for the transfer balance cap.

Increases and decreases to payments and value

Lifetime pension and lifetime annuity payments can only decrease in very limited circumstances, such as negative CPI. Most are indexed, so payments and the annual entitlement will increase over time. As the special value for these types of CDBISs is based on the annual entitlement multiplied by 16, the transfer balance credit is likely to be higher than the transfer balance debit when an SFT occurs and recipients of lifetime pensions or lifetime annuities will likely be disadvantaged by an SFT under current provisions.

The situation for other CDBIS types is less clear, as the special value could increase or decrease from one year to another, so the transfer balance credit could be higher or lower than the transfer balance debit that arises when an SFT occurs. For life expectancy pensions and life expectancy annuities, although the annual entitlement will most likely increase over time through indexation, the special value is calculated by multiplying the annual entitlement by the remaining term, which will decrease over time.

Payments under market linked pensions (payable under the SIS Act) and market linked annuities (payable under the RSA Act) can change from year to year to be higher or lower, leading to a higher or lower annual entitlement. The special value is determined based on the annual entitlement multiplied by the remaining term. Each year there will be a smaller remaining term, and the account balance will be impacted by payments already made and investment returns. When returns are strong, payments could increase. The result is that people with CDBISs other than lifetime pensions and lifetime annuities could be advantaged or disadvantaged by SFTs under current provisions with respect to their transfer balance.

<u>New law</u>

The amendments create a new rule for the amount of a credit that arises as part of an SFT. They provide that the credit that arises as part of an SFT is equal to the amount of the debit

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that arises as part of an SFT, so that the two transactions cancel each other out and the SFT has no net impact on a recipient's transfer balance.

Legislative authority for the regulatory amendments

Subsection 294-25(1) of the ITAA 1997 includes a table that sets out circumstances in which a credit to a transfer balance account arises, the amount of the credit, and the timing of the credit. Item 5 of the table provides for a credit to arise in circumstances provided for in regulations made for that purpose, and for the credit to be the amount worked out in accordance with the regulations, and for the credit to arise at the time specified in the regulations.

The amendments make use of table Item 5 to specify circumstances in which a credit will arise (those outlined in new subsection 294-25.03(1)), the amount of the credit (in subsection 294-25.03(2)) and the time that the credit arises (in subsection 294-25.03(3)).

Subsection 294-25(3) of the ITAA 1997 enables the regulations to provide that an item of the table in subsection (1) does not apply to a class of superannuation income streams. Subsection 294-25.03(4) of the amendments uses that power to provide that Item 2 of the table in subsection 294-25(1) of the ITAA 1997 does not apply if the credit arises under section 294-25.03 of the ITAR 2021. This ensures that the new rules for the credit that arises as part of an SFT apply instead of Item 2 of the table. Without subsection 294-25.03(4), there would have been two credits arising when an SFT occurs.

Circumstances in which the credit arises

A credit arises under the amendments when all paragraphs 294-25.03(1)(a) through to (e) are met. This limits the amendments to when a debit arises as part of an SFT.

Under paragraph 294-25.03(1)(a), the amendments only apply to an SFT, which is an involuntary transfer rather than a transfer that the recipient has requested.

The amendments only apply to a CDBIS, not other income streams. This is because the current provisions as they apply to non-CDBIS income streams do not result in a disadvantage for recipients who are subject to an SFT. Transfer balance debits and credits for account-based pensions are based on their account balance so where they arise due to an SFT they will generally cancel each other out, unlike CDBIS which are determined using a formula.

The amendments only apply to an individual who is a retirement phase recipient of the old stream immediately before the transfer. If a member is not in the retirement phase for an income stream when an SFT occurs, no debit or credit would arise as part of the SFT. This is because the requirements of Item 6 of the table in section 294-80(1) of the ITAA 1997 for a debit or Item 2 of the table in subsection 294-25(1) will not be met. An SFT that occurs before the member is a retirement phase recipient of the old stream will have no impact on the member's transfer balance, so the amendments are not needed to apply to that scenario and moreover the amendments should not apply a credit where a credit does not arise under current provisions.

The amendments only apply if a transfer balance debit arises in a recipient's transfer balance account, which ensures that the amendments do not apply a credit in a situation where a debit has not also arisen.

New amount of an SFT credit

Under the amendments, Item 1, new subsection 294-25.03(2), the amount of the credit that arises as part of an SFT is equal to the amount of the debit that arose as part of the SFT.

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Therefore, an SFT has no net impact on a CDBIS recipient's transfer balance because the debit and credit cancel each other out.

Timing of new SFT credit

Under the amendments, Item 1, new subsection 294-25.03(3), the credit arises on the day that the member starts to be the retirement phase recipient of the new stream. This would usually be the same date that the debit arises as part of the SFT, and in any case not before the debit arises.

Reversionary beneficiaries continue to have a 12-month delay before their transfer balance account is credited for becoming the retirement phase recipient of a superannuation income stream. The debit and credit that arise as part of the SFT are the same amount and cancel each other out so that there is no net impact on their transfer balance from the SFT.

Application of amendments

Under Item 2, section 1000-5.01, the amendments apply prospectively to any SFTs that occur on or after commencement.

The amendments also apply retrospectively if two conditions are met. The first condition is that the member started to be the retirement phase recipient of the new stream on or after 1 July 2017. This excludes the amendments from applying to any SFTs that occurred before 1 July 2017. Such SFTs can be disregarded as they would have no impact on a recipient's transfer balance because the SFT would not have resulted in a debit or credit arising. A CDBIS recipient's original transfer balance credit in that scenario would be determined based on the first payment on or after 1 July 2017.

The second condition that has to be met for retrospective application is that the SFT debit is smaller than the SFT credit that would arise under the current provisions, which is the amount of the special value. For prescribed lifetime pensions and annuities, the special value is the annual entitlement multiplied by 16, and for prescribed life expectancy or market linked pensions and annuities, the special value is the annual entitlement multiplied by the remaining term, under section 294-135 of the ITAA 1997.

The second condition ensures that the amendments only apply retrospectively if the SFT resulted in an increase to a recipient's transfer balance. If an SFT before commencement resulted in the same transfer balance, or a reduced transfer balance that potentially benefitted the recipient, then the amendments will not apply to that SFT, and any benefit obtained from the current provisions continues to apply.

The retrospective application applies to credits that arose from SFTs that occurred from 1 July 2017, including when the Income Tax Assessment Regulations 1997 were in force before the ITAR 2021 commenced.

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ATTACHMENT B

Statement of Compatibility with Human Rights

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

Income Tax Assessment Amendment (Superannuation) Regulations 2024

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 purpose of the Legislative Instrument is to, from commencement, remove the potential for recipients of capped defined benefit income streams (CDBISs) to have their transfer balances impacted by involuntary fund transfers.

Currently, a successor fund transfer (SFT) is the way that most mergers between superannuation funds are undertaken. An SFT involves the transfer of members' superannuation interests from one fund (the transferor fund) to another fund (the successor fund).

Under current provisions, if an individual is a retirement phase recipient of a CDBIS, an SFT results in a debit and a credit to their transfer balance account, as the original superannuation income stream ceases and a new one commences in the successor fund. Currently, the debit and credit could be different amounts, resulting in a net increase or decrease to their transfer balance. In the case of a net increase, this could cause their transfer balance account to exceed their transfer balance cap, which could result in additional taxation or require them to commute funds from a non-CDBIS pension that they hold, or both.

The amendments provide that, when an SFT occurs, the credit that arises in a CDBIS recipient's transfer balance account is equal to the debit that arises. This means that the debit and credit cancel each other out and the SFT has no net impact on the recipient's transfer balance. This puts CDBIS recipients of funds who undergo an SFT in the same position as if the SFT did not occur.

The amendments apply retrospectively where a CDBIS recipient has been disadvantaged by an SFT that occurred before commencement in relation to their transfer balance. Where a CDBIS recipient has had their transfer balance reduced due to an SFT that occurred before commencement, they can retain that benefit and will not be impacted by the amendments in relation to that SFT. In this way, the amendments only apply retrospectively if doing so provides an advantage to the member, and not if it would disadvantage a member.

Human rights implications

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

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Conclusion

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

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