

EXPLANATORY STATEMENT

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

Income Tax Assessment Act 1997

Retirement Savings Accounts Act 1997

Superannuation Industry (Supervision) Act 1993

*Treasury Laws Amendment (Legacy Retirement Product Commutations and Reserves)
Regulations 2024*

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

Section 909-1 of the ITAA 1997, section 200 of the RSAA and section 353 of the SISA provide 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 (Legacy Retirement Product Commutations and Reserves) Regulations 2024* is to relax commutation restrictions for a specified range of legacy retirement products and create a more flexible avenue for allocations from superannuation reserves. This will allow individuals to exit products that are no longer suitable for their circumstances, remove barriers that currently prevent the closure of obsolete funds and legacy products, and allow for the allocation of reserves that no longer serve an ongoing purpose. The Regulations apply to legacy lifetime, life expectancy and market-linked superannuation income stream products, which generally commenced prior to 20 September 2007, or commenced as a result of a conversion of an earlier legacy product that commenced prior to that date (legacy products).

Lifetime and life-expectancy products provide significantly less flexibility than more modern account-based income streams in terms of valuation and payments setting. Although market-linked income streams have similarities to account-based income streams, all these legacy products have broadly equivalent commutation restrictions. In practice, this means that the only way to voluntarily exit these products, prior to death or expiry of term, is conversion to another legacy product. If an individual were to commute their legacy product without meeting one of the exceptional circumstances, it would result in tax and regulatory consequences.

The use of reserves is a common feature for some legacy products, namely complying lifetime and life-expectancy pensions and annuities. These products guarantee income for an extended period. This often means some or all of the capital is moved to a reserve at commencement. Unlike account-based products, the actual underlying capital and investment returns held by the fund over the life of the product do not directly correlate to the total payments the member is entitled to. This means that strong investment performance may increase the reserve amount with limited means to distribute it to members.

Under current settings, an allocation from a reserve may be counted towards the receiving members' concessional contributions cap, non-concessional contributions cap, or may be exempt from both caps, depending on the circumstances. A trustee can avoid members having excess contributions consequences by allocating small amounts of the reserve each year through 'fair and reasonable' allocations. The result of these settings is that large unallocated reserves end up being 'stuck' in the superannuation system.

The objective of the Regulations is to address the current restrictions on commutation of legacy pensions and to provide funds with more flexibility for the allocation of reserves.

The Regulations relax commutation restrictions so that legacy products can be exited with the resulting capital used to commence another retirement phase interest, left in an accumulation interest account, or withdrawn from superannuation entirely. The commutation must occur in full and be completed within a designated 5-year grace period beginning on the day the Regulations commence.

The Regulations also provide more flexible pathways to make allocations from a reserve, by providing that where a reserve supported an income stream that is ceased or commuted, and the reserve is allocated to the former recipient of that income stream, it will be exempt from both contribution caps.

The ITAA 1997, RSAA Act and SIS Act do not specify any conditions that need to be satisfied before the power to make the Regulations may be exercised.

Public consultation was undertaken on an exposure draft of the Regulations from 17 September to 8 October 2024. 13 submissions were received from industry representatives and individuals. Following consultation, a number of changes were made to the Regulations and the Explanatory Statement to address stakeholder feedback to ensure that the Regulations are appropriately targeted to achieve the policy intent.

The *Income Tax Assessment (1997 Act) Regulations 2021* (ITA Regulations) are subject to sunseting under section 50 of the *Legislation Act 2003*.

The *Retirement Savings Account Regulations 1997* (RSA Regulations) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) are exempt from sunseting due to the operation of items 56B and 59A, respectively, of the table in regulation 12 of the *Legislation (Exemptions and Other Matters) Regulation 2015*. As outlined in the Explanatory Statement for the *Legislation (Exemptions and Other Matters) Amendment (2018 Measures No. 2) Regulations 2018*, the exemption is appropriate due to the substantial and complex matters that are dealt with by these regulations and the need to provide certainty and a stable framework of superannuation regulation.

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*, and are subject to disallowance.

The Regulations commenced on the day after it is registered.

Details of the Regulations are set out in [Attachment A](#).

A statement of Compatibility with Human Rights is at [Attachment B](#).

The Office of Impact Analysis has been (OIA) has been consulted and agreed that an Impact Analysis was not required.

Details of the *Treasury Laws Amendment (Legacy Retirement Product Commutations and Reserves) Regulations 2024*

Section 1 - Name of Regulations

This section provides that the title of the Regulations is the *Treasury Laws Amendment (Legacy Retirement Product Commutations and Reserves) Regulations 2024*.

Section 2 - Commencement

This section provides that the Regulations commence on the day after it is registered.

Section 3 - Authority

This section provides that the Regulations are made under the *Income Tax Assessment Act 1997 (ITAA)*, the *Retirement Savings Account Act 1997 (RSAA)* and the *Superannuation Industry (Supervision) Act 1993 (SISA)*.

Section 4 - Schedule(s)

This section would provide that each instrument identified in a Schedule to the proposed Regulations will be amended or repealed in accordance with the Regulations.

Schedule 1 – Amendments

Part 1 – Commutation of certain pensions and annuities

Amendments to the Retirement Savings Account Regulations 1997

Items 1 and 2 set out the circumstances in which a market-linked pension can be commuted in full.

Item 2 inserts new section 1.08AA which allows the full commutation of a market-linked pension if the commutation occurs during the 5-year grace period beginning on the day the Regulations commenced.

Amendments to the Superannuation Industry (Supervision) Regulations 1994

Items 3 to 6 set out the circumstances in which certain annuities may be commuted in full.

Item 6 inserts new section 1.05AA which allows the full commutation of certain annuities if the commutation occurs during the 5-year grace period beginning on the day the Regulations commenced. The new commutation rule applies to lifetime, life-expectancy and market-linked annuities covered by the provisions mentioned in items 3 to 5.

Subsection 1.05AA(2) provides that the 5-year grace period for commutation is limited to lifetime annuities purchased by a superannuation fund that is either:

- not a defined benefit fund;
- a self managed superannuation fund (SMSF); or
- was a small APRA-regulated fund (SAF) at the time the benefit commenced to be paid and at all earlier times.

This ensures that all lifetime annuities purchased by an SMSF or SAF are covered by the measure, including historical SMSFs and SAFs that may meet the definition of a defined benefit fund.

Item 3 inserts subparagraph 1.05(2)(f)(iiia) to allow commutations from lifetime annuities under the newly permitted circumstances in section 1.05AA.

Item 4 inserts subparagraph 1.05(9)(h)(via) to allow commutations from life-expectancy annuities under the newly permitted circumstances in section 1.05AA.

Item 5 inserts subparagraph 1.05(10)(d)(iva) to allow commutations from market-linked annuities under the newly permitted circumstances in section 1.05AA.

Items 7 to 10 include the permitted circumstances by which certain income streams may be commuted in full.

Item 10 inserts new section 1.06C which allows the full commutation of certain income stream products if the commutation occurs during the 5-year grace period beginning on the day the Regulations commenced. The new subsection 1.06C(1) lists the income stream products to which the commutation rule applies and includes lifetime, life-expectancy and market-linked pensions.

Subsection 1.06C(2) provides that the 5-year grace period for commutation is limited to income streams provided by a superannuation fund that is either:

- not a defined benefit fund;
- an SMSF; or
- was a SAF at the time the benefit commenced to be paid and at all earlier times.

This ensures that all income streams provided by an SMSF or SAF are covered by the measure, including historical SMSFs and SAFs that may meet the definition of a defined benefit fund.

Item 7 inserts subparagraph 1.06(2)(e)(iiia) to allow commutations from lifetime pensions under the newly permitted circumstances in section 1.06C.

Item 8 inserts subparagraph 1.06(7)(g)(va) to allow commutations from life-expectancy pensions under the newly permitted circumstances in section 1.06C.

Item 9 inserts subparagraph 1.06(8)(d)(iva) to allow commutations from market-linked pensions under the newly permitted circumstances in section 1.06C.

Part 2 – Allocations from reserves

Amendments to the Income Tax Assessment (1997 Act) Regulations 2021 (ITA Regulations)

Items 11 to 21 amend the *ITA Regulations* to provide more flexible pathways for unallocated reserves to be distributed.

Item 11 repeals the heading from subsection 291-25.01(2) to reflect the changes made by items 12 to 19.

Items 12 to 19 provide more flexible pathways to make allocations from a reserve. The more flexible treatment exempts reserve allocations from counting towards an individual's concessional contributions cap or non-concessional contributions cap where:

- the amount is an allocation from a reserve used solely for the purpose of enabling the superannuation fund to discharge liabilities in respect of superannuation income stream benefits; and
- the allocation is made to the recipient of a superannuation income stream to which the reserve relates.

This is subject to some qualifying conditions inserted by item 17, which ensures all other reserve allocations that were previously counted towards an individual's concessional contributions cap due to satisfying the conditions in subsection 291-25.01(3) of the ITAA 1997, are now instead counted towards their non-concessional contributions cap.

Where the regulations commence mid-way through a financial year, allocations made under the existing subdivision 291-B of the ITA Regulations prior to commencement of the Regulations will count towards an individual's concessional contributions cap. Amounts allocated after commencement will count towards an individual's non-concessional contributions cap for that year. That is, reserve allocations made in the financial year of commencement of the Regulations may count towards different contributions caps based on the timing of the allocation.

Item 12 repeals the subsections 291-25.01(3) to (5), so reserve allocations are no longer counted towards an individual's concessional contributions cap. The Regulations do not repeal subsection 291-25.01(6), so the requirement to multiply reserve allocations made in lieu of a contribution which would have been assessable income of the fund by 1.176 will remain in place, and the grossed-up amount will continue to be counted towards an individual's concessional contributions for a financial year.

Items 13 and 14 amend subsection 292-90.01(1) to better align the language in the regulations with that of the regulation making provision in subsection 292-90(4) of the ITAA 1997.

Item 15 inserts the heading '*Conditions – general*' before subsection 292-90.01(2), reflecting the changes made by item 17.

Item 16 amends subsection 292-90.01(2) to include the new conditions for a member's reserve allocations to count towards their non-concessional contributions cap.

Item 17 inserts new subsection 292-90.01(2A) which sets out the conditions for allocations from reserves to be counted towards an individual's non-concessional contributions cap. These conditions capture amounts previously included in an individual's concessional contributions prior to the changes made by these Regulations.

The non-concessional contributions cap is four-times larger than the concessional contributions cap. This enables a greater amount to be allocated from reserves each year without those contributions being subject to extra tax (depending on individual circumstances, and noting that some individuals may have a nil non-concessional contributions cap). The consequences for exceeding the non-concessional contributions cap are generally less severe than exceeding the concessional contributions cap, where excess

amounts are released from the system. Individuals who exceed their non-concessional contributions cap can elect to release all excess amounts plus 85 per cent of associated earnings. In this case, only the associated earnings are included in their taxable income, with a 15 per cent non-refundable tax offset. This compares to excess concessional contributions where, if released, the entire excess amount is included in assessable income with a similar 15 per cent offset. Further, the use of the non-concessional contributions cap mirrors the consequences that would arise if amounts were to be withdrawn from the superannuation system, gifted to an individual, and contributed back into the system. It provides a fair outcome while mitigating the risk of inter-generational wealth transfer within the superannuation system.

Item 18 amends paragraph 292-90.01(3)(g) to update language to refer to the termination payment made in the financial year is made on behalf of 'you'. This wording is consistent with other provisions in the ITAA 1997 and ITA Regulations.

Item 19 inserts new section 292-90.02 which sets out various conditions in which reserve allocations are not included in an individual's non-concessional contributions. The amount must be an allocation from a reserve used solely for the purpose of enabling the superannuation fund to discharge liabilities in respect of superannuation income stream benefits and the allocation is made to the recipient of a superannuation income stream to which the reserve relates. The note under subsection 292-90.02(1) clarifies that if this section applies due to any of the following subsections applying, the reserve allocation will not satisfy the condition in subsection 292-90.01(2A) for inclusion in an individual's non-concessional contributions for a financial year, and thus consequently also excluded from inclusion in an individual's concessional contributions.

Subsections 292-90.02(2) to (6) essentially maintain the existing rules for when reserves can be allocated, and the allocations that do not count towards an individual's non-concessional contributions cap. This includes the conditions for contribution reserves, 'fair and reasonable' allocations and pension reserve-related allocations.

Subsection 292-90.02(2) replicates the current 'fair and reasonable' allocation rule. This permits allocations for all members of the fund, or class of members to which the reserve relates, on a 'fair and reasonable' basis. If those allocations for the financial year are less than five per cent of the value of the member's interest in the superannuation plan at the time of the allocation is made, then it is not counted towards non-concessional contributions caps.

Subsection 292-90.02(3) provides that amounts allocated from a pension reserve of a complying superannuation plan for the reason of satisfying a pension liability during the financial year in which the liability is paid do not count towards non-concessional contributions caps.

Subsection 292-90.02(4) provides that all amounts allocated during a financial year from a pension reserve of a complying superannuation plan do not count towards non-concessional contributions caps where:

- the reserve is used to discharge all or part of a liability of the plan to pay a superannuation income stream of which the individual is a recipient;
- the superannuation income stream is commuted or ceases;

- the commutation or cessation is not a result of death of the primary beneficiary;
- the amount is allocated from the reserve for the individual as a result of the individual having been the recipient of the superannuation income stream (before the commutation or cessation); and
- if the reserve relates to more than one superannuation income stream, the allocation is fair and reasonable having regard to the factors listed in subparagraphs 292-90.02(4)(f)(i) and (ii) (having regard to income streams that have or have not been commuted or ceased).

Given the existing restrictions on commutation, in practice this provision will apply to:

- legacy product holders who choose to commute their income stream during the five-year commutation relaxation;
- individuals whose income stream ceased for some other reason, such as reaching the end of its term; and
- individuals who have been able to commute their income stream, such as flexi-pension holders, but still have a reserve amount.

These individuals can receive an allocation of the entire pension reserve. This may be made up of a commutation amount that reflects the lump sum they are entitled to under the fund or product rules, and any additional amounts that may still be in the reserve. Further, there is no limit on the amount of time that can elapse between when the income stream is commuted or otherwise ceases and when the allocation from a pension reserve is made because of that commutation or cessation. Where the reserve relates to more than one superannuation income stream, the allocation does not count towards either contribution cap if the allocation is fair and reasonable having regard to the respective values and interests that support those superannuation income streams.

Where the commutation is a result of the death of the primary beneficiary, subsection 292-90.02(5) provides that allocations do not count towards your contributions caps if the you are a death benefits dependant of the primary beneficiary and the amount is allocated for you in order to discharge the liabilities of the plan relating to superannuation income stream benefits that are payable as a result of the death, and if it is allocated as soon as practicable from the commutation. This subsection replaces the repealed subparagraph 291-25.01(5)(c)(i), with no change or expansion to the conditions that apply.

Subsection 292-90(6) provides that where the commutation is a result of the death of the primary beneficiary and an amount is allocated for you and paid as a superannuation death benefit and a lump sum as soon as practicable, the amount is also not to be counted towards the recipient's contributions caps. Death benefit lump sums can be paid to the deceased's dependants or non-dependants, depending on the governing rules of the fund and the relevant requirements of the SIS Regulations. This subsection replaces the repealed subparagraph 291-25.01(5)(c)(ii), with no change or expansion to the conditions that apply.

Subsection 292-90.02(7) defines the term a 'pension reserve'. A reserve is a 'pension reserve' of a complying superannuation plan at a particular time if the reserve is used at that time solely for the purpose of enabling the plan to discharge all or part of its pension

liabilities (contingent or not) as soon as they become due. This purpose is known as the ‘pension liability purpose’.

Subsection 292-90.02(8) provides additional clarity to what constitutes a ‘pension liability purpose’ and allows for the cap-free allocation pathway under 292-90.02(4). Where the reserve is used for the purpose of enabling the plan to discharge all or part of its pension liabilities, and the superannuation income stream is commuted or otherwise ceases, and an amount is allocated from the reserve for a person as a result of the person having been a recipient of the superannuation income stream before the commutation or cessation, that allocation is taken as being a use of the reserve for a pension liability purpose. This clarification ensures that any amount remaining in a reserve following the commutation or cessation of a superannuation income stream can be allocated to the former recipient of that income stream with no contributions cap consequences.

Item 20 inserts definitions of the terms ‘pension liability’ and ‘pension reserve’ into the definitions section of section 995-1.01.

Item 21 inserts a new section 1000-7.01, which is a transitional provision that is intended to deal with a situation where certain allocations from a reserve are made before the commencement of the Regulations. For the purpose of determining whether a reserve is a pension reserve at a particular time after commencement of the Regulations for allocations made under subsection 292-90.02(4), the transitional provision provides that certain allocations are disregarded if they were made before the commencement of the Regulations. This transitional provision is necessary to ensure that any allocations made prior to the commencement of the Regulations do not prevent the reserve being deemed to be a pension reserve so that the fund may make an allocation under subsection 292-90.02(4) to the former recipient of a superannuation income stream that ceased or was commuted prior to the regulations commencing. That is, if the reserve was a pension reserve at the time the superannuation income stream was commuted or ceased, any allocations from the reserve between that time and the commencement of these Regulations will not prevent it from being treated as a pension reserve.

Statement of Compatibility with Human Rights

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

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 *Treasury Laws Amendment (Legacy Retirement Product Commutations and Reserves) Regulations 2024* is to relax commutation restrictions for a specified range of legacy retirement products and create a more flexible avenue for allocations from superannuation reserves. This will allow individuals to exit products that are no longer suitable for their circumstances, remove barriers that currently prevent the closure of obsolete funds and legacy products, and allow for the allocation of reserves that no longer serve an ongoing purpose. The Regulations apply to legacy lifetime, life expectancy and market-linked superannuation income stream products, which generally commenced prior to 20 September 2007, or commenced as a result of a conversion of an earlier legacy product that commenced prior to that date (legacy products).

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The use of reserves is a common feature for some legacy products, namely complying lifetime and life-expectancy pensions and annuities. These products guarantee income for an extended period. This often means some or all of the capital is moved to a reserve at commencement. Unlike account-based products, the actual underlying capital and investment returns held by the fund over the life of the product do not directly correlate to the total payments the member is entitled to. This means that strong investment performance may increase the reserve amount with limited means to distribute it to members.

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The Regulations relax commutation restrictions so that legacy products can be exited with the resulting capital used to commence another retirement phase interest, left in an accumulation interest account, or withdrawn from superannuation entirely. The commutation must occur in full and be completed within a designated 5-year grace period beginning on the day the Regulations commence.

The Regulations also provide more flexible pathways to make allocations from a reserve, by providing that where a reserve supported an income stream that is ceased or commuted, and the reserve is allocated to the former recipient of that income stream, it will be exempt from both contribution caps.

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.