EXPLANATORY STATEMENT

Veterans’ Entitlements (Retention of Exemption for Asset-test Exempt Income Streams) Principles 2007

Summary

The Veterans’ Entitlements (Retention of Exemption for Asset-test Exempt Income Streams) Principles 2007 (the Principles) are made under subparagraphs (a)(iii) and (b)(ii) of the definition of partially asset-test exempt income stream in subsection 52(1AA) of the Veterans’ Entitlements Act 1986 (the Act).

The purpose of these Principles is to specify circumstances in which certain income streams are fully or partially exempt from the assets test under the Act.


Background

A partially asset-test exempt income stream is 50% asset-test exempt (that is, half of the value of the assets backing the income stream is taken into account under the assets test).

The effect of paragraph (a) of the definition in subsection 52(1AA) of the Act is that a partially asset-test exempt income stream is an asset-test exempt income stream that:

(i) is a market-linked income stream (covered by subsections 5JA(1)) or an ‘assets-test exempt income stream’ covered by subsections 5JA(1), 5JA(1A) or 5JB(1)) that is not in either case a defined benefit income stream; and
(ii) commences between 20 September 2004 and 19 September 2007 inclusive; and
(iii) is not covered by principles that the Commission has determined for this subparagraph.

The purpose of this provision is to ensure that income streams purchased between 20 September 2004 and 19 September 2007 which would otherwise be partially (50%) asset-test exempt retain their fully (100%) asset-test exemption, if they are covered by principles made under subparagraph (a)(iii). Thus, income streams covered by those principles retain their 100% asset-test exemption.

Part 2 of these Principles is made for the purposes of subparagraph (a)(iii) of the definition in subsection 52(1AA). That is, income streams covered by Part 2 of these Principles retain their 100% asset-test exemption (they are “asset-test exempt income streams” rather than being “partially asset-test exempt income streams”).

Part 2 covers certain income streams (the ‘new income stream’) that are purchased or acquired as the result of the commutation or rollover of an existing 100% assets-test exempt income stream.
If the new income stream is purchased or acquired between 20 September 2004 and 19 September 2007 inclusive, and the income stream is covered by Part 2 of these Principles, the new income stream will retain the 100% asset-test exemption that applied to the original income stream, provided the new income stream was commuted or rolled over from, and retains the features of the original income stream. The effect of not being covered by Part 2 of these Principles is that these income streams will lose the 100% asset-test exemption and will only be entitled to a 50% asset-test exemption (that is, will be ‘partially asset-test exempt income streams’ rather than being ‘asset-test exempt income streams’), even if they retain the features of the original income stream.

Part 2 of the Principles only ensure that income streams purchased between 20 September 2004 and 19 September 2007 which derived from 100% asset-test exempt income streams retain their 100% asset-test exempt status. Income streams purchased on or after 20 September 2007 which derive from 100% asset-test exempt income streams can retain their 100% asset-test exempt status only if they are determined by the Commission under subsection 5JA(5) or 5JB(4) of the Act, having regard to guidelines made under subsection 5JA(6) or 5JB(5) of the Act respectively. The Commission has made guidelines under subsections 5JA(6) and 5JB(5) of the Act, being the Veterans’ Entitlements (Guidelines for Determining whether Income Stream is Asset-test Exempt) Determination 2007 (No 1).

Paragraph (b) of the definition of partially asset-test exempt income stream in subsection 52(1AA) of the Act provides that a partially asset-test exempt income stream is an income stream that:

(i) commences on or after 20 September 2007; and
(ii) is covered by principles that the Commission has determined in relation to this issue.

The purpose of this provision is that income streams purchased on or after 20 September 2007 which derive from 50% asset-test exempt income streams retain the 50% asset-test exempt status if they are covered by principles made under sub-paragraph (b)(ii).

Part 3 of these Principles is made for the purposes of subparagraph (b)(ii) of the definition in subsection 52(1AA). That is, income streams covered by Part 3 retain their 50% asset-test exempt status (they are “partially asset-test exempt income streams” rather than having no exemption status at all).

Part 3 covers certain income streams that derive from pre-existing partially asset-test exempt income streams. The very first partially asset-test exempt income stream in a series of related income streams will have been purchased or acquired between 20 September 2004 and 19 September 2007 inclusive, although that initial income stream may have been commuted or rolled over into new income streams since that time. So long as the chain of partially asset-test exempt incomes streams has not been broken since that initial income stream purchased between 20 September 2004 and 19 September 2007 (because each income stream in the chain has either not been covered by the Veterans’ Entitlements (Partially Asset-test Exempt Income Stream – Exemption) Principles 2005 between 20 September 2004 and 19 September 2007, or
has been covered by a prior application of Part 3 of these Principles on or after 20 September 2007), then income streams derived from earlier income streams in that chain (and otherwise complying with Part 3) will also retain the 50% asset-test exemption.

Explanation of the Provisions

Part 1 - Introductory

Section 1.1 states that the name of the Principles is the Veterans’ Entitlements (Retention of Exemption for Asset-test Exempt Income Streams) Principles 2007.

The section includes a note to the effect that the Veterans’ Entitlements (Partially Asset-test Exempt Income Stream – Exemption) Principles 2005 ceases to be in force at the end of 19 September 2007 due to the cessation of the enabling provision under the Act.

Section 1.2 sets out that the Principles commence on 20 September 2007.

Section 1.3 sets out the purpose of the Principles. Paragraph (a) provides that Part 2 specifies the criteria that excludes an income stream from the class of partially asset-test exempt income streams established by paragraph (a) of the definition in subsection 52(1AA) of the Act. Paragraph (b) provides that Part 3 specifies the criteria that must be satisfied by an income stream to be covered by paragraph (b) of the definition in 52(1AA) of the Act.

The section includes three notes to the effect that the 100% value of the assets backing an asset-test exempt income streams and the 50% value of the assets backing partially asset-test exempt income streams is to be disregarded for the purposes of calculating the value of a person’s assets for the purposes of the assets test.

Section 1.4 provides definitions of terms used in the Principles.

Part 2 – Asset-test exempt income streams

Section 2.1 sets out that the Principles in Part 2 are those for the purposes of subparagraph (a)(iii) of the definition of ‘partially asset-test exempt income stream’ in subsection 52(1AA) of the Act. Income streams covered by the Principles under Part 2 will retain their 100% assets-test exemption.

The section includes a note signposting the definition of ‘asset-test exempt income stream’ in subsection 5JA(1) of the Act.

Section 2.2 sets out various income streams that are covered by the Principles and were purchased on or after 20 September 2004 and before 20 September 2007.

Any income stream covered by section 2.2 must meet the requirements of subsection 2.2(1) of the Principles: that is, it (referred to as the ‘present income stream’) must be covered by section 5JA or 5JB of the Act and must be purchased by the primary beneficiary from the commutation of an asset-test exempt income stream
originally purchased before 20 September 2004 (referred to in the section as the ‘original income stream’). A commutation is a lump sum withdrawal of capital from the assets backing the income stream. Commutations are separate from any regular income payments that are paid from the income stream.

In addition, the original income stream must meet the more specific requirements of one of the following subsections 2.2(2) to (5).

**Subsection 2.2(2)** sets out that the subsection applies to an original income stream if it is covered by subsection 5JA(1) or (1A) or section 5JB of the Act, and if:

- the income stream was purchased for the benefit of the primary beneficiary and a reversionary beneficiary; and
- payments under the original income stream were based on the reversionary beneficiary’s life expectancy; and
- that reversionary beneficiary has died before the primary beneficiary (that is, the primary beneficiary purchases a lifetime income stream and specifies that it must revert to the reversionary beneficiary who has a longer life expectancy at the time of purchase but predeceases the person who purchased the income stream).

**Subsection 2.2(3)** sets out that the subsection applies to an original income stream if it is covered by subsection 5JA(1) or (1A) or section 5JB of the Act and is not covered by section 2.4 or 2.5 of the Principles (payment splits and Family Court Orders). The original income stream must also have been purchased by the primary beneficiary for the benefit of both him or herself and a reversionary beneficiary who are members of a couple at the time of the purchase, but who subsequently part.

**Subsection 2.2(4)** sets out that the subsection applies to an original income stream which is a defined benefit pension covered by section 5JA or 5JB that is provided by a regulated superannuation fund and in relation to which the Commission is not satisfied as required by paragraph 5JA(1)(b) or 5JB(1A)(b) (that is, the Commission is not satisfied that there is in place a current actuarial certificate setting out that in the actuary’s opinion there is high probability that the income stream’s provider will be able to pay the income stream as required under the income stream’s contract or governing rules).

**Subsection 2.2(5)** sets out that the subsection applies to an original income stream which is an immediate annuity under a statutory fund established by a life company, or under a benefit fund, and the original income stream is either:

- an income stream to which the Commission is not satisfied as required by paragraph 5JA(1)(b) or 5JB(1A)(b) of the Act (that is, the Commission is not satisfied that there is in place a current actuarial certificate setting out that in the actuary’s opinion there is high probability that the income stream’s provider will be able to pay the income stream as required under the income stream’s contract or governing rules); or
- the income stream fails to satisfy the relevant standards published by the Australian Prudential Regulation Authority about minimum surrender values and paid up values.
Sections 2.3 to 2.9 of the Principles deal with the commutation of an ‘original income stream’ (as defined in each section) that was purchased before 20 September 2004 or was covered by the Veterans’ Entitlements (Partially Asset-test Exempt Income Stream – Exemption) Principles 2005 or by these Principles.

The fundamental difference between section 2.2 of the Principles and sections 2.3 to 2.9, is that the ‘original income stream’ can be commuted and rolled over only once under the Principles specified in section 2.2, that is, the ‘original income stream’ will not have been sourced from a previous income stream created after 20 September 2004. By contrast, under sections 2.3 to 2.9, the ‘original income stream’ may be one of a succession of intermediate income streams that itself has been sourced from the commutation and rollover of a previous ‘original income stream’ under any one of the principles specified in those sections. While the first of the succession of income streams must have commenced before 20 September 2004, subsequent income streams may have commenced after that date provided they satisfy the Principles specified in sections 2.3 to 2.9.

In these circumstances, the full (100%) exemption from the assets test would carry through to the new income stream. A further requirement of these sections is that the capital used to source the intermediate income stream and the new income stream must have originated only from the previous commuted income stream that is, it would not be permissible to increase this capital with assets from elsewhere, thus increasing the purchase price of the new income stream.

For a new income stream to be covered by any of sections 2.3 to 2.9 of the Principles, it must be covered by either section 5JA or 5JB of the Act and have been purchased on or after 20 September 2004. The original income stream, and any prior succession of income streams, which are the source of the new income stream, must also have been covered by either section 5JA or 5JB of the Act.

Section 2.3 of the Principles covers an income stream where it results from the transfer of the original income stream to a successor fund on or after 20 September 2004 (“successor fund” is defined in subregulation 1.03(1) of the Superannuation Industry (Supervision) Regulations 1994). The original income stream must have been provided by a regulated superannuation fund (“regulated superannuation fund” is defined in section 19 of the Superannuation Industry (Supervision) Act 1993).

Sections 2.4 and 2.5 of the Principles cover various income streams that are commuted because of the operation of the Family Law Act 1975 (the Family Law Act). The purpose of these sections is to ensure that the full exemption from the assets test is carried through to any new income streams sourced from the commutation of an original income stream, because of the operation of the Family Law Act.

Section 2.4 covers an income stream that has been purchased or acquired by the primary beneficiary or his or her spouse on or after 20 September 2004, and the income stream results from the original income stream being commuted as a result of a payment split under Part VIIIIB of the Family Law Act.
Section 2.5 covers an income stream that has been purchased or acquired by the primary beneficiary or his or her spouse on or after 20 September 2004, and the income stream results from the original income stream being commuted as a result of:

- an order made under either section 79 or 114 of the Family Law Act; or
- an injunction that has been granted under section 114 of that Act that is binding on a third party (such as the income stream provider) under Part VIIIAA of that Act; or
- any other order or injunction under the Family Law Act that relates specifically to the original income stream.

Section 2.6 of the Principles covers an income stream that has been purchased by the primary beneficiary on or after 20 September 2004, and which results from the commutation of the original income stream to pay a superannuation contributions surcharge debt.

Section 2.7 of the Principles covers an income stream that has been purchased by the primary beneficiary and results from the commutation of the original income stream to pay a hardship amount, which is defined in subsection 5JA(7) of the Act.

Section 2.8 of the Principles covers an income stream which was not sourced from a self managed superannuation fund, has been purchased by the primary beneficiary and results from the original income stream (sourced from a self managed superannuation fund) being commuted due to the closure of a self managed superannuation fund because:

- a member of the fund supporting the original income stream has died; or
- the administrative responsibilities of the fund supporting the original income stream have become too onerous due to the age or incapacity of a trustee.

Section 2.9 of the Principles covers an income stream which has been purchased by the primary beneficiary on or after 1 July 2007 and results from the original income stream being commuted and rolled over to a new income stream that is compliant with subregulation 6.21(2A) of the SIS Regulations.

This will apply in certain circumstances, such as where the contract or governing rules of the original income stream are altered to make the income stream compliant with subregulation 6.21(2A) of the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations); or

Part 3

Section 3.1 sets out that the Principles in Part 3 are those for the purposes of subparagraph (b)(ii) of the definition of ‘partially asset-test exempt income stream’ in subsection 52(1AA) of the Act. Income streams covered by the Principles under Part 3 will retain their 50% assets-test exemption.

The section includes a note signposting the definition of ‘asset-test exempt income stream’ in subsection 5J(1) of the Act.
Any income stream covered by section 3.2 must meet the requirements of subsection 3.2(1) of the Principles: that is, it (referred to as the ‘present income stream’) must be a partially asset-test exempt income stream and must be purchased by the primary beneficiary on or after 20 September 2007 from the commutation of an asset-test exempt income stream purchased on or after 20 September 2004 and before 20 September 2007 (referred to in the section as the ‘original income stream’). A commutation is a lump sum withdrawal of capital from the assets backing the income stream. Commutations are separate from any regular income payments that are paid from the income stream.

In addition, the original income stream must meet the more specific requirements of one of the following subsections 3.2(2) to (5).

**Subsection 3.2(2)** sets out that the subsection applies to an original income stream if it is covered by subsection 5JA(1) or (1A) or section 5JB or 5JBA of the Act, if:

- the income stream was purchased for the benefit of the primary beneficiary and a reversionary beneficiary; and
- payments under the original income stream were based on the reversionary beneficiary’s life expectancy; and
- that reversionary beneficiary has died before the primary beneficiary (that is, the primary beneficiary purchases a lifetime income stream and specifies that it must revert to the reversionary beneficiary who has a longer life expectancy at the time of purchase) but predeceases the person who purchased the income stream.

**Subsection 3.2(3)** sets out that the subsection applies to an original income stream if it is covered by subsection 5JA(1) or (1A) or section 5JB or 5JBA of the Act and is not covered by section 3.4 or 3.5 of the Principles (payment splits and Family Court Orders). The original income stream must also have been purchased by the primary beneficiary for the benefit of both him or herself and a reversionary beneficiary who are members of a couple at the time of the purchase, but who subsequently part.

**Subsection 3.2(4)** sets out that the subsection applies to an original income stream which is a defined benefit pension covered by section 5JA or 5JB that is provided by a regulated superannuation fund and in relation to which the Commission is not satisfied as required by paragraph 5JA(1)(b) or 5JB(1A)(b) (that is, the Commission is not satisfied that there is in place a current actuarial certificate setting out that in the actuary’s opinion there is high probability that the income stream’s provider will be able to pay the income stream as required under the income stream’s contract or governing rules).

**Subsection 3.2(5)** sets out that the subsection applies to an original income stream which is an immediate annuity under a statutory fund established by a life company, or under a benefit fund, and the original income stream is either:

- an income stream to which the Commission is not satisfied as required by paragraph 5JA(1)(b) or 5JB(1A)(b) of the Act (that is, the Commission is not satisfied that there is in place a current actuarial certificate setting out that in the actuary’s opinion there is high probability that the income stream’s
provider will be able to pay the income stream as required under the income stream’s contract or governing rules); or

- the income stream fails to satisfy the relevant standards published by the Australian Prudential Regulation Authority about minimum surrender values and paid up values.

Sections 3.3 to 3.9 of the Principles deal with an ‘original income stream’ (as defined in each section) that was purchased on or after 20 September 2004 and before 20 September 2007 or was covered by the Principles.

The fundamental difference between section 3.2 of the Principles and sections 3.3 to 3.9, is that the ‘original income stream’ can be commuted and rolled over only once under the Principles specified in section 3.2, that is, the ‘original income stream’ must have been purchased on or after 20 September 2004 and before 20 September 2007. By contrast, under sections 3.3 to 3.9, the ‘original income stream’ may be one of a succession of intermediate income streams that itself has been sourced from the commutation and rollover of a previous ‘original income stream’ under any one of the principles specified in those sections. While the first of the succession of income streams must have commenced on or after 20 September 2004 and before 20 September 2007, subsequent income streams may have commenced after that date provided they satisfy the Principles specified in sections 3.3 to 3.9.

In these circumstances, the partial (50%) exemption from the assets test would carry through to the new income stream. A further requirement of these sections is that the capital used to source the intermediate income stream and the new income stream must have originated only from the previous commuted income stream that is, it would not be permissible to increase this capital with assets from elsewhere, thus increasing the purchase price of the new income stream. That is, under sections 3.3 to 3.9, the original income stream could have been purchased on or after 20 September 2007 from a previous 50% asset-test exempt income stream which itself was purchased on or after 20 September 2007 from a 50% asset-test exempt income stream (and had that status because it was not covered by the Veterans’ Entitlements (Partially Asset-test Exempt Income Stream – Exemption) Principles 2005 when they were in force, or was covered by a prior application of Part 3 of these Principles).

For a new income stream to be covered by any of sections 3.3 to 3.9 of the Principles, the new income stream must be covered by either section 5JA, 5JB or 5JBA of the Act and have been purchased on or after 20 September 2007. The original income stream, which is the source of the new income stream, and any succession of income streams, must also have been covered by either section 5JA, 5JB or 5JBA of the Act and have either been purchased on or after 20 September 2004 and before 20 September 2007, or was covered by a prior application of Part 3 of these Principles.

Section 3.3 of the Principles covers an income stream where it results from the transfer of the original income stream to a successor fund on or after 20 September 2007 (“successor fund” is defined in subregulation 1.03(1) of the Superannuation Industry (Supervision) Regulations 1994). The original income stream must have been provided by a regulated superannuation fund (“regulated superannuation fund” is defined in section 19 of the Superannuation Industry (Supervision) Act 1993).
Sections 3.4 and 3.5 of the Principles cover various income streams that are commuted because of the operation of the Family Law Act 1975 (the Family Law Act). The purpose of these sections is to ensure that the 50% exemption from the assets test is carried through to any new income streams sourced from the commutation of an original income stream, because of the operation of the Family Law Act.

Section 3.4 covers an income stream that has been purchased or acquired by the primary beneficiary or his or her spouse on or after 20 September 2007, and the income stream results from the original income stream being commuted as a result of a payment split under Part VIIIB of the Family Law Act.

Section 3.5 covers an income stream that has been purchased or acquired by the primary beneficiary or his or her spouse on or after 20 September 2007, and the income stream results from the original income stream being commuted as a result of:

- an order made under either section 79 or 114 of the Family Law Act; or
- an injunction that has been granted under section 114 of that Act that is binding on a third party (such as the income stream provider) under Part VIIIA of that Act; or
- any other order or injunction under the Family Law Act that relates specifically to the original income stream.

Section 3.6 of the Principles covers an income stream that has been purchased by the primary beneficiary on or after 20 September 2007, and which results from the commutation of the original income stream to pay a superannuation contributions surcharge debt.

Section 3.7 of the Principles covers an income stream that has been purchased by the primary beneficiary on or after 20 September 2007 and results from the commutation of the original income stream to pay a hardship amount, which is defined in subsection 5JA(7) of the Act.

Section 3.8 of the Principles covers market-linked income streams under section 5JBA of the Act if the income stream results from the commutation and rollover of all the assets of the original income stream.

Section 3.9 of the Principles covers an income stream which was not sourced from a self managed superannuation fund, has been purchased by the primary beneficiary and results from the original income stream (sourced from a self managed superannuation fund) being commuted due to the closure of a self managed superannuation fund because:

- a member of the fund supporting the original income stream has died; or
- the administrative responsibilities of the fund supporting the original income stream have become too onerous due to the age or incapacity of a trustee.

Section 3.10 of the Principles covers an income stream which has been purchased by the primary beneficiary on or after 1 July 2007 and results from the original income
stream being commuted and rolled over to a new income stream that is compliant with subregulation 6.21(2A) of the SIS Regulations.

This will apply in certain circumstances, such as where the contract or governing rules of the original income stream are altered to make the income stream compliant with subregulation 6.21(2A) of the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations); or

**Consultation**

The Department of Families, Community Services and Indigenous Affairs (FaCSIA) was consulted in relation to the instrument. FaCSIA consulted the Department of Education, Science and Training and the Department of Employment and Workplace Relations to ensure a co-ordinated approach in respect of payments under the Act for which those Departments have responsibility.

FaCSIA also consulted the Department of the Treasury, the Australian Prudential Regulatory Authority, the Attorney-General’s Department and the Investment and Financial Services Association.

**Regulatory Impact Analysis**

This instrument does not require a Regulatory Impact Statement (RIS) and/or a Business Cost Calculator Figure. This instrument is not regulatory in nature, will not impact on business activity and will have no, or minimal, compliance costs or competition impact. It is not expected that any compliance costs will be incurred by business against the nine categories listed as a result of this instrument.