

EXPLANATORY STATEMENT

Veterans' Entitlements (Guidelines for determining whether income stream is asset-test exempt) Determination 2011

Summary

The *Veterans' Entitlements (Guidelines for determining whether income stream is asset-test exempt) Determination 2011* (the Determination) is made under subsections 5JA(6) and 5JB(5) of the *Veterans' Entitlements Act 1986* (the Act).

The purpose of the Determination is to specify circumstances in which certain income streams retain their 100% exemption from the assets test under the Act.

Background

Subsections 5JA(6) and 5JB(5) allow the Commission to determine guidelines for the purpose of making a determination under subsections 5JA(5) and 5JB(4) respectively that an income stream is an asset-test exempt income stream where it would not otherwise meet the requirements of sections 5JA or 5JB.

The Determination covers certain income streams (the 'new income stream') that are purchased or acquired as the result of the commutation or rollover of a 100% asset-test exempt income stream that was covered by subsections 5JA(1), 5JA(1A) or 5JB(1) that was also purchased or acquired before 20 September 2004 (the 'original income stream').

If the new income stream is purchased or acquired on or after 20 September 2007, and the income stream is covered by the Determination, the new income stream will retain the 100% exemption that applied to the original income stream (whether the original income stream was purchased before 20 September 2004 or was commuted and rolled over to another income stream between 20 September 2004 and 19 September 2007), provided it was commuted or rolled over from, and retains the features of the original income stream. The effect of not being covered by the Determination is that these income streams will lose the 100% exemption altogether, even if they retain the features of the original income stream.

Explanation of the Provisions

Part 1 Preliminary

Section 1 states the name of the Determination is the *Veterans' Entitlements (Guidelines for determining whether income stream is asset-test exempt) Determination 2011*.

Section 2 sets out that the Determination commences on the day after it is registered on the Federal Register of Legislative Instruments.

Section 3 provides that the *Veterans' Entitlements (Guidelines for Determining whether Income Stream is Asset-test Exempt) Determination 2007 (No. 1)* made by the Commission on 19 September 2007 is revoked.

Section 4 provides definitions of terms used in the Determination.

Section 5 sets out the purpose of the Determination, namely to set out guidelines in relation to certain income streams with which the Commission must comply when making a determination under subsection 5JA(5) or 5JB(4) of the Act.

The section includes a note to the effect that, under subsection 5JA(5) or 5JB(4) of the Act, the Commission may determine that an income stream is an asset-test exempt income stream.

Section 6 is an application provision and sets out that Part 2 of the Determination applies to certain income streams commencing on or after 1 July 2007 and Part 3 applies to certain income streams commencing on or after 20 September 2007.

Part 2 Guidelines for certain income streams commencing on or after 1 July 2007

Section 7 of the Determination provides that the Commission may determine that 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, is asset-test exempt for the purposes of the Act. Such an income stream must also meet the other requirements of the section.

Part 3 Guidelines for certain income streams commencing on or after 20 September 2007

Section 8 provides that if an income stream meets the requirements of subsection 8(1) and the original income stream that it was derived from meets the requirements of any of subsections 8(2) through (5), then the Commission may determine it to be an asset-test exempt income stream for the purposes of the Act.

Any income stream covered by section 8 must meet the requirements of **subsection 8(1)** of the Determination: that is, it must be covered by section 5JA or 5JB of the Act (or would have been covered by those provisions if paragraph 5J(A)(1)(aa) and subparagraph 5JB(1)(a)(i) of the Act did not apply) and must be purchased by the primary beneficiary on or after 20 September 2007 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 8(2) to (5).

Subsection 8(2) sets out that the subsection applies to an original income stream if it is covered by either 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 purchases the income stream).

Subsection 8(3) sets out that the subsection applies to an original income stream if it is covered by either subsection 5JA(1) or (1A) or section 5JB of the Act and is not covered by sections 11 and 12 of the Determination (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 8(4) sets out that the subsection applies to an original income stream which is a defined benefit pension covered by section 5JA or 5JB 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 8(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.

Section 9 is similar to section 8 and provides that if an income stream meets the requirements of subsection 9(1) and the original income stream that it was derived from meets the requirements of any of subsections 9(2) through (5), then the Commission may determine it to be an asset-test exempt income stream for the purposes of the Act.

Any income stream covered by section 9 must meet the requirements of **subsection 9(1)** of the Determination: that is, the new asset-test exempt income stream (referred to in the section as the ‘present income stream’) must be covered by section 5JA or 5JB (or would have been covered by those provisions if paragraph 5JA(1)(aa) and subparagraph 5JB(1)(a)(i) of the Act did not apply) and must have been sourced from an intermediate asset-test exempt income stream created on or after 20 September 2004 and before 20 September 2007 that itself had been created from an earlier asset-test exempt income stream created before 20 September 2004 (referred to in the section as the ‘original income stream’). The latter two income streams must have been covered by section 5JA or 5JB of the Act.

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 9(2) to (5).

Subsection 9(2) sets out that the subsection applies to an original income stream if it is covered by either 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 (that is, a person purchases a lifetime income stream and specifies that it must revert to his or her partner (who has a longer life expectancy at the time of purchase), however the partner predeceases the person who purchases the income stream).

Subsection 9(3) sets out that the subsection applies to an original income stream if it is covered by either subsection 5JA(1) or (1A) or section 5JB of the Act and is not covered by section 11 and 12 of the Determination (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 9(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 9(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.

Income streams covered by **sections 10 to 16** must be covered by section 5JA or 5JB (other than paragraph 5JA(1)(aa) or subparagraph 5JB(1)(a)(i)) of the Act, have been purchased on or after 20 September 2007 and must be purchased from the proceeds of the commutation of an asset-test exempt income stream (the 'original income stream'). The original income stream must have been:

- purchased before 20 September 2004; or
- resulted from the proceeds of the commutation of an asset-test exempt income stream, or a succession of asset-test exempt income streams where the first income stream in the succession of income streams was purchased before 20 September 2004.

A commutation is a 'cash out' of the assets backing the income stream. A commutation may be used to pay a debt or other financial obligation or be used to purchase another income stream product. Alternatively, the owner of the original asset-test exempt income stream may rollover the commuted amount to purchase another asset-test exempt income stream. Commutations are separate from any regular income payments that are paid from the income stream.

The fundamental difference between sections 8 and 9 of the Determination and sections 10 to 16, is that the 'original income stream' can be commuted and rolled over only once for the purposes of in sections 8 and 9 (that is, the 'original income stream' will not have been sourced from a previous income stream). By contrast, under sections 10 to 16, 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 the *Veterans' Entitlements (Partially Asset-test Exempt Income Stream — Exemption) Principles 2005* (the 2005 Principles), the *Veterans' Entitlements (Guidelines for Determining whether Income Stream is Asset-test Exempt) Determination 2007 (No. 1)* (the 2007 Determination) or this Determination, as specified in those sections.

Where an income stream meets the requirements of one or sections 10 to 16 then, the original income stream's 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.

In addition to the common requirements listed above, sections 10 to 16 provide rules relating to certain different circumstances in which an original income stream may have been commuted and rolled over into a new income stream for the purposes of the Commission determining whether the new income stream retains the original's asset-test exempt status.

Section 10 of the Determination 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*). This section excludes Self-Managed Superannuation Funds and small APRA Funds.

Sections 11 and 12 of the Determination 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 11 covers an income stream that has been purchased or acquired by the primary beneficiary or his or her partner or former partner 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 12 covers an income stream that has been purchased or acquired by the primary beneficiary or his or her partner or former partner 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, 90SM, 90SS or 114 of the Family Law Act; or
- an injunction that has been granted under section 90SS or 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 13 of the Determination 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 14 of the Determination 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 an amount to give effect to a release authority given in relation to the primary beneficiary under section 292-415 of the *Income Tax Assessment Act 1997* or section 292-80C of the *Income Tax*

(*Transitional Provisions*) Act 1997, that is, to pay the primary beneficiary's excess contributions tax liability.

Section 15 of the Determination 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 16 of the Determination 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 became too onerous due to the age or incapacity of a trustee.

Section 17 provides that the Commission should determine that a family law affected income stream, whose contract or governing rules do not meet the requirements of subsection 5JA(2) or 5JB(2), is an asset-test income stream for the purposes of the Act if:

- either:
 - as long as the income stream did meet the requirements of either paragraphs 5JA(2)(a) to (l) or 5JB(2)(a) to (l) up until the operation of an order under Part VIIIAA or a payment split under Part VIIIB of the Family Law Act and would have continued to meet those requirements if it had not been for the payment split; or
 - as a result of the operation of one or more orders under Part VIIIAA or one or more payment splits under Part VIIIB of the Family Law Act , the income stream was derived from an income stream that is an asset-test exempt income stream to which subsection 5JA(1A) or 5JB(1B) of the Act applied at the time of the relevant order or payment split; and
- the original family affected income stream from which the income stream is derived as a result of the operation of one or more orders under Part VIIIAA or one or more payment splits under Part VIIIB of the Family Law Act was purchased before 20 September 2004.

This provision ensures that income streams created from an original income stream as a consequence of a payment split that result in lower payments from the new income stream(s), do not necessarily cause a loss of the income stream's asset-test exempt status.

Additionally, income streams that are an immediate annuity under a statutory fund established by a life company, or under a benefit fund must satisfy the standards published by the Australian Prudential Regulation Authority about minimum surrender values and paid up values that apply to the annuity. All other income streams must meet the requirements of subsection 17(2). Subsection (2) provides that an income meets the requirements of this subsection if:

- the Commission is satisfied that there is in force a current actuarial certificate that states that in the actuary's opinion there is a high probability that the provider of the income stream will be able to pay the income stream as required under the contract or governing rules under which the income stream is provided; or
- for a period of not more than 26 weeks beginning when an actuarial certificate, as mentioned in paragraph 17(2)(a), ceases to be in force.

In deciding whether an appropriate certificate is in force in relation to an income stream, the Commission must have regard to any guidelines prepared for this purpose under subsection 5JA(1B) or 5JB(1D). Additionally, the effect of this provision is that, where an actuarial certificate expires, it will be taken, for the purposes of these Guidelines, to remain in force for a period of 26 weeks after its expiration.

When the Commission is considering whether or not the contract or governing rules of the primary FLA income stream in question would have met the requirements of subsection 5JA(2) or 5JB(2), but for the operation of a payment split under Part VIIIB of the *Family Law Act 1975* then, where there has been any rollover, transfer, commutation or lump sum payment from the original family law affected income stream, the primary FLA income stream will be taken to meet those requirements as long as the amount rolled-over, transferred, commuted or paid out is not greater than the amount that was required to satisfy the non-member spouse's entitlement in relation to the payment split. That is, unless the Act so provides, the owner of an income stream cannot take the opportunity, where there is a payment split in relation to their income stream, to withdraw, from their income stream, an extra amount, that is, an amount that is more than the amount of funds that they are required to pay to their former spouse, and still retain an asset-test exempt status in relation to the income stream.

Section 18 provides that the Commission should determine that a defined benefit income stream is asset-test exempt for the purposes of the Act:

- as long as the income stream has been a defined benefit income stream from the day the income stream began being paid; and
- if the income stream is also an original family law affected income stream, any amount of the original family law affected income stream that is rolled over, transferred, commuted or paid as a lump sum is not more than the amount required to satisfy the non-member spouse's entitlement under a payment split under Part VIIIB of the Family Law Act. That is, unless the Act so provides, the owner of an income stream cannot take the opportunity, where there is a payment split in relation to their income stream, to withdraw, from their income stream, an extra amount, that is, an amount that is more than the amount of funds that they are required to pay to their former spouse, and still retain an asset-test exempt status in relation to the income stream.

If the income stream is not an original family law affected income stream, paragraph (a) will apply provided the income stream falls within the conditions of paragraph (a).

Consultation

Consultation regarding the attached instrument was undertaken (by e-mail) with the Department of Families and Housing, Community Services and Indigenous Affairs (FaHCSIA) which has prepared a similar determination to the one attached. In turn FaHCSIA consulted the Department of Education, Employment and Workplace Relations, which also prepared a similar instrument, to ensure a co-ordinated approach in respect of payments under the *Social Security Act 1991* for which those two Departments have responsibility.

Regulatory Impact Analysis

The attached instrument does not require a Regulatory Impact Statement (RIS) and/or a Business Cost Calculator Figure. It 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. For the nine categories see:

http://www.finance.gov.au/obpr/proposal/handbook/appendix-G-business-cost-calculator.html#table_g1