EXPLANATORY STATEMENT

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

Income Tax Assessment Act 1997

Income Tax Assessment Amendment (Transfer Balance Account Value for Certain Superannuation Income Streams) Regulations 2024

Section 909-1 of the *Income Tax Assessment Act 1997* (the Act) 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 294-135(4) of the Act provides that regulations may specify a method for determining the special value of a superannuation interest that supports a superannuation income stream prescribed by regulations made for the purposes of subsection 294-130(2). Item 8 of the table in section 294-80 of the Act provides for regulations to cause a transfer balance debit to arise for the purpose of that section and to specify details for working out the amount of the debit and the time it arises.

The purpose of the *Income Tax Assessment Amendment (Transfer Balance Account Value for Certain Superannuation Income Streams) Regulations 2024* ('the Regulations') is to prescribe rules for dealing with certain superannuation income streams for the purpose of the transfer balance account provisions in Division 294 of the Act. The Regulations prescribe a special value for transfer balance account reporting purposes and provide for a transfer balance debit to arise when these superannuation income streams cease and the cessation does not otherwise result in a transfer balance debit.

The regulations apply to certain non-lifetime permanent incapacity pensions that scheme trustees had not reported as a superannuation income stream because they did not meet relevant legislative criteria prior to the Government's legislative response to the Federal Court decision in *Commissioner of Taxation v Douglas* [2020] FCAFC 220 (the Douglas decision). The regulations apply where the scheme trustee has not reported to the Commissioner for transfer balance cap purposes prior to the commencement of these regulations. These pensions have subsequently been prescribed as capped defined benefit income streams and are superannuation income streams as a result of the Government's legislative response to the Douglas decision.

The Regulations provide that the special value for these superannuation income streams is worked out using one of two methodologies. The methodology is whichever gives the lesser amount of annual entitlement multiplied by 16, or annual entitlement multiplied by the term remaining if the income stream has a fixed term. This approach will ensure that the special value for these superannuation income streams uses the method that is most advantageous to the member. The special value of the superannuation income stream is calculated from the later of 1 July 2017 or the date that the superannuation income stream commenced.

The regulations also provide for a transfer balance debit to be applied if one of these superannuation income streams ceases and the cessation does not otherwise result in a transfer balance debit. The value of the transfer balance debit will be equal to the value of the original transfer balance credit, less certain other transfer balance debits that have arisen prior to cessation. This change will address an unintended consequence of the government's legislative response to the Douglas decision, which resulted in these non-lifetime permanent incapacity pensions having to be reported as superannuation income streams for transfer balance cap purposes. It will ensure that the person does not have their transfer balance cap space taken up by that pension if it ceases, and is not adversely affected when commencing a new retirement phase superannuation income stream.

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

Targeted consultation on an exposure draft of the Regulations was undertaken with superannuation funds and administrators who have schemes that provide non-lifetime pensions that had been treated as superannuation lump sums prior to the Government's legislative response to the Douglas decision. Following consultation, further changes were made to the draft regulations to ensure that they were appropriately targeted to the correct cohort and addressed unintentional consequences relating to the transfer balance cap provisions.

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

The Regulations are subject to disallowance under section 42 of the *Legislation Act 2003*.

The Regulations are subject to sunsetting under section 50 of the *Legislation Act 2003*.

The Regulations commenced on the day after registration on the Federal Register of Legislation.

The Regulations have retrospective operation as it is necessary to prescribe a special value to determine the transfer balance credit that is to be used for the purpose of the transfer balance provisions, which commenced on 1 July 2017. It is also necessary to apply the transfer balance debit to relevant pensions that may have ceased prior to the commencement of the Regulations. The retrospective application is a consequence of the Douglas response legislation that retrospectively provided that these superannuation benefits are superannuation income streams. While it is possible that some taxpayers may have a detrimental impact as a result of the Douglas response legislation, these Regulations will not have any detrimental impacts on individual taxpayers and therefore are not affected by subsection 12(2) of the *Legislation Act 2003*.

Details of the Regulations are set out in <u>Attachment A</u>.

A statement of Compatibility with Human Rights is at <u>Attachment B.</u>

The Office of Impact Analysis has been (OIA) has been consulted (OIA23-06092) and agreed that an Impact Analysis is not required.

ATTACHMENT A

Details of the Income Tax Assessment Amendment (Transfer Balance Account Value for Certain Superannuation Income Streams) Regulations 2024

Section 1 – Name

This section provides that the name of the regulations is the *Income Tax Assessment Amendment (Transfer Balance Account Value for Certain Superannuation Income Streams) Regulations 2024* (the Regulations).

Section 2 – Commencement

Schedule 1 to the Regulations commence the day after the instrument is registered on the Federal Register of Legislation.

Section 3 – Authority

The Regulations are made under the *Income Tax Assessment Act 1997* (the Act).

Section 4 – Schedule

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

Schedule 1 – Amendments

Item 1 – new transfer balance debit when certain superannuation income streams cease

Item 1 inserts a new section 294-80.02B into the *Income Tax Assessment (1997 Act) Regulations 2021* ('the Principal Regulations') to provide for a transfer balance debit to arise in an individual's transfer balance account in certain circumstances. The debit applies:

- if a credit arose in the person's transfer balance account under items 1 or 2 of the table in subsection 294-25(1) of the Act;
- the superannuation income stream is supported by an interest covered by subsection 294-135.01(6) of the regulations;
- the superannuation income stream ceases; and
- that cessation does not give rise to a transfer balance debit under another provision.

The transfer balance debit will apply to a non-lifetime permanent incapacity pension in a scheme that had not been reporting for transfer balance cap purposes for these pension types prior to the commencement of these regulations.

This new transfer balance debit is intended to address an unintentional consequence of the government's legislative response to the Douglas decision that arises where non-lifetime permanent incapacity pensions have become subject to the transfer balance account provisions under the Act. The amendments mean that individuals who are receiving a permanent incapacity pension, where that scheme did not previously have to report for transfer balance purposes for these pension types, will not have their cap space used up by that superannuation income stream if it ceases under the relevant scheme rules. This will allow a more appropriate amount of cap space for the individuals to use in their retirement.

Subsection (2) provides that the amount of the transfer balance debit is the amount of the initial transfer balance credit in respect of that superannuation income stream, less any transfer balance debits that have previously arisen in respect of the income stream (other than debits covered by item 4 of the table in subsection 294-80(1) of the Act, which deals with family law payment splits). This means that if one of these superannuation income streams cease, the transfer balance debit will offset the original transfer balance credit, so the non-lifetime permanent incapacity pension does not reduce the transfer balance account cap space that would otherwise have been available to them in retirement. Transfer balance debits arising prior to the cession are taken into account (with the exception of debits arising because of a payment split), noting that the resulting amount of the debit cannot be less than zero.

The transfer balance debit under this provision arises at the time the superannuation income stream ceases.

<u>Items 2 and 3 – special commencement value for certain superannuation income streams</u>

Items 2 and 3 amend section 294-135.01 of the Principal Regulations to prescribe methodology to work out the special commencement value for certain superannuation income streams. The special value of the superannuation income stream is calculated from the later of 1 July 2017 or the date that the superannuation income stream commenced.

Item 2 is a consequential amendment, inserting a reference to the new subsection 294-135.01(6) that is inserted by item 3.

Item 3 inserts new subsections (6) to (9) into section 294-135.01, which provide rules for working out the special value for the purposes of the transfer balance account provisions in subsection 294-135(4) for certain superannuation income streams.

Subsection 294-135.01(6) deals with the scope of the new special value provisions. The special value rules apply to a superannuation interest in a superannuation plan if it meets the following conditions:

- The superannuation interest supports an income stream that is, or was at any time, a superannuation income stream prescribed by section 294-130.01 to which subsection 294-130.01(7) applies. This means superannuation income streams that were prescribed as capped defined benefit income streams as a result of the Douglas response legislation applying to them.

- A superannuation benefit was paid from the superannuation income stream to the person, whether before, at or after the commencement of these regulations. This means that the special value provisions operate retrospectively and prospectively to income streams commencing before and after the commencement of these regulations, ensuring consistent treatment of members of the relevant superannuation plans.

- The superannuation benefit was paid to the person because they satisfied a condition of release specified in item 103 of the table in Schedule 1 of the

Superannuation Industry (Supervision) Regulations 1994. This covers benefits paid due to the person's permanent incapacity.

- The superannuation provider in relation to the superannuation plan had not reported that a transfer balance credit arose in the person's transfer balance account before the time these regulations commenced. This will mean that members of these superannuation plans, whether they commenced a superannuation income stream before or after the commencement of the regulations, will be within scope of this provision. This ensures consistent treatment for members of those superannuation plans.

Subsection 294-135.01(7) sets out the methodology that is to be used to determine the special value for those superannuation interests covered by subsection 294-135.01(6). The special value is the lesser of:

- the amount worked out under subsection 294-135(2) of the Act, which is the annual entitlement multiplied by 16; or

- if the superannuation income stream has a particular period throughout which benefits are payable, the amount worked out under subsection 294-135(3) of the Act, which is the annual entitlement multiplied by the term remaining.

Subsection 294-135.01(8) explains how this method is to be used when working out the special value for capped defined benefit income streams for transfer balance cap purposes under section 294-135 of the Act.

The reference to a superannuation income stream that has a particular period throughout which benefits are payable is intended to cover 'fixed term' interests. That is, interests that, under the scheme rules, are payable for a certain period or until the person reaches a certain age. Subsection 294-135.01(9) clarifies that this is intended to cover such superannuation income streams even if the scheme rules provide that the income stream may cease earlier in certain circumstances, such as commutation.

If the superannuation income stream does not have a particular period throughout which benefits are payable, then the method will be the annual entitlement multiplied by 16.

Prescribing a valuation method will provide certainty for individuals and trustees for these superannuation interests. It will ensure that for income streams where there is an identifiable period throughout which benefits are payable, where both methodologies could apply, the method is used that will be the most advantageous for the individual.

Example

A then 44-year-old was earning $120,000 from employment in 2016-17 just before being originally assessed as permanently incapacitated. The commencing annual permanent incapacity pension payment was $80,000. They are in receipt of that pension until it stops when they reach age 60. They have also made a $330,000 non-concessional contribution into another account in 2017-18.

As a result of the Douglas response legislation, a credit will arise in their transfer balance account for the permanent incapacity pension as of 1 July 2017. The scheme trustee has not reported a credit at the date these regulations commenced. Applying the commencement value methodology set out in item 3 of these regulations, the credit value is $1,200,000 (based on a term remaining of 15 years, which gives a lesser value than the annual entitlement multiplied by 16, which would be $1,280,000).

Under item 1 of these regulations, they will receive a $1,200,000 transfer balance debit (assuming no other debits have arisen) when the permanent incapacity pension ceases in 2032-33. This will enable them to use that returned transfer balance cap space to commence a lifetime retirement pension and/or retirement account-based pension.

In the absence of these regulations, when the pension ceases in 2032-33 they would not receive a transfer balance debit, and the transfer balance credit of $1,200,000 would take up transfer balance cap space. In this scenario, commencing a new retirement product may cause them to exceed their transfer balance cap and require them to commute amounts from the account-based pension and pay excess transfer balance tax or defined benefit income tax.

<u>Item 4 – transitional matters</u>

Item 4 inserts a new Part 1000-6 into the Principal Regulations to deal with transitional matters.

Section 1000-6.01 sets out definitions relevant to this Part.

2021 commencement time refers to time that the *Income Tax Assessment (1997 Act) Regulations 2021* commenced, which is 1 April 2021.

amending instrument means the *Income Tax Assessment Amendment (Transfer Balance Account Value for Certain Superannuation Income Streams) Regulations 2024*.

old regulations refers to the *Income Tax Assessment Regulations 1997*, which were repealed, but have continuing application in relation to certain matters, including the transfer balance cap provisions.

Section 1000-6.02 provides that the new transfer balance debit provision in section 294-80.02B applies in relation to a superannuation income stream that ceases on or after the 2021 commencement time. Similarly, the amendments made by the Regulations apply in relation to working out the special value of a superannuation income stream on or after the 2021 commencement time, subject to the modifications in new section 1000-6.03.

Section 1000-6.03 modifies the application of the old regulations so that the provisions in these amending regulations apply to superannuation income streams that started to be in the retirement phase and/or ceased before 1 April 2021 (the 2021 commencement date). This transitional provision is necessary to enable the new transfer balance debit and the special value set by these Regulations to apply to a superannuation income stream that commenced and/or ceased prior to the 2021 commencement date.

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 (Transfer Balance Account Value for Certain Superannuation Income Streams) 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 *Income Tax Assessment Amendment (Transfer Balance Account Value for Certain Superannuation Income Streams) Regulations 2024* ('the Regulations') is to prescribe rules for dealing with certain superannuation income streams for the purpose of the transfer balance account provisions in Division 294 of the Act. The Regulations prescribe a special value for transfer balance account reporting purposes and provide for a transfer balance debit to arise when these superannuation income streams cease and the cessation does not otherwise result in a transfer balance debit.

The regulations apply to certain non-lifetime permanent incapacity pensions that scheme trustees had not reported as a superannuation income stream because they did not meet relevant legislative criteria prior to the Government's legislative response to the Federal Court decision in *Commissioner of Taxation v Douglas* [2020] FCAFC 220 (the Douglas decision). The regulations apply where the scheme trustee has not reported to the Commissioner for transfer balance cap purposes prior to the commencement of these regulations. These pensions have subsequently been prescribed as capped defined benefit income streams and are superannuation income streams as a result of the Government's legislative response to the Douglas decision.

The Regulations provide that the special value for these superannuation income streams is worked out using one of two methodologies. The methodology is whichever gives the lesser amount of annual entitlement multiplied by 16, or annual entitlement multiplied by the term remaining if the income stream has a fixed term. This approach will ensure that the special value for these superannuation income streams uses the method that is most advantageous to the member. The special value of the superannuation income stream is calculated from the later of 1 July 2017 or the date that the superannuation income stream commenced.

The regulations also provide for a transfer balance debit to be applied if one of these superannuation income streams ceases and the cessation does not otherwise result in a transfer balance debit. The value of the transfer balance debit will be equal to the value of the original transfer balance credit, less certain other transfer balance debits that have arisen prior to cessation. This change will address an unintended consequence of the government's legislative response to the Douglas decision, which resulted in these non-lifetime permanent incapacity pensions having to be reported as superannuation income streams for transfer balance cap purposes. It will ensure that the person does not have their transfer balance cap space taken up by that pension if it ceases, and is not adversely affected when commencing a new retirement phase superannuation income stream.

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.