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TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL  
2021: REQUIREMENT FOR ACTUARIAL CERTIFICATES FOR CERTAIN  
SUPERANNUATION FUNDS

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EXPOSURE DRAFT EXPLANATORY MATERIALS



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# ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
APRA	Australian Prudential Regulation Authority
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
ITAR 2021	<i>Income Tax Assessment (1997 Act) Regulations 2021</i>
SISR	<i>Superannuation Industry (Supervision) Regulations 1994</i>
SMSF	Self managed superannuation fund



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# **Chapter 1**

## ***Requirement for actuarial certificates for certain superannuation funds***

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### **Outline of chapter**

- 1.1 Schedule XX amends the ITAA 1997 to remove the requirement for superannuation trustees to obtain an actuarial certificate when calculating exempt current pension income, where all members of the fund are fully in retirement phase for all of the income year. This is achieved by permitting such funds to use the segregated method to calculate exempt current pension income.
- 1.2 The amendment removes a redundant requirement which will reduce costs and remove unnecessary red tape for affected funds.
- 1.3 All legislative references in this chapter are to the ITAA 1997 unless otherwise stated.

### **Context of amendments**

#### **Existing law**

- 1.4 Income that a superannuation fund derives from assets held to support retirement phase income streams is exempt from income tax (see sections 295-385 and 295-390). This type of income is known as exempt current pension income. There are two methods for calculating exempt current pension income — the segregated method and the proportionate method.
- 1.5 Superannuation funds are required to obtain an actuarial certificate to claim certain forms of exempt current pension income. The actuarial certificate is required to ensure that the amount of exempt current pension income that can be claimed is calculated correctly. However, there are some limited circumstances where an actuarial certificate does not provide an integrity benefit for calculating exempt current pension income.
- 1.6 If a fund has segregated current pension assets, then the exempt current pension income for income derived from those assets must be calculated by the segregated method under section 295-385.

1.7 If a fund does not have segregated current pension assets, then the fund's exempt current pension income must be calculated by the proportionate method under section 295-390.

1.8 Funds using the proportionate method must engage an actuary to determine the 'exempt proportion' of income based on the proportion of the fund's superannuation liabilities that are current pension liabilities (see subsections 294-390(3) and (4)). The exempt proportion is then applied to the fund's assessable income for the period to determine the amount that is exempt current pension income.

1.9 The 'disregarded small fund asset rules' under section 295-387 provides that disregarded small fund assets cannot be segregated current pension assets. If a fund does not have segregated current pension assets, then the fund's exempt current pension income must be calculated by the proportionate method. Subsection 295-385(7) operates to require certain funds that have disregarded small fund assets (that is, SMSFs and small APRA-regulated funds) to only use the proportionate method even when the fund is in full retirement phase.

1.10 Section 295-387 was introduced as an integrity measure so that funds were required to use the proportionate method to mitigate the risk of asset-cycling between the earnings-tax-free retirement phase and the accumulation phase where earnings tax applies. It required certain funds to use the proportionate method and provide the relevant actuarial certificate.

1.11 However, this means that funds with disregarded small fund assets that have all members fully in retirement phase for all of the income year are nonetheless required to use the proportionate method and obtain actuarial certificates. As such funds do not hold any accumulation phase assets, it is not possible for the fund to asset-cycle between the accumulation and retirement phases, and the actuarial certificate adds no integrity value.

1.12 For a superannuation fund to have all members fully in retirement phase it must have no assets supporting superannuation interests that are in accumulation phase or that support income streams that are not in retirement phase. All of the fund's assets support retirement phase income streams, and therefore are not subject to income tax. As the taxation treatment of all the fund's assets is the same, there is no compliance benefit gained by requiring these funds to obtain actuarial certificates.

1.13 The amendment will reduce costs and remove unnecessary red tape for affected funds.



## **Summary of new law**

1.14 Schedule XX amends the ITAA 1997 to remove the requirement for superannuation trustees to obtain an actuarial certificate when calculating exempt current pension income, where all members of the fund are fully in retirement phase for all of the income year. This is achieved by permitting such funds to use the segregated method to calculate exempt current pension income.

## **Detailed explanation of new law**

1.15 A fund is not covered by the disregarded small fund assets rule for an income year if at all times during the income year, all of the assets of the superannuation fund would, apart from subsection 295-385(7), be segregated current pension assets. Subsection 295-385(7) provides that disregarded small fund assets are not segregated current pension assets. *[Schedule XX, item 1, subsection 295-387(3)]*

1.16 This means that funds who would only be prevented from using the segregated method for calculating exempt current pension income by the disregarded small fund assets rule, can now use the segregated method.

1.17 Superannuation income stream benefits prescribed by regulation 295-385.01 of the ITAR 2021 are not required to obtain an actuarial certificate when using the segregated method to calculate exempt current pension income.

1.18 An actuarial certificate is still required for funds where it is possible that at any time during the income year, assets and earnings are greater than the estimated liabilities, even if all members are fully in retirement phase. In such circumstances, because the assets and earnings are greater than the amount required to discharge the estimated pension liabilities, the income stream is generating taxable income and therefore the excess amount is liable for income tax. As the exempt proportion is no longer 100 percent, not all the fund's assets will be segregated current pension assets and an actuarial certificate would provide necessary rather than redundant information.

### **Example 1.1**

On 30 June 2021, James has a total superannuation balance of \$1.5 million. His sole superannuation interest in the fund for the year supports a complying lifetime pension (under 1.06(2) of the SISR) in SMSF J&L. Lisa has a total super balance of \$1.0 million. Her sole superannuation interest in the fund on 30 June 2021 supports a complying lifetime pension in SMSF J&L. Lisa had an accumulation account in the fund on 1 July 2020 but withdrew her account in full on 31 July 2020. SMSF J&L maintains a pension reserve account, in

accordance with fund rules. The total assets of the fund exceed the amount required to guarantee the payment of the lifetime pensions when worked out on a 'best estimates' basis as required by the Institute of Actuaries Professional Standard 406.

Subsection 295-387(3) does not apply to SMSF J&L as not all of the assets of the fund would be segregated current pension assets apart from subsection 295-385(7). SMSF J&L must obtain an actuarial certificate and must use the proportionate method to calculate the exempt current pension income.

1.19 In other words, if an amount of income was not exempt current pension income under the existing law solely because of section 295-385(7), then it is not exempt current pension income under the new law.

## **Application and transitional provisions**

1.20 The amendment made by this Schedule applies to assessments for the 2021-22 income year and later income years. [*Schedule XX, item 2*]