EXPLANATORY STATEMENT

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

Superannuation Industry (Supervision) Act 1993

Retirement Savings Accounts Act 1997

Income Tax Assessment Act 1997

Treasury Laws Amendment Instrument 2024: Self-managed superannuation funds – legacy retirement product conversions and reserves

The *Income Tax Assessment Act 1997* (ITAA 1997), *Retirement Savings Accounts Act 1997* (the RSA), 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 RSA 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 Instrument 2024: Self-managed superannuation funds – legacy retirement product conversions and reserves* 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 measure applies to legacy lifetime, life expectancy and market-linked superannuation income stream products that commenced prior to 20 September 2007, or were 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 core feature of legacy products, namely complying lifetime and life-expectancy pensions and annuities. These products guarantee income for an extended period, so at commencement, a portion of the starting capital is reserved for contingencies. The reserve amount sits outside the main capital upon which the payment entitlements are initially calculated. Unlike account-based products, the actual underlying capital and

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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 circumstances. A trustee can avoid members having excess contributions consequences by titrating 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 an account-based income stream, left in an accumulation interest account, or withdrawn from superannuation entirely. The commutation must occur in full 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, and the reserve is allocated to the former recipient of that income stream, it will be exempt from both contribution caps.

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

The *Retirement Savings Account Regulations 1997* (RSA Regulations) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) are exempt from sunsetting 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*.

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

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

The Regulations commenced on the day of Royal Assent.

Details of the Regulations are set out in Attachment A.

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ATTACHMENT A

Details of the *Treasury Laws Amendment Instrument 2024: Self-managed superannuation funds – legacy retirement product conversions and reserves*

Part 1 – Commutation of certain pensions and annuities

Amendments to the RSA Regulations

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

Item 2 inserts new regulation 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, and the whole of the benefit is commuted.

Amendments to the SIS Regulations

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

Item 6 inserts new regulation 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, and the whole of the benefit is commuted. The new commutation rule applies to lifetime, life-expectancy and market-linked annuities covered by the provisions mentioned in items 3 to 5.

Subregulation 1.05AA(2) clarifies that the commutation relaxation applies to lifetime annuities purchased by superannuation funds that are not defined benefit funds.

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

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

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

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

Item 10 inserts new regulation 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, and the whole of the benefit is commuted. The new subregulation 1.06C(1) lists the income stream products to which the commutation rule applies and includes lifetime, life-expectancy and market-linked pensions.

Subregulation 1.06C(2) provides that the 5-year commutation relaxation applies if the fund providing the benefit is not 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 regulation 1.06C.

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

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

Part 2 – Allocations from reserves

Items 11 to 20 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 reflect the intent to provide a more flexible pathway to make allocations from a reserve. The more flexible treatment exempts reserve allocations from counting towards an individual's concessional contributions or non-concessional contributions 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 due to satisfying the conditions in subsection 291-25.01(3) of the ITAA 1997, are now instead counted towards their non-concessional contributions.

Item 12 repeals the subsections 291-25.01(3) to (5), so reserve allocations are no longer counted towards an individual's concessional contributions.

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 whereby a member's reserve allocations count towards their non-concessional contributions.

Item 17 inserts new subsection 292-90.01(2A) which sets out the conditions for which allocations from reserves are now counted towards an individual's non-concessional contributions instead of their concessional contributions. Using non-concessional contributions cap provides greater flexibility as the non-concessional cap is four-times larger than the concessional cap, thus allowing far more to be allocated from reserves each year. Additionally, the consequences for exceeding this cap are less severe than if an individual were to exceed the concessional cap. 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 fair outcomes while mitigating the risk of inter-generational wealth transfer within the self-managed superannuation fund system.

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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 made in these conditions count towards neither the concessional contributions cap, nor the non-concessional contribution caps. This includes the conditions for contribution reserves, 'fair and reasonable' allocations and pension reserve-related allocations.

Subsection 292-90.02(2) replicates the current rule that where an amount allocated for an individual is allocated for all members of the fund, or class of members to which the reserve relates is done on a 'fair and reasonable basis'; and where allocations for the financial year that are less than 5 per cent of the value of the members interest in the superannuation plan at the time of the allocation is made, then it is not counted towards non-concessional contributions caps in addition to being disregarded as a concessional contribution under subsection 292-25.91(4) of the ITA Regulations.

Subsection 292-90.02(3) exempts from all contributions caps 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.

Subsection 292-90.02(4) exempts from all contributions caps, all amounts allocated during a financial year from a pension reserve of a complying superannuation plan where:

- the reserve is used to discharge liability of the plan to pay a superannuation income stream of which you are 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 commencement); and
- if the reserve relates to more than one superannuation income streams, the allocation is fair and reasonable having regard to the factors listed in

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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 exemption should apply to superannuation income stream recipients who choose to commute their income stream during the 5-year commutation relaxation; as well as those who would have done so, but their income stream has already ceased for some other reason, such as reaching the end of its term. These people can receive an allocation of the entire pension reserve; both the commutation amount, reflecting 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) disregards such allocations from the individual's contributions caps if the individual is a death benefits dependant of the primary beneficiary and the amount is allocated to them in order to discharge the liabilities of the plan that are a result of the death, and if it is allocated as soon as practicable from the commutation.

Additionally, where the commutation is a result of the death of the primary beneficiary and an amount is allocated as soon as practicable for the individual and paid as a superannuation lump sum and a superannuation death benefit, the amount is also not to be counted towards either contributions cap under subsection 292-90.02(6).

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'. Where the reserve is used for the purpose of enabling the plan to discharge all or part of its pension liabilities, and is commuted or 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 where a pension has been commuted or otherwise ceases and there are no members receiving any superannuation income stream benefits, any amount remaining in reserve will meet the definition of pension reserve and be able to be allocated to individuals who were income stream recipients before the commutation or cessation.

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

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