

**ATTACHMENT 11 – LEGISLATIVE AMENDMENTS, ELIGIBLE DEFERRED
LIFETIME ANNUITIES, KPMG AND LANDER AND ROGERS, APRIL 2013**



Challenger Life Company Limited

**Submissions: Legislative
amendments**

Eligible deferred lifetime annuity

April 2013

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1 Background

This report details proposed amendments to the *Income Tax Assessment Act 1997* ("ITAA 97") and the *Income Tax Assessment Act 1936* ("ITAA 36"), specifically in relation to the following sections:

- Section 995-1 ITAA 97;
- Division 320 ITAA 97;
- Part 3-30 ITAA 97;
- Section 27H ITAA 36; and
- Division 16E ITAA 36.

Other legislation referred to in this report are:

- *Income Tax Assessment Regulations 1997* ("ITAR 97");
- *Superannuation Industry (Supervision) Act 1993* ("SIS Act");
- *Superannuation Industry (Supervision) Regulations 1994* ("SIS Regs");
- *Life Insurance Act 1995* ("Life Act"); and
- *Retirement Savings Accounts Act 1997* ("RSA Act").

1.1 Deferred lifetime annuities

Deferred lifetime annuity products are designed to provide guaranteed income for life once the policyholder reaches old age, at an age where the policyholder's retirement savings may be depleted.

Like a traditional annuity, deferred lifetime annuity policies allow purchasers to convert a lump sum into a pension-like stream of income for life. However, the policyholder of the deferred lifetime annuity will not receive annuity payments until reaching a certain nominated age. Importantly, deferred lifetime products cannot be converted into a lump sum receipt by the policyholder, and if the policyholder never reaches the stipulated age, there will be no payment required from the issuer.

The purpose of this report is to outline possible amendments to the ITAA 97 and ITAA 36 (and associated legislation) to ensure that the taxation of deferred lifetime annuities issued by life insurance companies are taxed similarly to other risk business of life insurance companies. Further, this report suggests amendments to ensure that holders of deferred lifetime annuities, particularly superannuation funds, are taxed in a way which is consistent with policy objectives.

2 Policy objectives

2.1 Submission 1

Eligible deferred lifetime annuities should constitute *annuities* for the purposes of the SIS Act.

2.2 Submission 2

Life insurance companies should be able to issue *eligible deferred lifetime annuities* such that they are taxed in the same way as they are taxed on other risk products.

2.3 Submission 3

Holders of *eligible deferred lifetime annuities* should not be assessed on an accruals basis during the deferral period (i.e. when no amounts are received by the policyholder).

2.4 Submission 4

Holders of *eligible deferred lifetime annuity* should not be assessed on payments received in respect of the *eligible deferred lifetime annuity*.

2.5 Submission 5

It is desirable that superannuation funds that seek to offer *eligible deferred lifetime annuities* insure themselves appropriately by purchasing these annuities from regulated life insurance companies (rather than “self-insuring”).

2.6 Submission 6

Individuals should be able to purchase *eligible deferred lifetime annuities* with “ordinary money” (i.e. directly with money that is not a *superannuation roll-over benefit*).

2.7 Submission 7

Individuals should be able to purchase *eligible deferred lifetime annuities* before attaining preservation age or retirement age.

3 Summary of proposed technical amendments

Table of amendments

Submission/s	Section/s	Proposed amendment	Explanation	Reference
All	s 995-1 ITAA 97	<ul style="list-style-type: none"> Insert definition of <i>eligible deferred lifetime annuity</i> <i>Eligible deferred lifetime annuities</i> to include those purchased in respect of members who have attained <i>preservation age</i> by superannuation funds or with <i>superannuation roll-over benefits</i> 	<ul style="list-style-type: none"> Introduces the concept of <i>eligible deferred lifetime annuity</i> which will be referenced in other sections 	4.1.1 Amendment 1 Amendment 1A Amendment 1B Amendment 1C
Submission 1	s 10 SIS Act	<ul style="list-style-type: none"> Definition of <i>annuity</i> for the purposes of the SIS Act / SIS Regs to include <i>eligible deferred lifetime annuities</i> Alternative: Amend definition of <i>annuity</i> in s 995-1 to include an <i>eligible deferred lifetime annuity</i> 	<ul style="list-style-type: none"> Current definition of <i>annuity</i> in SIS Act does not include <i>eligible deferred lifetime annuities</i> <i>Eligible deferred lifetime annuities</i> should be taxed to holders in the same way as other annuities issued by life insurance companies 	4.1.2 Amendment 2 Amendment 2A
Submission 2 / All	s 995-1 ITAA 97	<ul style="list-style-type: none"> Amend definition of <i>life insurance policy</i> to include an <i>eligible deferred lifetime annuity</i> 	<ul style="list-style-type: none"> Allows <i>eligible deferred lifetime annuities</i> to be afforded similar tax treatment to other life insurance policies 	4.2.2.1 Amendment 3
Submission 2	Div 320 ITAA 97	<ul style="list-style-type: none"> Amend definition of <i>risk component</i> to include all amounts paid under an <i>eligible deferred lifetime annuity</i> 	<ul style="list-style-type: none"> Allows <i>eligible deferred lifetime annuities</i> to be taxed in the hands of the issuing life company as per other risk 	4.2.2.2 Amendment 4

Submission/s	Section/s	Proposed amendment	Explanation	Reference
			<p>business of life insurance companies</p> <ul style="list-style-type: none"> PA 3 and PA 4 also allows premiums / claims / movement in policy liabilities to be taxed as per other risk business 	
Submission 2	s 995-1 ITAA 97	<ul style="list-style-type: none"> Amend definition of <i>excluded complying superannuation/FHSA life insurance policy</i> to include an <i>eligible deferred lifetime annuity</i> 	<ul style="list-style-type: none"> Ensures that <i>eligible deferred lifetime annuities</i> will not be taxed as <i>complying superannuation/FHSA life insurance policies</i> 	4.2.4 Amendment 5
Submission 3	Div 16E ITAA 36	<ul style="list-style-type: none"> Amend definition of <i>ineligible annuity</i> in s 159GP(1) to include an <i>eligible deferred lifetime annuity</i> 	<ul style="list-style-type: none"> Ensures that Division 16E will not apply to tax policyholders on an accruals basis during the deferral period (i.e. prior to receipt of any payments) 	4.3.1 Amendment 6
Submission 4	s 27H ITAA 36	<ul style="list-style-type: none"> Amend definition of <i>annuity</i> for the purposes of s 27H to specifically exclude an <i>eligible deferred lifetime annuity</i> 	<ul style="list-style-type: none"> Ensures that policyholders are not assessed on amounts received in respect of <i>eligible deferred lifetime annuities</i> 	4.3.2 Amendment 7
Submission 4	s 295-335 ITAA 97	<ul style="list-style-type: none"> Include a payment in respect of an <i>eligible deferred lifetime annuity</i> in the table of amounts excluded from assessable income in s 295-335 	<ul style="list-style-type: none"> Ensures that superannuation fund policyholders are not assessed on receipts in respect of <i>eligible deferred lifetime annuities</i> 	4.3.3 Amendment 8
Submission 4	s 307-5(1) ITAA 97	<ul style="list-style-type: none"> Include a payment in respect of an <i>eligible deferred lifetime annuity</i> in the table of <i>superannuation benefits</i> in s 307-5(1) 	<ul style="list-style-type: none"> Ensures that superannuation fund members are not assessed on benefits they receive in respect of <i>eligible deferred lifetime annuities</i> 	4.4.1 Amendment 9

Submission/s	Section/s	Proposed amendment	Explanation	Reference
Submission 4	s 306-10 ITAA 97	<ul style="list-style-type: none"> No specific amendment necessary 	<ul style="list-style-type: none"> <i>Superannuation rollover benefits</i> are able to be used to purchase an <i>eligible deferred lifetime annuity</i> if Proposed Amendment 2 adopted 	4.4.2
Submission 5	s 295-385 ITAA 97	<ul style="list-style-type: none"> No amendment necessary 	<ul style="list-style-type: none"> There should be no specific amendment to allow segregation of assets supporting <i>eligible deferred lifetime annuities</i> as this may encourage superannuation funds to “self-insure” Receipts from <i>eligible deferred lifetime annuities</i> should not be assessable to superannuation funds under Proposed Amendments 6 to 8. 	
Submission 6	s 995-1 ITAA 97	<ul style="list-style-type: none"> Add category of <i>eligible deferred lifetime annuity (ordinary)</i> to the definition of <i>eligible deferred lifetime annuity</i> 	<ul style="list-style-type: none"> Individuals should be able to purchase <i>eligible deferred lifetime annuities</i> with money that is not a <i>superannuation roll-over benefit</i> 	4.5.1 Amendment 10
Submission 6	s 292-80 ITAA 97	<ul style="list-style-type: none"> Include the purchase price of an <i>eligible deferred lifetime annuity (ordinary)</i> to the categories of <i>non-concessional contributions</i> 	<ul style="list-style-type: none"> Ensures that if a person purchases an <i>eligible deferred lifetime annuity</i> with money that is not a <i>superannuation roll-over benefit</i>, the purchase price of the <i>eligible deferred lifetime annuity</i> is captured in the calculation of that person’s superannuation contributions cap for that year 	4.5.2 Amendment 11

Submission/s	Section/s	Proposed amendment	Explanation	Reference
Submission 7	s 995-1 ITAA 97	<ul style="list-style-type: none"> Amend definition of <i>eligible deferred lifetime annuity</i> in Proposed Amendment 1 to remove the requirement that the relevant member has attained <i>preservation age</i> 	<ul style="list-style-type: none"> Allows individuals (and superannuation funds for the benefit of individuals) to purchase <i>eligible deferred lifetime annuities</i> while the member is in accumulation phase (i.e. prior to the member attaining <i>preservation age</i>) 	4.6 Amendment 12

4 Technical amendments – detailed explanation

4.1 Definitions

Definitions in the current law will need to expand to incorporate the concept of deferred lifetime annuities.

4.1.1 Definition of eligible deferred lifetime annuity

In order for the concept of deferred lifetime annuities to be contemplated by other sections, the concept should be defined in section 995-1 of the ITAA 97.

The proposed amendment below is structured such that there is a general definition for *deferred lifetime annuities*, stipulating the general requirements which reflect the principles embedded in the SIS Act and SIS Regulations. This definition incorporates policies where payments continue to be made to a surviving spouse on the death of the policyholder.

PROPOSED AMENDMENT 1: SECTION 995-1 ITAA 97

To be inserted:

deferred lifetime annuity means an annuity payable pursuant to a contract issued by a *life insurance company in respect of a natural person (*primary beneficiary*) that provides for the payment of an annuity for the benefit of the primary beneficiary (and which may, but need not, provide for the payment of a reversionary annuity for the benefit of a *spouse of a primary beneficiary (*reversionary beneficiary*) following the death of the primary beneficiary) subject to the terms and conditions set out in the annuity contract and which has the following features:

- (a) the purchase date of the annuity is on or after the date on which the primary beneficiary attains his or her *preservation age;
- (b) the payment period for a particular primary beneficiary commences after the primary beneficiary satisfies a *relevant condition of release;
- (c) for the avoidance of doubt, payment of the annuity is contingent upon the primary beneficiary (or, if there is a reversionary beneficiary, either the primary beneficiary or the reversionary beneficiary) being alive at the commencement of the payment period and may (but need not) be contingent upon satisfying additional conditions specified in the annuity contract;
- (d) the annuity contract provides for payments to be made throughout the life of the primary beneficiary and reversionary beneficiary if there is one;
- (e) the amount paid as the purchase price for the annuity is wholly converted into annuity payments;
- (f) there is no arrangement for an amount (or a percentage of the purchase price) prescribed by the annuity contract to be returned to the primary beneficiary or reversionary beneficiary when the annuity ends;
- (g) the amounts payable are specified in the annuity contract or calculated in accordance with a method specified in the annuity contract;

- (h) the annuity contract provides that the annuity cannot be commuted, in whole or in part except where the sole purpose of the commutation is to meet the rights of a client to return a financial product under Division 5 of Part 7.9 of the *Corporations Act 2001*;
- (i) the annuity has no surrender value at any time except to the extent of any repayment of purchase price to meet the rights of a client to return a financial product under Division 5 of Part 7.9 of the *Corporations Act 2001*;
- (j) the annuity is not transferable, with the exception of a transfer to a reversionary beneficiary on the death of the primary beneficiary; and
- (k) the capital value of the annuity and the income from it cannot be used as a security for a borrowing.

To include situations where a superannuation fund would purchase a single policy for the benefit of many members, the concept of a *master deferred lifetime annuity* has been included.

PROPOSED AMENDMENT 1A: SECTION 995-1 ITAA 97

To be inserted:

master deferred lifetime annuity means a contract issued by a *life insurance company in relation to one or more natural persons where the rights and obligations under that policy in relation to each natural person would, if taken severally, meet the definition of a *deferred lifetime annuity.

There is then an “umbrella definition” for *eligible deferred lifetime annuities*, which will be the types of *deferred lifetime annuities* that the tax law amendments suggested in this paper will apply to. This concept facilitates the addition of future categories of *eligible deferred lifetime annuities* to be included in the scope of the income tax rules, without requiring further additional amendments.

The “umbrella definition” below includes *deferred lifetime annuities* that are:

- Purchased by superannuation funds for members’ benefits, including where a single policy is purchased for the benefit of multiple members (*eligible deferred lifetime annuity (superannuation)*); and
- Purchased by members using “superannuation money” (*eligible deferred lifetime annuity (roll-over)*).

after the member has reached his or her *preservation age*.

PROPOSED AMENDMENT 1B: SECTION 995-1 ITAA 97

To be inserted:

eligible deferred lifetime annuity means:

- (a) an *eligible deferred lifetime annuity (superannuation)*;
- (b) an *eligible deferred lifetime annuity (roll-over)*; or
- (c) an *eligible deferred lifetime annuity (ordinary)*.

eligible deferred lifetime annuity (superannuation) means a *deferred lifetime annuity or *master deferred lifetime annuity purchased by the trustee of a *complying superannuation fund for the benefit of one or more members of the fund where each primary beneficiary under the annuity contract is a member of the fund.

eligible deferred lifetime annuity (rollover) means a *deferred lifetime annuity purchased by a natural person where the annuity is purchased with a *roll-over superannuation benefit and that person is the primary beneficiary under the annuity contract.

A consequential definition is also required in section 995-1 to include the concept of a relevant condition of release. This restricts the relevant conditions of release to those appropriate for an *eligible deferred lifetime annuity*.

PROPOSED AMENDMENT 1C: SECTION 995-1 ITAA 97

To be inserted:

relevant condition of release means a condition of release for which the cashing restriction is "Nil", as specified in Part 1 of Schedule 1 of the *Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations)* which is to be determined, in relation to a primary beneficiary, by reference to the SIS Regulations as at the purchase date.

4.1.2 Definition of annuity

"Annuity" is currently defined in section 995-1 as including:

- (a) an annuity, within the meaning of the SIS Act; or
- (b) a pension, within the meaning of the RSA Act.

As an *eligible deferred lifetime annuity* may not necessarily satisfy the definitions of *annuity* and *pension* in the relevant Acts, it may not fall within the current definition of *annuity*.

Accordingly, one of the following definitions should include the concept of an *eligible deferred lifetime annuity*:

- *annuity* in the SIS Act;
- *annuity* in the RSA Act; or
- *annuity* in section 995-1.

Having regard to other considerations discussed below, we consider the simplest option be an amendment to the definition in the SIS Act, as follows:

PROPOSED AMENDMENT 2: SECTION 10 SIS ACT / SIS REGS

To be amended: definition of annuity amended to include an eligible deferred lifetime annuity as defined in ITAA 97.

Alternatively, the following amendment could also be considered:

PROPOSED AMENDMENT 2A: SECTION 995-1 ITAA 97

To be inserted:

annuity includes:

- (a) an annuity, within the meaning of the *Superannuation Industry (Supervision) Act 1993*;
- (b) a pension, within the meaning of the *Retirement Savings Accounts Act 1997*; or
- (c) an *eligible deferred lifetime annuity.

4.2 Taxation of life insurance companies

4.2.1 Assessment of premiums

Paragraph 320-15(1)(a) states that a life insurance company's assessable income includes "the total amount of the life insurance premiums paid to the company in the income year".

"Life insurance premiums" is defined in section 995-1 as follows:

life insurance premiums includes consideration received or receivable in respect of the grant of, or the undertaking of liabilities in respect of, an *annuity or a *personal injury lump sum.

If the above Proposed Amendment 2 or 2A are implemented, this definition of life insurance premiums would include premiums paid on *eligible deferred lifetime annuities*, such that no further amendment would be required.

4.2.2 Deduction of claims

Subsection 320-80(1) states that a life insurance company can deduct amounts paid in respect of "the risk components of claims paid under life insurance policies during the income year".

Accordingly, in order for amounts paid to be deductible, there are two elements:

- The amounts must be in respect of *life insurance policies*; and
- The amounts must be in respect of the *risk components* of those policies.

4.2.2.1 Life insurance policies

To allow payments on *eligible deferred lifetime annuities* to be deductible to the life insurance company, the definition of *life insurance policy* should include *eligible deferred lifetime annuities*. Currently, this is not clearly included. As such, the following amendment is proposed:

PROPOSED AMENDMENT 3: SECTION 995-1 ITAA 97

To be amended:

life insurance policy has the meaning given to the expression **life policy** in the *Life Insurance Act 1995* but includes:

- (a) a contract made in the course of carrying on business that is *life insurance business because of a declaration in force under section 12A or 12B of that Act;
- (b) a sinking fund policy within the meaning of that Act; and
- (c) an *eligible deferred lifetime annuity.

4.2.2.2 Risk components

The other element of section 320-80 is that only the *risk component* of the policy is deductible. Currently, subsection 320-80(2) provides the mechanism for determining the *risk component* on different types of policy (paragraphs (a)-(c)). These do not provide for the type of payment that would be made on eligible deferred lifetime annuities.

Therefore, in order for these payments to be deductible to the life insurance company, the calculation of *risk component* should provide for amounts paid on *eligible deferred lifetime annuities*.

PROPOSED AMENDMENT 4: SECTION 320-80 ITAA 97

To be inserted after paragraph 320-80(2)(b) :

- (ba) if the policy is an *eligible deferred lifetime annuity — all amounts paid under the *eligible deferred lifetime annuity; or ...

4.2.3 Movement in liabilities

Movements in the value of liabilities under “net risk components of the life insurance policies” are assessable under paragraph 320-15(1)(h) and deductible under section 320-85.

Similar to the analysis in relation to section 320-80 above, there are two elements in the application of these provisions:

- The movement is in value of liabilities in respect of *life insurance policies*;
- The movement is in the value of liabilities under *net risk components* under those policies.

Net risk component is currently defined as follows:

net risk component of a *life insurance policy means so much of the policy’s risk component as:

- (a) is not reinsured under a contract of reinsurance; or
- (b) is reinsured under a contract of reinsurance to which subsection 148(1) of the *Income Tax Assessment Act 1936* applies.

Based on this definition, if the above amendments (Proposed Amendments 3 and 4) are made, the application of paragraph 320-15(1)(h) and section 320-85 should automatically extend to movement in the value of liabilities on eligible deferred lifetime annuities.

4.2.4 Definition of complying superannuation/FHSA life insurance policy

In order to ensure that *eligible deferred lifetime annuities* are not taxed as *complying superannuation/FHSA life insurance policies*, the definition of *complying superannuation/FHSA life insurance policy* should be amended to specifically exclude *eligible deferred lifetime annuities*.

The definition of *complying superannuation/FHSA life insurance policy* in section 995-1 excludes *excluded complying superannuation/FHSA life insurance policies*, as defined. Accordingly, *eligible deferred lifetime annuities* should be included in the list of *excluded complying superannuation/FHSA life insurance policies* in section 995-1, as follows:

PROPOSED AMENDMENT 5: SECTION 995-1 ITAA 97

To be amended:

excluded complying superannuation/FHSA life insurance policy means a *life insurance policy that:

- (a) provides only for *superannuation death benefits, *disability superannuation benefits or temporary disability benefits of a kind referred to in paragraph 295-460(c), that are not *participating benefits;
- (b) is an *exempt life insurance policy; or
- (c) is an *eligible deferred lifetime annuity.

4.3 Taxation of eligible deferred lifetime annuity holders

4.3.1 No taxation in deferral period

Individuals receiving payments under *eligible deferred lifetime annuities* should not be taxed under Division 16E on an accruals basis, as this would result in the policyholder being taxed prior to receiving any payments.

Broadly, Division 16E applies to tax *qualifying securities* on an accruals basis. *Qualifying security* is defined in subsection 159GP(1), which provides that the term *qualifying security* does not include an annuity, except where provided by subsection 159GP(10).

As currently drafted, subsection 159GP(10) states that an annuity can be a *qualifying security* to which Division 16E applies if the annuity is not an *ineligible annuity*. Accordingly, in order to ensure that *eligible deferred lifetime annuities* are not captured in the operation of Division 16E, the definition of *ineligible annuity* in subsection 159GP(1) should include an *eligible deferred lifetime annuity*.

More simply, in short, Division 16E applies to all annuities except for *ineligible annuities* (broadly being annuities issued to individuals by life companies). *Eligible deferred lifetime*

annuity (superannuation) may directly fall within this definition as currently drafted. However, for simplicity and to ensure that other categories of *eligible deferred lifetime annuity* fall within this definition, an amendment is proposed whereby all *eligible lifetime annuities* will be included in the definition of *ineligible annuities* in subsection 159GP(1), such that all *eligible deferred lifetime annuities* will be outside the application of Division 16E.

Consequently, an *eligible deferred lifetime annuity* will also fall outside Division 230 Taxation of financial arrangements due to the exception in subsection 230-460(5) for *life insurance policies* other than *qualifying securities*.

PROPOSED AMENDMENT 6: SUBSECTION 159GP(1) ITAA 36

To be amended:

“ineligible annuity” means:

- (a) an annuity issued by a life assurance company to or for the benefit of a natural person other than in the capacity of trustee of a trust estate; and
- (b) an eligible deferred lifetime annuity (within the meaning of the *Income Tax Assessment Act 1997*); ...

4.3.2 Taxation of annuities

Section 27H of the ITAA 36 provides that “the amount of any annuity derived by the taxpayer during the year of income” is included in the assessable income of a taxpayer”. As per Submission 4, policyholders (individuals and superannuation funds) should not be assessed on amounts received on *eligible deferred lifetime annuities*, akin to superannuation fund payments during pension phase.

For the purposes of this section, *annuity* is not specifically defined, but subsection 27H(4) specifies that it does not include:

- (a) an annuity that is a qualifying security for the purposes of Division 16E; or
- (b) a superannuation income stream (within the meaning of the *Income Tax Assessment Act 1997*).

As per Proposed Amendment 6 above, *eligible deferred lifetime annuity* should not be a *qualifying security* for Division 16E purposes.

A *superannuation income stream* has the meaning given by the ITAR 97 as at Reg 995-1.01, which states that a *superannuation income stream* is an income stream that is taken to be an annuity or pension for the purposes of the SIS Act. If Proposed Amendment 2 is implemented, *eligible deferred lifetime annuities* should be excluded from the application of section 27H under paragraph (b) of the definition of *annuity* in subsection 27H(4).

However, we recommend that, for clarity, the definition of *annuity* in subsection 27H(4) should be amended to specifically exclude payments from *eligible deferred lifetime annuities*, as follows:

PROPOSED AMENDMENT 7: SUBSECTION 27H(4) ITAA 36

To be amended as follows:

annuity means an annuity, a pension paid from a foreign superannuation fund (within the meaning of the *Income Tax Assessment Act 1997*) or a pension paid from a scheme mentioned in paragraph 290-5(c) of that Act, but does not include:

- (a) an annuity that is a qualifying security for the purposes of Division 16E;
- (b) an eligible deferred lifetime annuity (within the meaning of the *Income Tax Assessment Act 1997*); or
- (c) a superannuation income stream (within the meaning of the *Income Tax Assessment Act 1997*).

4.3.3 Superannuation fund – amounts excluded from assessable income

Bonuses on life insurance policies are not assessable to superannuation funds under section 295-335. Similarly, a payment under an *eligible deferred lifetime annuity* should not be assessable to a superannuation fund that holds the *eligible deferred lifetime annuity* on behalf of a member.

Accordingly, we would suggest the following amendment:

PROPOSED AMENDMENT 8: SECTION 295-335 ITAA 97

To be inserted after Item 3 in table at section 295-335

Item	This entity:	Does not include this in assessable income:
4	CSF CADF PST	A payment in respect of an *eligible deferred lifetime annuity

4.3.4 Superannuation fund – segregated current pension assets

Under section 295-385, income from assets that are *segregated current pension assets* of a superannuation fund will not be assessable income to the superannuation fund.

A *segregated current pension asset* is, broadly, one which is held “solely to enable the fund to discharge all or part of its liabilities... in respect of superannuation income stream benefits that are payable by the fund at the time”.

As any payments in respect of an *eligible deferred lifetime annuity* received by a superannuation fund should not be assessable to the superannuation fund if Proposed Amendments 6 to 8 are adopted, it should not be necessary to amend section 295-385 to allow assets held to support *eligible deferred lifetime annuity* payments to members to be segregatable assets for the purposes of section 295-385.

4.4 Taxation of superannuation fund member

4.4.1 Superannuation benefits tax free

In accordance with the principle in section 301-10, a superannuation fund member who has invested in an *eligible deferred lifetime annuity* should not be assessed on receipts under the policy.

Under section 301-10 ITAA 97, where a member is 60 years or over *superannuation benefits* received by the member are not assessable income and not exempt ("NANE") income.

Section 307-5 provides a list of *superannuation benefits*, which includes *superannuation annuity payment* at Item 8 of the table in subsection 307-5(1).

A *superannuation annuity payment* is a payment from a *superannuation annuity*, which is defined in Reg 995 ITAR 97 as being either:

- an income stream issued by a life insurance company that commenced before 20 September 2007 and is an *annuity* within the meaning of subsection 10(1) of the SIS Act; or
- an income stream issued by a life insurance company that meets the standards in subregulation 1.05(1) of the SIS Regulations.

The amendment could therefore be implemented by either changing the definition of *superannuation annuity* or by amending subregulation 1.05(1) of the SIS Regulations.

However, it is considered that the simplest and most easily understood method of amendment would be the following amendment to section 307-5, which will also result in payments received by superannuation fund members from *eligible deferred lifetime annuities* being NANE:

PROPOSED AMENDMENT 9: SUBSECTION 307-5(1) ITAA 97

To be inserted after Item 8 in table at subsection 307-5(1):

Item	Column 1 Superannuation benefit type	Column 2 Superannuation member benefit	Column 3 Superannuation death benefit
9	eligible deferred lifetime annuity payment	A payment to you sourced from an *eligible deferred lifetime annuity	N/A

4.4.2 Roll-over superannuation benefit

Roll-over superannuation benefits taken to be received under section 307-15 (i.e. payments applied at the member's direction) are NANE under section 306-5.

Under section 306-10, *roll-over superannuation benefits* are only able to be paid to a complying superannuation plan or an entity to purchase a superannuation annuity from the entity.

As noted in 4.4.1, a *superannuation annuity* should include an *eligible deferred lifetime annuity* if Proposed Amendment 2 is adopted. Accordingly, no additional proposed amendments are made in respect of this element.

4.5 Purchase of eligible deferred lifetime annuity with “ordinary money”

4.5.1 Definition of eligible deferred lifetime annuity (ordinary)

In order to provide appropriate taxation in circumstances where individuals purchase *eligible deferred lifetime annuities* with money that is not a *roll-over superannuation benefit* (“ordinary money”), a new category of *eligible deferred lifetime annuity* should be added to the definition, as follows:

PROPOSED AMENDMENT 10: SECTION 995-1 ITAA 97

To be amended (from insertion at Proposed Amendment 1):

eligible deferred lifetime annuity means:

- (a) an *eligible deferred lifetime annuity (superannuation)*;
- (b) an *eligible deferred lifetime annuity (roll-over)*; and
- (c) an *eligible deferred lifetime annuity (ordinary)*.

eligible deferred lifetime annuity (ordinary) means a *deferred lifetime annuity purchased by a natural person which is not an *eligible deferred lifetime annuity (roll-over).

4.5.2 Inclusion of purchase price in non-concessional contributions cap

Where an individual purchases an *eligible deferred lifetime annuity* with “ordinary money” (i.e. an *eligible deferred lifetime annuity (ordinary)*), it is appropriate that the purchase price of the annuity is part of and reduces that person’s cap for concessional superannuation contributions.

In order to achieve this, the purchase price of an *eligible deferred lifetime annuity (ordinary)* should be included in the categories of payments that form part of a person’s *non-concessional contributions* in section 292-90 ITAA 97, as follows:

PROPOSED AMENDMENT 11: SECTION 292-90 ITAA 97

To be inserted after paragraph 292-90(1)(b):

- (c) the purchase price of an **eligible deferred lifetime annuity (ordinary)*.

4.6 Purchase of eligible deferred lifetime annuity prior to preservation age / retirement

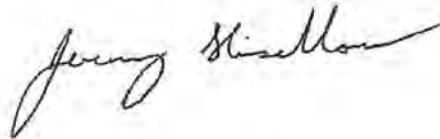
In order to provide appropriate taxation in circumstances where individuals purchase *eligible deferred lifetime annuities* (either through a superannuation fund or otherwise) prior to

preservation age and/or retirement, we would propose the following amendment to Proposed Amendment 1 (discussed above at 4.1.1):

PROPOSED AMENDMENT 12: SECTION 995-1 ITAA 97

*To be deleted from the definition of **deferred lifetime annuity** in Proposed Amendment 1:*

- (a) the purchase date of the annuity is on or after the date on which the primary beneficiary attains his or her *preservation age;



**Eligible deferred lifetime annuities
- superannuation law and social security implications**

1. We refer to the draft submissions (**KPMG Submissions**) identifying proposed legislative amendments to cater for eligible deferred lifetime annuities, as set out in a draft report from KPMG dated 24 April 2013 (**KPMG Report**).
2. This memorandum is designed to be read with, and to supplement, the KPMG Report.
3. We have been asked to comment on the superannuation and social security law implications of the KPMG Submissions. In particular, we have been asked to comment on whether any amendments to the provisions of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) and the *Superannuation Industry (Supervision) Regulations 1994* (**SIS Regulations**) would be required in order to give effect to the KPMG Submissions.
4. We note that the KPMG Report sets out a detailed description of a type of annuity referred to as an "eligible deferred lifetime annuity", and proposes a definition of this concept for inclusion in section 995-1 of the *Income Tax Assessment Act 1997*. The submissions set out below are based on that description.
5. **Submission 1: The SIS Act should be modified so that an eligible deferred lifetime annuity is recognised as an annuity for the purposes of the SIS Act.**

Submission 2: The SIS Act should be modified so that a pension that is provided through the purchase of an eligible deferred lifetime annuity is recognised as a pension for the purposes of the SIS Act.

We propose addressing Submissions 1 and 2 as follows:

Insert the following new definitions in section 10 of the *Superannuation Industry (Supervision) Act 1993*:

'eligible deferred lifetime annuity' means an annuity that meets the definition of an eligible deferred lifetime annuity in the *Income Tax Assessment Act*;

'eligible deferred lifetime pension' means a pension that is payable to a member solely from the proceeds of an eligible deferred lifetime annuity

Instead of amending the 'annuity' and 'pension' definitions in the *Superannuation Industry (Supervision) Act 1993*, we propose amending Regulations 1.05 and 1.06 of the *Superannuation Industry (Supervision) Regulations 1994* as follows:

Insert the following new sub-regulation immediately after sub-regulation 1.05(1):

'1.05(1AA) An eligible deferred lifetime annuity is taken to be an annuity for the purposes of the Act.'

Insert the following new sub-regulation immediately after sub-regulation 1.06(1):

'1.06(1AA) An eligible deferred lifetime pension is taken to be a pension for the purposes of the Act.'

6. **Submission 3: The proposed restriction on the types of insurance policy that may be purchased to provide benefits should be amended to allow for the purchase of deferred lifetime annuities [either in the accumulation phase or the growth phase]**

Superannuation Legislation Amendment Regulation 2013 (No. 1) introduced a new operating standard for regulated superannuation funds with effect from 1 July 2014. The new operating standard is set out in Regulation 4.07D of the SIS Regulations.

Regulation 4.07D(2) provides that:

'A trustee of a regulated superannuation fund must not provide an insured benefit in relation to a member of the fund unless the insured event is consistent with a condition of release specified in item 102, 102A, 103 or 109 of Schedule 1.'

Technically, the income benefit payable under an eligible deferred lifetime annuity (and indeed other pension benefits funded by the purchase of an annuity) could be classified as insured benefits for the purposes of this Regulation, which we consider to be an unintended consequence.

To address this, we recommend that the definition of "insured benefit" in SIS Regulation 4.07C be amended as shown in track changes:

insured benefit, for a member, means a right, other than an anti-detriment payment, for the member's benefits to be increased on the realisation of a risk but does not include a right to be paid a pension that is funded from an annuity, the payment of which is contingent on the member (or a dependant of the member) being alive.

7. **Submission 4: For the purpose of the "assets test" under the *Social Security Act 1991 (Cth)* (SS Act), the value of an eligible deferred lifetime annuity should be its purchase price.**

By way of background:

- (a) Section 9(1B) of the SS Act provides that a *managed investment* includes a *deferred annuity*. Section 9(1) of the SS Act defines a *deferred annuity* as:

"an annuity, within the meaning of section 10 of the Superannuation Industry (Supervision) Act 1993, that is not presently payable."

- (b) Section 9(1C) of the SS Act lists investments that are not *managed investments* for the purposes of the SS Act. Currently, "*investments in a deferred annuity if the investor has not yet reached pension age*" are included in this list.

We propose amending the SS Act to include the following new definition in section 9(1):

"eligible deferred lifetime annuity has the meaning given by section 995-1 of the *Income Tax Assessment Act 1997* (Cth)."

We also propose amending section 9(1C) of the SS Act to exclude an eligible deferred lifetime annuity from the definition of "managed investments" by inserting the following new paragraph immediately after paragraph (h):

"(i) an investment in an eligible deferred lifetime annuity."

We further assume that once the payment period commences, an eligible deferred lifetime annuity is intended to qualify as an income stream. The definition of "income stream" in section 9 of the SS Act includes:

(a) an income stream arising under arrangements that are regulated by the *Superannuation Industry (Supervision) Act 1993*;

and

(d) an income stream provided as life insurance business by a life company registered under section 21 of the *Life Insurance Act 1995*;

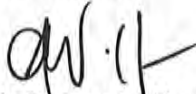
We assume however that an eligible deferred lifetime annuity is not intended to qualify as an asset-test exempt income stream (as set out in clause 9A of the SS Act) or a defined benefit income stream (as set out in clause 9(1F) of the SS Act).

We propose amending section 1119 of the SS Act by inserting the words "and is not an eligible deferred lifetime annuity" immediately after the words "does not have an account balance" in subsection 1119(4) and inserting the following new subsection immediately after section 1119(4):

"(5) If the income stream is provided under an eligible deferred lifetime annuity, the value of the income stream, for the purposes of the assets test, is equal to the amount of purchase price paid for the eligible deferred lifetime annuity."

Please do not hesitate to contact us if you have any questions.

Yours faithfully



 Ruth Stringer | Partner
D +61 2 8020 7661
rstringer@landers.com.au