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TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL  
2021: PROVIDING CHOICE FOR TRUSTEES CALCULATING EXEMPT  
CURRENT PENSION INCOME

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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.

<i>Abbreviation</i>	<i>Definition</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>



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# **Chapter 1**

## **Providing Choice for Trustees Calculating Exempt Current Pension Income**

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### **Outline of chapter**

1.1 This chapter amends the ITAA 1997 to allow superannuation trustees to choose their preferred method of calculating exempt current pension income when they have member interests in both accumulation and retirement phases at one time, but only retirement phase interests at another time, during an income year.

1.2 These amendments provide superannuation trustees with greater choice in how they calculate exempt current pension income and minimise the complexity and cost in a fund's reporting.

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 that is used to discharge its liabilities in respect of superannuation income stream benefits that are in retirement phase is exempt income. This type of income is known as exempt current pension income (ECPI). Currently under the ITAA 1997, there are two methods for calculating ECPI, the segregated method and the proportionate method.

#### ***Segregated method***

1.5 If a fund has segregated current pension assets, then the ECPI must be calculated by the segregated method under section 295-385. Under subsection 295-385(3), assets of a superannuation fund are segregated current pension assets when assets are held separate from any other assets the fund holds and used for the sole purpose of discharging the liabilities of superannuation income stream benefits of retirement phase income streams. These assets are held separately from any assets the fund holds supporting accumulation phase interests.

1.6 When using the segregated method, the fund's ECPI is equal to the value of the ordinary and statutory income derived from the funds segregated current pension assets. If all of a fund's assets are supporting

superannuation income streams that are in retirement phase (that is, the fund has no unallocated reserves and no amount of assets in excess of the amount actuarially determined to be necessary to discharge its liabilities in respect of any defined benefit pensions) at any point in an income year the fund is required to use the segregated method to calculate ECPI for the period or periods of time that the fund was fully in retirement phase.

***Proportionate method***

1.7 To the extent that a fund does not have segregated current pension assets, then the fund’s ECPI must be calculated by the proportionate method under section 295-390.

1.8 Under the proportionate method the fund’s ECPI is calculated based on the proportion of the fund’s total liabilities (‘average value of superannuation liabilities’) that are current pension liabilities (‘average value of current pension liabilities’). If a fund has segregated current pension assets for any period of time in the income year then the liabilities in respect of which those segregated current pension assets are held cannot be included in a fund’s average value of current pension liabilities or the fund’s average value of superannuation liabilities.

1.9 The formula to calculate ECPI using the proportionate method is:

$$\frac{\textit{Average value of current pension liabilities}}{\textit{Average value of superannuation liabilities}}$$

1.10 Where a superannuation fund discharges part of its current pension liabilities from current pension assets and part from other assets then under the current law the fund must use the segregated method to calculate part of its ECPI and the proportionate method to calculate the remainder. Income that is exempted under the segregated method cannot be exempted using the proportionate method.

1.11 A fund using the proportionate method will be required to change its calculation method if the fund’s assets are held solely to discharge liabilities in relation to retirement phase interests for part of the income year. In this situation, the fund will calculate its ECPI using the proportionate method for the first part of the income year and segregated for the other part.

***Determining which method to use***

1.12 A trustee is required to use the segregated method when a fund is fully in retirement phase at any time in an income year. A fund is fully in retirement phase when all of the fund’s assets are held solely to discharge liabilities in relation to retirement phase interests. If a fund is



fully in retirement phase at any time in the income year then the fund must calculate its ECPI using the segregated method.

### ***ATO Law Companion Ruling 2016/8***

1.13 On 8 March 2017, the ATO finalised Law Companion Ruling 2016/8 Superannuation reform: transitional CGT relief for complying superannuation funds and pooled superannuation trusts (LCR 2016/8). In LCR 2016/8, the ATO set out the view that where a fund's assets are held solely to discharge liabilities in relation to retirement phase interests for any part of the income year, those assets are segregated current pension assets for that period. In accordance with that view, the fund must use the segregated method to calculate its ECPI for that part of the income year. Assets of a fund will not be segregated current pension assets where they are held in an unallocated reserve or are used to support defined benefit pensions where the assets are in excess of the amount actuarially determined to be necessary to discharge its liabilities in respect of those pensions.

1.14 Currently, this leads to unnecessarily complicated compliance obligations. Rather than being required to use different methods to calculate ECPI for different periods in the same income year, it may simplify compliance obligations if, in such circumstances, trustees could choose to apply the proportionate method for the whole of the income year based on a single actuary's certificate.

## **Summary of new law**

1.15 The Bill amends section 295-385 so that superannuation trustees can choose whether or not to treat an asset as a segregated current pension asset where all of the fund's assets are held solely to discharge liabilities in relation to retirement phase interests.

## **Detailed explanation of new law**

1.16 Schedule 1 to the Bill amends the definition of segregated current pension assets in section 295-385 of the by expanding the circumstances when a superannuation trustee can choose to not treat an asset of a fund as a segregated current pension asset.

1.17 Specifically, the amendments provide that superannuation trustees can choose whether to treat an asset held by the fund as a segregated current pension asset, where all of the fund's assets are held solely to discharge liabilities in relation to retirement phase interests for part of the income year, but not for the whole income year. [*Schedule 1, item 1, sections 295-385(8), 295-385(9) and 295-385(10)*].

1.18 By choosing whether or not an asset is a segregated current pension asset, a trustee can decide whether the proportionate method or segregated method is applied to income derived from that asset when calculating funds exempt current pension income. It is expected that this will minimise the complexity for trustees and reduce the associated reporting costs for funds.

1.19 In practice a trustee will only be able to exercise this choice if all of the interests in the fund are in retirement phase and all of the income derived from the fund's assets is supporting retirement phase income stream benefits payable from an allocated pension, market linked pension or an account based pension. Trustees cannot choose to treat an asset as a segregated current pension asset if amounts of income derived from the asset are supporting the payment of other superannuation benefits or are being held in unallocated reserves.

## **Application and transitional provisions**

1.20 The Bill commences on the first 1 January, 1 April, 1 July or 1 October after the day this Act receives Royal Assent and the amendments will apply to the 2021-22 income year and later income years. [*Schedule 1, item 2*]