15 October 2024

Tax and Transfers Branch
Retirement Income and Superannuation Division
Treasury
Langton Cres
Parkes ACT 2600

Email: superannuation@treasury.gov.au

Dear Sir/Madam,

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

The SMSF Association welcomes the opportunity to provide this submission in response to *Treasury Laws Amendment Instrument 2024: Self-managed superannuation funds – legacy retirement product conversions and reserves* exposure draft consultation.

We thank Treasury for the work undertaken so far with respect to the legacy pension amnesty. Many of the recommendations in this submission have been informed by recent discussions with Treasury and we thank Treasury for this ongoing engagement.

These measures were first announced in the 2021/2022 Budget and are urgently needed, particularly given the ages of the members involved. The passage of time is exacerbating the issues for impacted members. We therefore urge Government and Treasury to progress these measures as a matter of priority.

We welcome the policy approach taken by Treasury, acknowledging the existing policy frameworks and the need for consistency. These measures go some ways to achieving the desired policy outcomes with appropriate guardrails.

We note that it is common practice for legacy pensions to cease, rather than be commuted, on the death of the primary beneficiary or on the completion of the payment term. However, the Exposure Draft regulations do not provide a cap-free pathway for situations where a pension has ceased in such a manner and the pension recipient has died. We encourage Treasury to consider the inclusion of a third option to allow a pension reserve to be exited from the superannuation system where the pension recipient(s) has died.

Ideally, on the commutation or cessation of the pension, the regulations would permit the pension reserve to be allocated to the deceased member's account and paid as a death benefit to the deceased member's SIS dependants or their estate. This would ensure a range of circumstances could be addressed, including where there is no surviving spouse. It would also avoid the need for a beneficiary to become a member of an SMSF for the sole purpose of receiving an entitlement from the fund's pension reserve. This proposed amendment is discussed in further detail in ***Appendix A*** (attached).

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While the focus of this policy development seeks to address those with significant wealth held in pension reserves, what cannot be overlooked are the vast majority of pensioners who do not have significant wealth in these reserves and are in need of an urgent remedy. There are many examples of individuals who are trapped in an SMSF despite it no longer being a suitable vehicle. These include those with small balances where the annual cost to administer the fund exceeds the pension benefit received. Several examples are contained in ***Appendix B*** (attached).

These pensions also present significant challenges for the legal personal representatives of members who step in as trustee where the member is no longer able to act as trustee of the fund. Indeed, issues also arise on the death of the member.

The existing framework for these pension interests are complex and challenging for many practitioners to interpret and apply. These amendments would therefore benefit from the inclusion of practical examples in the explanatory statement that clearly set out and illustrate the operation of these measures. To assist, several sample case studies have been provided in ***Appendix C*** (attached).

Detailed feedback and information are included in the appendices to this submission.

We would be pleased to further discuss any elements of our submission and to assist Treasury with any questions it may have. Please direct any queries to Tracey Scotchbrook, Head of Policy and Advocacy on traceyscotchbrook@smsfassociation.com.

We thank you again for the opportunity to provide this submission.

Yours sincerely,

Peter Burgess
Chief Executive Officer

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members and a diverse range of financial professionals. The SMSF Association continues to build integrity through professional and education standards for practitioners who service the SMSF sector. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them with access to independent education materials to assist them in the running of their SMSF.

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Appendix A: Detailed feedback

Table of Recommendations

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1.	We urge Treasury to finalise and table these regulations as soon as practicable, to enable members to act swiftly, and minimise the negative impact on members where the pension and/or the SMSF is no longer fit for purpose.	*Page 6*
2.	We encourage Treasury to re-visit the wording in sub-paragraphs (4), (7) and (8) to ensure they are more clearly articulated and achieve the intended outcomes.	*Page 6*
3.	We encourage Treasury to consider introducing an additional ‘cap-free’ pathway allowing for the allocation of pension reserve amounts that relate to the cessation of a pension interest of a deceased member, including where the member’s death pre-dates this amnesty.	*Page 8*
4.	We encourage Treasury to work with the Department of Social Services to ensure a legislative instrument, providing debt waiver relief, is issued in a timely manner. This instrument should apply equally to the commutation of legacy pension across all SMSFs, Small APRA Funds, as well as APRA-Regulated funds.	*Page 9*
5.	We encourage Treasury to work with the Department of Social Services to provide a solution to ensure that the asset test exemption is not immediately lost once these regulations are tabled. It is noted that Section 9A(5) of the Social Security Act 1991 allows the secretary to determine that an income stream is an asset test exempt income stream for the purposes of that Act.	*Page 10*
6.	Commissioner discretion to be incorporated into these provisions to permit the commutation of a legacy pension, and deal with a pension reserve under the terms of the amnesty where in the circumstances, it is appropriate that the amnesty be made available beyond the prescribed five-year period.	*Page 11*
7.	To avoid any potential for misunderstanding or confusion, we encourage Treasury to explicitly outline, and provide an example of, how these draft tax regulations apply to reserve allocations following the commutation of a ‘flexi-pension’.	*Page 11*
8.	We ask that, through the process of finalising these regulations, Treasury provides a range of practical worked examples in the Explanatory Statement (ES) to assist industry participants, and regulators, with the implementation of these measures.	*Page 12*
9.	In keeping with Treasury's objective to allow the entire amount supporting a legacy pension (including associated reserves) to be released under these measures, and to alleviate this seemingly unnecessary complexity, we encourage Treasury to consider the removal of the restrictions contained within Regulations 1.06(6), 1.06(7), and 1.08 that limit the commutation values of these pensions.	*Page 12*
10.	We ask that, through the process of finalising these regulations, Treasury also considers providing an additional ability to partially commute a legacy pension on an ongoing basis for those individuals who choose to continue receiving their legacy pension beyond the proposed five-year time period.	*Page 13*

Importance of regulation

SMSFs have not been permitted to commence a lifetime, fixed term, or life expectancy pension since 1 January 2006. However, if the pension was commenced prior to this date, the pension can continue to operate.

The typically 'non-commutable' nature of these pensions meant they received concessional treatment under the now repealed reasonable benefit limit regime. These pensions may also have received concessional asset test treatment when assessing eligibility for certain Government income support payments.

However, these 'legacy' pensions now exist in an environment where they have little relevance and one where many SMSF trustees, and professionals alike, no longer fully comprehend their operation – as they have not been able to be established for over 18 years. They are both difficult to administer and advise on, for industry as well as regulators, as evidenced by their impact on an individual's Transfer Balance Cap (TBC).

An opportunity to 'clean up' many of these legacy pensions is therefore desirable for the Government, regulators and the superannuation industry for the purposes of achieving modernisation, simplicity and efficiency.

Despite not being an extremely large segment of the sector, the administrative burden and amount of industry, ATO and Treasury time and resources allocated to the issue of legacy pensions is not insignificant. A period of time to 'flush out' legacy pensions will provide an opportunity for individuals to take up more innovative and simpler retirement income products rather than being locked into complex and costly legacy pension products. It will also provide an opportunity for some members to exit and wind up their SMSFs which have long ceased to be an appropriate or viable vehicle for them.

The proposed introduction of a 'contribution cap-free' pathway for members to exit these legacy pensions will increase the likely take-up of this opportunity. Further, the 'cap-free' allocation of pension reserves into a member's account, will result in those monies re-entering a member's superannuation interest – counting toward their Total Superannuation Balance (TSB) and/or their TBC. In turn, this may impact an individuals' ability to engage with a variety of superannuation concessions whose eligibility is typically linked to an individuals' TSB.

As these allocated reserve amounts will form part of a member's superannuation benefits, this will also expedite the exit of these monies from the superannuation system – due to the compulsory cashing requirements upon death.

Independent of any other prevailing government policies, the SMSF Association has long advocated for a mechanism to provide fund members a choice to exit these complex legacy pensions. These draft regulations, and the choices they provide members, will go a long way to solving these long-standing complexities.

Tabling of these regulations is a vitally important part of solving significant complexity for various superannuation fund members and are in everybody's interests.

We have included several real-world client scenarios to illustrate the case for progressing these regulations as a matter of urgency. Please refer to ***Appendix B***.

Recommendation 1: We urge Treasury to finalise and table these regulations as soon as practicable.

Furthermore, with the proposed introduction of Division 296, reserve allocations made on or after 1 July 2025 are likely to increase a member's Division 296 tax liability, so it's critically important legacy pension recipients, and beneficiaries of fund reserves, are given an adequate amount of time before 1 July 2025 to restructure these pensions.

In any event, and for the reasons outlined earlier, the tabling of these regulations should not be linked to the passage of the Division 296 legislation, to enable members to act swiftly, and minimise the negative impact on members where the pension and/or the SMSF is no longer fit for purpose.

Pension reserve definition

Proposed Sub-regulation 292-90.02(4) provides a 'cap-free' pathway enabling monies to be released from a pension reserve to a member who is in receipt of a legacy pension.

Further, it is the SMSF Association's understanding that Treasury's intention is to extend this 'cap-free' pathway to the commutation of a legacy pension by a reversionary beneficiary, who is in receipt of the legacy pension.

Proposed Sub-regulation 292-90.02(7) and (8) seek to define a pension reserve.

It is our understanding that where a pension has already ceased, Treasury's approach will be to determine whether a reserve is a 'pension reserve' at the time of that pension's cessation. That is, a reserves' status as a 'pension reserve' will be crystallized at the time that pension ceased.

We further understand that it is Treasury's intention that any allocations subsequently made from such a reserve, and/or the addition of investment earnings to that reserve, since the cessation of that pension, will not impact on the status of a reserve as a 'pension reserve'.

While we support the intended outcomes outlined above, the current wording of the draft regulations made it difficult to clearly arrive at the above interpretation and intended outcomes.

Recommendation 2: We encourage Treasury to re-visit the wording in sub-paragraphs (4), (7) and (8) to ensure they are more clearly articulated and achieve the intended outcomes.

We also refer to our discussion on the inclusion of case studies, **Recommendation 8** and ***Appendix C.***

Dealing with deceased pension recipients

There are many instances where fund members, who were previously in receipt of a legacy pension, have died – leaving behind reserves that continue to sit in their fund awaiting subsequent allocation to remaining members / beneficiaries. In some instances, the death may have occurred many years ago.

Equally, going forward, where a member who is currently in receipt of a legacy pension dies, and that legacy pension ceases due to their death, this will typically result in the reserve amounts associated with that legacy pension being left in the fund.

In both scenarios, there will be circumstances in which there are no surviving fund members, or where for the intended beneficiaries, it is not appropriate for them to become (or remain) members of an SMSF. This may be due to their age, capacity, or the fund no longer being economically viable.

We are aware of circumstances where the SMSF is incurring annual administrative costs that exceed the pension benefits paid each year. Although the SMSF may no longer be an appropriate or viable vehicle, it is forcibly being maintained in order to gradually drip feed reserve amounts to beneficiaries.

Based on the draft regulations, we understand that a 'cap-free' pathway, similar to the 'cap-free' pathway for living members (as per sub-regulation (4) discussed above), is not available where a pension recipient has died, and a pension reserve is subsequently allocated. That is, the proposed 'cap-free' pathway in sub-regulation (4) essentially requires the reserve allocation be made to a pension recipient (or former pension recipient) who is still alive.

Further, it is common practice for these pensions to simply cease rather than being commuted on the death of the primary beneficiary. The wording in subsection (5) and (6) requires the reserve allocation to be the result of a commutation so it does not appear to provide a 'cap-free' pathway for pension reserves to be released if the pension has simply ceased. We are aware of many SMSFs which hold pension reserves because of the cessation of a legacy pension, where the primary beneficiary has since passed away. The pension cessation may have been caused by the death of the primary or reversionary beneficiary or because the pension's payment term has now ended.

We acknowledge that the introduction of subsection 292-90.01(2A) will result in reserve allocations being counted toward an individual's non-concessional contribution (NCC) cap – as compared to their concessional contribution cap. While this may lead to a more favourable tax outcome for some, this may not always be the case – particularly where a beneficiary's TSB exceeds the General TBC.

We firmly believe that a superannuation 'clean up' of reserve amounts is desirable for the Government, regulators and the superannuation industry for the purposes of modernisation, simplicity and efficiency. However, counting these reserve allocations as a non-concessional contribution, where those reserve amounts arose from the death of a legacy pension recipient and the cessation of the legacy pension, is likely to result in reserve accounts continuing to exist and remain in the superannuation environment.

Allowing the allocation of these types of reserves, coupled with a requirement for the timely payment of a death benefit, in a manner that is consistent with the current SIS Act requirements when dealing with death benefits, under a 'cap-free' pathway would remove barriers and expedite the exit of these reserve amounts from the superannuation system.

It would be entirely reasonable for any such 'cap-free' pathway to require that reserve amounts be dealt with, and paid, as a death benefit in accordance with existing policy and regulatory settings, within a specified timeframe following the introduction of these regulations (for existing reserves), or a specified timeframe following the death of a member (where death occurs following the introduction of these regulations).

This approach is consistent with the objective to expeditiously 'clean' out reserve amounts from the superannuation system.

We also believe that it is consistent with the sole purpose test in that it will:

- attribute benefits to the member who generated the reserve, which has generally arisen because investment decisions made have produced investment returns that exceeded actuarial assumptions, and
- enable the subsequent payment of benefits in respect of a member of the fund, on or after their death, to dependants and/or the deceased members estate.

Further, we do not believe there is any mischief associated with allocating these reserves in such a 'cap-free' manner. Particularly as any subsequent lump sum death benefits paid to a non-dependant beneficiary will be subject to tax – ensuring that monies exiting the system are being appropriately taxed.

In fact, we believe that such an approach would minimize the level of intergenerational wealth transfer that would otherwise occur through the superannuation system as a result of these reserves gradually being allocated to a beneficiary's member balance and retained in the superannuation system until that beneficiary's eventual retirement – accessed as a tax-free superannuation benefit.

Example: Benefit of an additional cap-free pathway – dealing with death benefits:

Anu was the sole member of his SMSF and commenced a lifetime pension in 2001 (i.e. a pension complying with SIS Reg 1.06(2)). Anu's pension comprised entirely of a taxable component. Anu died in 2019.

The remainder of the capital that formerly supported Anu's lifetime pension became, and was retained as, a pension reserve within the fund. The value of this reserve is currently $600,000.

Anu was a widower but has an adult child, Raj. For a variety of reasons, an SMSF is not appropriate for Raj. However, Anu's SMSF has not been wound up due to the continued existence of this reserve.

Once the Regulations commence, based on the current draft regulations, any allocation from this reserve to Raj's member account would be counted toward his NCC cap. This means he would not be able to completely allocate the reserve to his member account for several years without exceeding his NCC Cap – meaning the reserve balance will likely persist for an extended period.

Even after allocating the reserve to his member account over several years, these monies would remain within the superannuation system until Raj's eventual retirement.

Should an additional 'cap-free' pathway be introduced (for the purpose of allocating such a pension reserve following the death of the pension recipient(s)), this remaining reserve could be allocated more efficiently, resulting in a payment being made to Raj as a death benefit, and enabling the SMSF to be wound up.

As the effective payment of the reserve to Raj will be treated as a death benefit, the SMSF will calculate, deduct and remit PAYG tax of $102,000.

Recommendation 3: We encourage Treasury to consider introducing an additional 'cap-free' pathway allowing for the allocation of pension reserve amounts that relate to the cessation of a pension interest of a deceased member, including where the member's death pre-dates this amnesty.

This would facilitate the payment of a death benefit in accordance with existing policy and regulatory settings.

Social Security – Debt waiver required

Currently, if a recipient commutes a lump sum from an Asset Test Exempt (ATE) income stream and it is not an 'allowable commutation' the income stream will be assessed as if it never had ATE status (that is, it will be treated as an asset-tested income stream from its commencement day).

Of particular concern is that this may result in a debt being raised, with the debt being calculated on the basis that the income stream was never ATE.

Typically, the size of the resulting debt will be the difference between the amount of income support paid to the individual and the amount that would have been paid if the income stream had been asset tested over the period extending back 5 years from the day the income stream was commuted.

While such claw-back provisions continue to exist, the full policy intent of these draft regulations will not be realised. These claw-back provisions place a heavy financial burden upon those legacy pension recipients who rely on government support but would benefit from commuting their pension under these draft regulations, acting as a significant disincentive.

Recommendation 4: We encourage Treasury to work with the Department of Social Services to ensure a legislative instrument, providing debt waiver relief, is issued in a timely manner.

This would be consistent with previous debt waiver relief provided in 2009 and 2011[1].

The instrument should apply equally to the commutation of legacy pension across all SMSFs, Small APRA Funds, as well as APRA-Regulated funds.

Social Security – Retention of asset test exemption

Section 9A, Social Security Act 1991, provides the meaning of *asset test exempt income stream – lifetime income streams*.

It is our understanding that:

- Paragraph (a) of subsection (1) requires the income stream, arising under the contract or governing rules, to meet the requirements of subsection (2) and that the Secretary has not made a determination under subsection (4) in respect of the income stream.
- Subsection (2) lists the requirements of an asset-test exempt income stream, including paragraph (h) which states that the income stream cannot be commuted except where the commutation meets one of the exceptions listed in subparagraphs (i) to (v).

[1] For an example of such a legislative instrument, we refer to Social Security (Waiver of Debts – Self Managed Superannuation Funds and Small APRA Funds) (DSS) Specification 2021 F2021L00865 – which currently deals with certain commutations from a complying income stream.

Naturally, the commutation exceptions listed do not include the proposed new amnesty (i.e. the 5-year exit measure).

Note: These commutation restrictions are similarly reflected in Sections 9B and 9C which provide the meanings of *asset test exempt income stream life expectancy* and *market linked income streams* respectively. The requirements within these sections give rise to the same concern.

By virtue of the fact that legacy pensions will be commutable during the proposed five-year period, under circumstances not permitted by 9A(2)(h), this raises the concern that from the moment these regulations are finalised, all legacy pensions will immediately cease to meet the requirements of an asset test exempt income stream.

This would have an immediate impact on individuals, including those who choose not to avail themselves of this commutation opportunity and instead choose to retain their legacy pension(s).

While we understand that this is not Treasury's intended outcome, this would have disastrous implications for many individuals.

Recommendation 5: We encourage Treasury to work with the Department of Social Services to provide a solution to ensure that the asset test exemption is not immediately lost once these regulations are tabled.

It is noted that Section 9A(5) of the Social Security Act 1991 allows the secretary to determine that an income stream is an asset test exempt income stream for the purposes of that Act.

Time limit – A barrier impacting effectiveness of draft regulations

The draft regulations impose a fixed five-year period on an individual's ability to commute a legacy pension, with no explicit justification provided in the explanatory statement for this restriction.

While five years offers a reasonable window for fund members to act, and encourages swift action, greater flexibility in relation to the permitted timeframe would benefit those who are unable to act within this prescribed period.

The commutation of a legacy pension is a complex task that should not be undertaken without first obtaining appropriate and sufficient expert advice – which is likely to involve an individual consulting with several professionals.

For instance, this may require the review and/or amendment of an SMSFs governing rules, enlisting the services of an actuary to perform various calculations, as well as detailed financial planning advice to determine whether commuting a legacy pension will result in a desirable member outcome – and that any consequences are well understood.

Given the heavy advice burden, coupled with the relatively small number of suitably experienced advice professionals available to provide such detailed advice on largely obsolete products, impacted members may find it difficult to obtain the necessary advice within the prescribed timeframe.

The difficulty in accessing relevant and appropriate advice is only exacerbated for individuals who live in remote or rural areas.

In addition to the difficulties in accessing appropriate levels of advice, there will be a range of circumstances that may impede or prevent an individual from taking the necessary actions within the prescribed time frame. This includes situations such as:

- a fund member in receipt of a legacy pension has lost capacity and their legal personal representative(s) have been appointed to act as trustees on their behalf; or
- a deceased member's beneficiary is now in receipt of a reversionary legacy pension, having only assumed their trustee obligations following the death of the primary pensioner;
- members or their legal representative reside in a remote or rural community; or
- the impacts of natural disasters.

The above list is not exhaustive but provides real-life examples of the kinds of circumstances which may negatively impact an individual's ability to access advice and take action to utilise the amnesty.

The introduction of Commissioner discretion would ensure those individuals who, due to circumstances beyond their control, have been unable to access the amnesty within the prescribed time frame, may avail themselves of the ability to commute their legacy pension(s).

Recommendation 6: Commissioner discretion to be incorporated into these provisions to permit the commutation of a legacy pension, and deal with a pension reserve under the terms of the amnesty where in the circumstances, it is appropriate that the amnesty be made available beyond the prescribed five-year period.

Pensions commenced under SIS Regulation 1.06(6) – Flexi-pensions

The SMSF Association appreciates that pensions commenced under SIS Regulation 1.06(6) 'flexi-pensions' are not explicitly addressed by the draft SIS regulations allowing for the commutation of legacy pensions – as these pensions are typically commutable pension products it is not necessary that they do so.

However, we understand that where a pension reserve is associated with a 'flexi-pension', any amounts allocated (in accordance with draft sub-regulation 292-90.02(4)) would not be counted as a non-concessional contribution – where the allocation is made to a pension recipient (or former pension recipient) who is still alive.

Recommendation 7: To avoid any potential for misunderstanding or confusion, we encourage Treasury to explicitly outline, and provide examples of, how these draft tax regulations apply to reserve allocations following the commutation of a 'flexi-pension'.

Clarification and Case Studies

There is an inherent level of complexity associated with the operation of legacy pensions and their associated reserves – as well as dealing with the allocation of amounts from reserves generally. With the release of these draft regulations, the existing level of complexity will only be further exacerbated.

Following an initial review and analysis of these draft regulations, it became apparent from experienced industry participants that industry's collective understanding of the proposed measures would benefit significantly by the inclusion in the Explanatory Statement (ES) of intentional clarification covering a broad range of likely scenarios.

It is worth noting that the industry participants referred to above are those who will largely be responsible for communicating these changes to various advice professionals across the financial services sector.

Appendix C includes a number of sample case studies that we encourage Treasury to adopt or modify, as required, with the intention of providing greater clarity to industry participants and regulators alike – making for a more seamless implementation of the proposed measures.

The included case studies seek to clarify the application of these regulations to a number of common scenarios, covering various types of legacy pensions that will potentially be impacted, as well as an illustration of the application of the cap-free pathway in conjunction with other pathways.

Given the re-location of 292-90.02(5) and (6), this would also be a timely opportunity for Treasury to provide greater clarity on the application of paragraphs (5) and (6) which have not typically been well understood.

Recommendation 8: We ask that, through the process of finalising these regulations, Treasury provides a range of practical worked examples in the Explanatory Statement (ES) to assist industry participants, and regulators, with the implementation of these measures.

Some examples case studies have been included in ***Appendix C***.

Constraints on commutation values

Following the commutation of a lifetime legacy pension, in keeping with ATO guidance provided by ATOID 2015/22, the entire amount payable (comprising both the commutation value as well as any associated reserve) is permitted to be rolled over as a singular amount.

As a result, the commutation of a lifetime pension is typically processed in a single transaction, with the tax components of the new income stream reflecting the same proportions as those that applied to the original income stream.

On the other hand, when commuting fixed-term legacy pensions, SIS Regulations 1.06(6), 1.06(7), and 1.08 operate to impose a maximum commutation value – to be calculated in accordance with the respective regulation.

These maximum commutation values introduce additional administrative complexity when commuting pensions provided under SIS Regulation 1.06(6) or 1.06(7), by requiring a two-step process when these pensions are commuted.

That is, a maximum commutation value must first be calculated and paid. Secondly, the associated pension reserve must be allocated and dealt with – separately to the commutation amount.

The apparent benefit, in the current superannuation environment, of imposing a maximum restriction on the commutation value of these pensions is not entirely clear.

The SMSF Association understands that Treasury's intention is not to constrain commutation amounts able to be released under these new draft regulations.

Recommendation 9: In keeping with Treasury's objective to allow the entire amount supporting a legacy pension (including associated reserves) to be released under these measures, and to alleviate this seemingly unnecessary complexity, we encourage Treasury to consider removing the restrictions contained within Regulations 1.06(6), 1.06(7), and 1.08 that limit the commutation values of these pensions.

Partial commutations

It is anticipated that, notwithstanding the flexibility afforded to legacy pension recipients by the provisions contained in these draft regulations, there is likely to be a cohort who choose to retain their legacy pension(s).

For this cohort, in addition to the provisions available through these draft regulations, a **permanent** ability to **partially** commute these pensions would be particularly useful in a number of scenarios, including where:

- A legacy pension recipient subsequently requires access to capital to fund aged care, or similar, costs,
- A fund subsequently encounters liquidity concerns impacting its ability to continue to meet contractual pension obligations, and
- A member seeks to manage excess TBC implications following a pension restructure. Since April 2022, members have been able to partially commute MLPs (say) to deal with an excess but must wait for a commutation authority from the ATO.

Recommendation 10: We ask that, through the process of finalising these regulations, Treasury also considers providing an additional ability to partially commute a legacy pension on an ongoing basis for those individuals who choose to continue receiving their legacy pension beyond the proposed five-year time period.

Appendix B: Live member scenarios

The following scenarios are based on several real-world member experiences. All these scenarios have resulted in undesirable outcomes for the affected members – highlighting the case for progressing these regulations as a matter of urgency.

Client scenario 1 – Mrs D

Mrs D (age 77) has a Market Linked Income Stream (MLIS) with a four-year remaining term. Her late husband originally commenced this income stream in 2004 as a reversionary pension.

Mrs D's account balance on 1 July 2024 was $17,000 – comprising $4,000 cash and $13,000 in an illiquid asset which cannot be redeemed. Mrs D does not have any assets outside of her MLIS that could be used to purchase the illiquid asset from the fund.

The annual pension payment is $4,630 per annum. The ATO supervisory levy is $259, the SMSF audit fee is $300 and annual administration fees are $150, totalling $709 per annum.

Whilst the audit and administration expenses would generally be considered inexpensive, the fund expenses represent over 4% of the total account balance and over 15% of the annual pension payment. The supervisory levy alone represents 1.5% of the total account balance and 5% of the annual pension payment.

The rules applying to a MLIS mean that Mrs D cannot commute or otherwise convert the pension to an Account Based Pension (ABP) or accumulation account which would negate the need to maintain an inefficient arrangement.

The annual pension payment and expenses will result in the available cash being exhausted within the year. After this time the fund will not be able to meet its pension payments and will therefore be in breach of the pension standards. In addition, the fund will be unable to pay its ATO supervisory levy.

It would be in the best interest of the member if she were able to take a lump sum commutation of the illiquid asset and wind the fund up as soon as possible.

Client scenario 2 – Mrs K

Mrs K is a 76-year-old widow who commenced receiving a reversionary lifetime complying pension following the death of her husband.

Her annual pension payments are $9,000 which Mrs K receives as a monthly payment of $750. The assets supporting the pension are $20,500 and the actuary is unable to certify the solvency of the pension. As the trustee is unable to take any action to return the fund to a solvent position the trustee must initiate winding-up proceedings.

Currently, the pension can only be commuted in order to acquire an annuity or a MLIS. However, as Mrs K is 76, the maximum annual payment under a newly established MLIS with an account balance of $20,500 would be $2,068 per annum or $172 per month.

Mrs K relies on the $750 monthly payment plus the age pension to maintain her very modest lifestyle. A $578 per month income reduction would cause great hardship.

Client scenario 3 – Mr V

Mr V is 83. He is receiving a legacy pension.

Mr V's age, risk profile and account balance are inconsistent with the type of individual typically suited to being a member, and trustee, of an SMSF.

In addition, the changes to financial advice fees and disclosure have resulted in his adviser discontinuing the provision of advice. The complexity of managing this type of account is beyond his level of expertise.

Mr V is concerned about the onset of dementia and the need to fund entry into aged care.

It would be in his best interest if he were able to take a lump sum commutation of the balance in the SMSF and wind the fund up as soon as possible.

Client scenario 4 – Mr K

Mr K is 86. His complying pension failed the high probability test as at 30 June 2021. At that time his previously complying pension lost its Centrelink assets test exemption. As at 30 June 2022 the pension was assessed as insolvent and was converted to a MLIS in the SMSF.

Mr K's age, risk profile and account balance are inconsistent with the type of individual suited to being a member, and trustee, of an SMSF. However, he has not been able to identify a suitable alternative as the only retail MLIS his adviser can locate does not accept a MLIS that does not have a Centrelink assets test exemption.

It would be in his best interest if he were able to take a lump sum commutation of the balance in the SMSF and wind the fund up as soon as possible.

Client scenario 5 – Mr L

Mr L is 85. He is receiving a complying lifetime pension (i.e. a pension complying with SIS Reg 1.06(2)) of $26,550 pa. The assets supporting the pension, including associated reserves, total $168,000. The pension has been in place since 1 December 2004 and receives a 50% exemption from the assets test for the purposes of the age pension.

The last actuarial valuation of the fund showed that Mr L's pension met both the "best estimate" and "high degree of probability" solvency tests.

Mr L's daughter and son-in-law are also members of the fund. Their combined balances represent the vast majority of the fund's total assets.

Mr L would now like to move to an aged care facility and to do so would like to access some of the assets built up in the fund. He is also quite ill and would prefer to wind up his interests in the SMSF.

The relevant provisions in both the SIS Act and the Social Security Act prohibit him from ending his pension to access the capital for his move to an aged care facility. He can only commute it to acquire another complying pension.

Superannuation law ***does*** permit him to end his membership of the SMSF by transferring the value of his complying lifetime pension to another fund to acquire a MLIS.

However, social security rules only permit him to do this under a limited number of circumstances as an "allowable commutation". Any commutation that is not an allowable commutation triggers a reassessment of his age pension entitlement for the last 5 years. As such, he will effectively be assessed as having a debt if the age pension payments he has received over that time would have been lower if the account balance supporting his complying lifetime pension had been included in the age pension assets test.

Mr L does not meet the "allowable commutation" conditions such as:

- Failing the solvency test (his pension is satisfactorily funded);
- Winding up the fund due to because the administrative responsibilities have become too great. The fund cannot be wound up because it has other members.

He is therefore effectively trapped in his current structure with no ability to access his capital or end his membership of the SMSF.

Appendix C: Case Study Examples

The following sample case studies are offered to assist Treasury in developing case studies of a type and level that we feel would benefit industry and regulators with the adoption and implementation of the proposed measures included in the draft regulations.

We would welcome Treasury to adopt and/or modify these case studies, as required, with the intention of providing greater clarity to industry participants and regulators alike – making for a more seamless implementation of the proposed measures.

Example 1

Adam, age 78, is a member of an SMSF. The other members of the fund are Adam's wife Bridget, age 77, and his children Craig (50) and Debra (48).

Adam commuted his flexi pension (i.e. a pension complying with SIS Reg 1.06(6)) on 30 June 2017. The 'commutation value' of the pension was allocated to his accumulation account at that time.

The remainder of the capital that formerly supported Adam's flexi pension became, and was retained as, a pension reserve. No allocations have since been made from the reserve.

Once the Regulations commence, any amount allocated from the pension reserve to Adam during his lifetime will not count towards his non-concessional contributions cap (because of 292-90.02(4)).

Example 2

Extending example 1, prior to the commencement of the Regulations, allocations had been made from the pension reserve to Adam and to other members of the SMSF.

Once the Regulations commence, any amount allocated from the pension reserve to Adam during his lifetime will not count towards his non-concessional contributions cap (because of 292-90.02(4)). However, any amount allocated from the pension reserve to *other members* of the SMSF (i.e. Bridget, Craig and Debra) will count towards their non-concessional contributions cap unless the allocation:

- is made in a fair and reasonable manner to *every member* of the SMSF (including Adam), and
- the amount allocated in a financial year is less than 5% of the value of the members' interests in the SMSF at the time of allocation

i.e. unless 292-90.02(2) applies.

The SMSF trustee resolves to make an allocation from the pension reserve to the accumulation account of each member of the SMSF, and the amount of the reserve allocation for each member will be equivalent to 4.9% of their respective interests in the fund at that time.

Adam's allocation will not count towards his non-concessional contributions cap (because of 292-90.02(4)). The allocations for Bridget, Craig and Debra will not count towards their non-concessional contribution caps because of 292-90.02(2).

Example 2A

Extending Example 2 above, in a particular year, Adam's receives two allocations – one is his 4.9% allocation (as per Example 2). The second allocation is the remainder of the reserve.

Unless the trustee can argue that Adam and the remaining members belong to different classes of members, this would mean the allocations (as a whole) were no longer fair and reasonable (i.e. a much higher amount is allocated to Adam).

Hence the allocations to the other members would count towards their non-concessional cap. Adam's allocation would not (due to the operation of 292-90.02(4)).

Example 3

Eric was a member of an SMSF. He had a "fixed 'term' complying life expectancy pension" (i.e. a pension complying with SIS Reg 1.06(7)) that reverted to his wife Fran years ago when he died.

The fixed term of that pension has ended and the remainder of the capital that formerly supported the complying life expectancy pension became a pension reserve when the pension reached the end of the term – and has been retained as such.

Once the Regulations commence, any amount allocated from the pension reserve to Fran during her lifetime will not count towards her non-concessional contributions cap (because of 292-90.02(4)). This is because Fran had been the recipient of the pension, and the cessation of the pension is not due to Eric's death – the pension simply reached the end of its term.

Example 4

Gail was a member of an SMSF. When she died, her "flexi" pension (i.e. a pension paid under SIS Reg 1.06(6)) payable from her SMSF automatically reverted to her spouse Harry.

Harry decided to commute the flexi pension and used the commutation value to commence a new death benefit account-based pension.

The remainder of the capital that formerly supported the flexi pension became, and was retained as, a pension reserve.

Once the Regulations commence, any amount allocated from the pension reserve to Harry during his lifetime will not count towards his non-concessional contributions cap (because of 292-90.02(4)).

Any amount allocated from the pension reserve to *other members* of the SMSF will count towards their non-concessional contributions cap unless the allocation:

- is made in a fair and reasonable manner to *every member* of the SMSF (including Harry), and
- the amount allocated in a financial year is less than 5% of the value of the members' interests in the SMSF at the time of allocation

i.e. unless 292-90.02(2) applies.

Example 5

When Jack died, his fixed-term pension ceased to be payable (i.e. it did not revert on his death).

If the *commutation value* of the fixed-term pension is paid to:

- Jack's spouse: the allocation of the *commutation value* to her will not count towards her non-concessional contributions cap as (292-90.02(5)):
    - The commutation is as a result of Jack's death,
    - She is a death benefits dependant of Jack's, and
    - The amount allocated to the spouse (i.e. the commutation value) from the pension reserves is to discharge the fund's liability in relation to the pension on Jack's death,

  and she can choose to commence a death benefit account-based pension with the amount allocated or draw a lump sum death benefit. As this amount is a death benefit for Jack's spouse, it cannot be combined with her own super and/or remain in her accumulation account.

- Jack's adult financially independent children: the allocation of the *commutation value* to them will not count towards their non-concessional contributions cap if (292-90.02(6)):
    - The commutation is as a result of Jack's death, and
    - The amount allocated to them (i.e. the commutation value) from the pension reserves is paid out to them as a lump sum death benefit.

  Any allocation of the *remaining* pension reserves will count towards the recipient's non-concessional contributions cap unless 292-90.02(2) applies.

Example 6

Heather is the sole member of her SMSF. To benefit from a Centrelink asset test exemption, she commenced a complying lifetime pension in 2001.

Given changes to her asset levels, she no longer requires the asset test exemption afforded by this pension. She needs access to her capital to fund her impending entry into aged care, and maintaining an SMSF is becoming an administrative burden for her in her advanced years.

Once the Regulations commence, Heather decides to commute her lifetime pension.

Any amount allocated from the pension reserve to Heather during her lifetime will not count towards her non-concessional contributions cap (because of 292-90.02(4)).

Any amount Heather retains as a superannuation member interest will be assessed in accordance with the existing Centrelink means testing regime.