TR 2011/D3 - Income tax: when a superannuation income stream commences and ceases

Draft Taxation Ruling

Income tax: when a superannuation income stream commences and ceases

Contents Para

What this Ruling is about

1. This draft Ruling considers when a superannuation income stream commences and when it ceases, and consequently when a superannuation income stream is payable. These concepts are relevant to determining the taxation consequences for both the superannuation fund and the member in relation to superannuation income stream benefits paid.

2. This draft Ruling considers the case where:

- a member[1] with an accumulation interest in their taxed complying superannuation fund commences a superannuation income stream as defined in regulation 995-1.01 of the Income Tax Assessment Regulations 1997 (ITAR 1997) on or after 1 July 2007; and
- the superannuation income stream is taken to be a pension in accordance with subregulation 1.06(1) and paragraph 1.06(9A)(a) of the Superannuation Industry (Supervision) Regulations 1994 (SISR 1994).

3. A product that satisfies these provisions is referred to as an 'account based pension' or a superannuation income stream in this draft Ruling. However, the principles discussed in this draft Ruling will typically apply to other pension types payable under the SISR 1994.

[1] The term 'member' refers to the person who first commences a superannuation income stream.

Ruling

What is an 'income stream' and 'superannuation income stream'

4. The phrase 'income stream' in the definition[2] of 'superannuation income stream' requires that there is a series of periodic payments that relate to each other. That series of periodic payments that relate to each other is a superannuation income stream (account based pension) if the requirements of subregulation 1.06(1)[3] of the SISR 1994 are met. It is these periodic payments that are superannuation income stream benefits.

5. A payment made upon partial commutation from an interest that supports a superannuation income stream is a superannuation lump sum.

6. Any payment made from an interest that supported a superannuation income stream after that superannuation income stream has ceased is a superannuation lump sum.[4]

When a superannuation income stream commences

7. A superannuation income stream cannot commence before all of the capital which is to support that income stream has been added by way of contribution or rollover to the relevant superannuation interest from which the superannuation income stream is to be paid.[5]

8. A superannuation income stream commences on the first day of the period to which the first payment of the superannuation income stream relates.

9. When the 'first day of the period to which the first payment of the superannuation income stream relates' occurs must be determined by reference to the terms and conditions of the superannuation income stream agreed by the trustee and member, the rules of the superannuation income stream as set out in the superannuation fund's trust deed and the relevant regulations of the SISR 1994.

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[2] Regulation 995-1.01 of the ITAR 1997.
[3] Although superannuation income stream is more broadly defined this draft Ruling is concerned with an income stream that meets the requirements of subregulation 1.06(1) of the SISR 1994. See paragraph 2 of this draft Ruling.
[4] For further explanation see paragraphs 44 to 55 of this draft Ruling.
[5] For further explanation see paragraphs 72 to 75, and Example 4 paragraphs 31 to 33, of this draft Ruling.

10. The commencement day may occur before the due date of the first payment, depending on the rules which govern the superannuation income stream. However, it cannot occur prior to the day on which:

- the member and the trustee agree to the terms and conditions that will govern the superannuation income stream; or
- in circumstances where a member or dependent beneficiary[6] becomes entitled to the superannuation income stream under the terms of the superannuation fund's trust deed, the time at which the entitlement to start the income stream arises.[7]

11. Once a superannuation income stream commences it is payable (that is, there is an obligation to pay superannuation income stream benefits under that superannuation income stream) until such time as that superannuation income stream ceases.

When a superannuation income stream ceases

12. A superannuation income stream ceases when there is no longer a member who is entitled, or a dependent beneficiary of a member who is automatically entitled, to be paid a superannuation income stream benefit from a superannuation interest that supports a superannuation income stream.

13. It is not the effect of regulation 307-200.05 of the ITAR 1997 to ensure that once an income stream commences it can only cease once the amount in the relevant interest is exhausted.[8]

14. When a superannuation income stream ceases is determined by reference to the relevant superannuation fund's trust deed, the relevant requirements of the SISR 1994 and the particular facts and circumstances of the payment of the member's, or dependent beneficiary's, benefits.[9]

15. The common circumstances in which a superannuation income stream ceases are outlined below.

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[6] The term 'dependent beneficiary' refers to a dependant of a member who commences to receive a pension after the member's death. That is, a spouse; a child under 18 years of age or a financially dependent child that is under 25 years of age; or a child of a member who has a disability of the kind described in subsection 8(1) of the *Disability Services Act 1986* (see subregulation 6.21(2A) of the SISR 1994).

[7] For further explanation see paragraphs 63 to 70, and Examples 1 to 3 paragraphs 25 to 30, of this draft Ruling.

[8] For further explanation see paragraphs 77 to 79 of this draft Ruling.

[9] For further explanation see paragraphs 80 to 83 of this draft Ruling.

Failure to comply with pension rules and the payment standards of the SISR 1994

16. A superannuation income stream ceases for income tax purposes if any of the requirements of the SISR 1994 relating to the payment of the superannuation income stream are not met in an income year. This is the case even if a member remains entitled to receive a payment from the superannuation fund in relation to the purported superannuation income stream under the terms of the superannuation trust deed, or under general trust law concepts.

17. Further, the trustee is taken ***not*** to have been paying a superannuation income stream at any time during the income year in which the relevant requirements are not met.

18. If the requirements are again met in the following income year this results in the commencement of a new superannuation income stream.[10]

Exhaustion of capital

19. A superannuation income stream ceases when the capital supporting it has been reduced to nil, and the member's right to have any other amounts applied (other than by way of contribution or roll over) to their superannuation interest has been exhausted.[11]

Commutation

20. A superannuation income stream ceases upon receipt of a valid request from a member or a dependent beneficiary to *fully* commute their entitlements to future superannuation income stream benefits for an entitlement to a lump sum.

21. A superannuation income stream will *not* cease upon receipt of a person's application to partially commute some of their entitlements to future superannuation income stream benefits for an entitlement to a lump sum.

22. The amount payable to the person upon a full commutation of a superannuation income stream is a superannuation lump sum for income tax purposes as the superannuation income stream has ceased.

23. The amount payable to the person upon a partial commutation of a superannuation income stream is a superannuation lump sum for income tax purposes as the member is taken to have made an election under paragraph 995-1.03(b) of the ITAR 1997 for that payment not to be treated as a superannuation income stream benefit.[12]

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[10] For further explanation see paragraphs 85 to 89, and Example 6 paragraphs 37 to 39, of this draft Ruling.
[11] For further explanation see paragraph 91 of this draft Ruling.
[12] For further explanation see paragraphs 92 to 108 of this draft Ruling.

Death

24. A superannuation income stream ceases as soon as the member in receipt of the superannuation income stream dies, unless a dependent beneficiary of the deceased is automatically entitled under the superannuation fund's deed, or the rules of the superannuation income stream, to receive an income stream on the death of the member.[13]

Examples

Example 1: when a superannuation income stream commences – application date

25. A member applies using the relevant product disclosure statement application form to receive a superannuation income stream (an account based pension) from the XYZ Superannuation Fund. The form requires the member to specify the frequency of payments as monthly, quarterly, half-yearly or yearly and to specify the month in which the first payment is to be made. The rules also provide the superannuation income stream payable will commence on the date of a member's application. A member applies on 9 July, to receive monthly payments of $2,000 commencing in August, and the superannuation fund receives the request on 10 July.

26. The superannuation income stream will commence on 9 July as the rules state it will commence on the application date.

Example 2: when a superannuation income stream commences – first day of the period

27. The facts are as per Example 1, but the rules of the XYZ Superannuation Fund state that the superannuation income stream commences on the first day of the month after a member's application is received. A member applies on 10 July to receive monthly payments of $2,000 commencing in August.

28. The superannuation income stream will commence on 1 August.

[13] For further explanation see paragraphs 109 to 118, and Example 5 paragraphs 34 to 36 of this draft Ruling.

Example 3: when a superannuation income stream commences – cooling off period

29. The facts are as per Example 1, but the rules of the XYZ Superannuation Fund state that the superannuation income stream cannot commence before the end of the statutory cooling off period that is imposed by the *Corporations Act 2001*.[14] A member applies on 20 July to receive monthly payments of $2,000 commencing in August.

30. The superannuation income stream will commence the day after the cooling off period ends.

Example 4: superannuation income stream cannot commence until all capital is received

31. Fred is a member of XYZ Superannuation Fund, where his interest is valued at $500,000, and DEF Superannuation Fund, where his interest is valued at $1 million. Fred wishes to rollover the amount he has in DEF Superannuation Fund to XYZ Superannuation Fund to commence a superannuation income stream based on $1.5 million.

32. Fred completes the application form attached to the XYZ Superannuation Fund's pension product disclosure statement on 10 July. In that form he authorises the trustees of XYZ Superannuation Fund to obtain a rollover of his benefits from DEF Superannuation Fund.

33. On 15 July, XYZ Superannuation Fund sends Fred's rollover request to DEF Superannuation Fund. XYZ Superannuation Fund receives the rollover monies on 10 August. Fred's superannuation income stream, which is based on $1.5 million, cannot commence before 10 August. That is, the superannuation income stream cannot commence before all amounts that are to form the capital of the income stream are paid into Fred's interest with the XYZ Superannuation Fund.

Example 5: payment of a superannuation income stream to a dependant beneficiary – no cessation

34. David is a member of the EFG Superannuation Fund and has been married to Aggie for 20 years. The terms of the EFG Superannuation Fund deed provide that if a member is in receipt of a superannuation income stream when the member dies the income stream will continue to be paid to their spouse, provided that person had been the member's spouse for at least 3 years prior to the member's death.

35. David commences to receive a superannuation income stream on 1 July 2008. David dies on 1 September 2009. Aggie is automatically entitled to receive (and does receive) superannuation income stream benefits under the terms of the superannuation fund deed. There is, therefore, a continuing liability to make payments under that superannuation income stream.

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[14] Division 5 of Part 7.9 of the *Corporations Act 2001* provides for a cooling off period in relation to the purchase of a financial product (such as a superannuation income stream). The standard period is 14 days, but can differ in particular circumstances.

36. In these circumstances there is no cessation of the superannuation income stream.

Example 6: failure to meet minimum annual payment requirements – cessation of superannuation income stream

37. Bill is a member of the JKL Superannuation Fund (a self managed superannuation fund) and has commenced a superannuation income stream (an account based pension). The minimum annual payments were made to Bill during the first two income years the superannuation income stream was payable. At the start of the third income year the trustee of JKL Superannuation Fund calculates that the minimum annual payment they will be required to make under clause 1 of Schedule 7 of the SISR 1994 is $100.

38. During the third income year the trustee of the JKL Superannuation Fund makes a single payment to Bill of $50. As this amount is less than the minimum annual payment required the superannuation income stream has not met the requirements of the SISR 1994 for the income year. The superannuation income stream ceases for tax purposes at the beginning of this income year, and the $50 payment is a superannuation lump sum.

39. This is the case even if Bill remains entitled to receive a payment from the superannuation fund in relation to the pension under the terms of the superannuation trust deed, or under general trust law concepts, in future years.

Date of effect

40. When the final Ruling is issued, it is proposed to apply from 1 July 2007.

41. The Commissioner invites comments on what, if any, transitional arrangements are appropriate in implementing the final Ruling, including arrangements appropriate to cater for circumstances where an entity needs to make systems or process changes to be fully compliant with the views expressed in the Ruling.

42. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
13 July 2011

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

43. This draft Ruling explains:

- the meaning of 'superannuation income stream' (paragraphs 44 to 55);
- the relevance of when a superannuation income stream commences and ceases (paragraphs 56 to 62);
- when a superannuation income stream commences (paragraphs 63 to 79); and
- when a superannuation income stream ceases (paragraphs 80 to 118).

The meaning of 'superannuation income stream'

44. The meaning of 'superannuation income stream' is directly relevant to the meaning of 'superannuation income stream benefit'. Under Divisions 301 through to 307 of the ITAA 1997, certain income tax consequences apply to a member of a superannuation fund who receives a superannuation income stream benefit. There are also particular income tax consequences that apply to a superannuation fund that is paying a superannuation income stream.

45. A 'superannuation income stream' is defined[15] to mean:

(a) an income stream that is taken to be:

(i) an annuity for the purposes of the SIS Act in accordance with subregulation 1.05(1) of the SIS Regulations; or

(ii) a pension for the purposes of the SIS Act in accordance with subregulation 1.06(1) of the SIS Regulations; or

(iii) a pension for the purposes of the RSA Act in accordance with regulation 1.07 of the RSA Regulations;

46. It is clear from this definition that the meaning of 'superannuation income stream' is concerned with benefits that are 'income streams' within the ordinary meaning of that expression.

[15] Regulation 995-1.01 of the ITAR 1997. This draft Ruling does not specifically consider pensions or annuities that are covered by paragraph (b) of the definition and it has not been reproduced.

47. As the term ‘superannuation income stream benefit’[16] is separately defined, the Commissioner considers that a superannuation income stream refers to the particular arrangement or product, as defined by its rules, the agreement between the fund and the member and any other relevant documentation, rather than the particular payments made under that arrangement or product. The payments made from an interest that supports a superannuation income stream will be superannuation income stream benefits or superannuation lump sum payments made from partial commutations.

The meaning of ‘income stream’

48. The term ‘income stream’ is not defined for the purposes of the ITAA 1997 and hence takes its ordinary meaning in the context in which it appears.[17]

49. There is no dictionary meaning of the composite term ‘income stream’. However, one of several meanings given for ‘income’ by the Macquarie Dictionary[18] is:

> **1.** the returns that come in periodically, especially annually, from one’s work, property, business, etc; revenue; receipts

One of several meanings given for ‘stream’ is:

> **5.** a continuous flow or succession of anything: *a stream of words*

50. In light of the ordinary meanings of these terms, the Commissioner considers the ordinary meaning of the phrase ‘income stream’ refers to a series of periodic (including annual) payments made from the member’s interest in the superannuation fund. The payments that comprise the income stream must relate to each other such that it is possible to identify a series of periodic payments made to the member over time. The payments need not be periodic in the sense that they are always paid at the same, recurring intervals. Rather, what is required is that the trustee is liable to pay at least one annual amount for an identifiable, but not necessarily fixed, term.

Requirement for an income stream to be a pension

51. An income stream is only a ‘superannuation income stream’ if, relevantly for this draft Ruling,[19] it is capable of being taken to be a pension in accordance with subregulation 1.06(1) of the SISR 1994.[20] Subregulation 1.06(1) defines a benefit as a pension if:

(a) it is provided under rules of a superannuation fund that:

(i) meet the standards of subregulation (9A); and

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[16] Regulation 995-1.01 of the ITAR 1997.
[17] *CIC Insurance* Ltd *v. Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408.
[18] 4th Edn.
[19] See paragraph 2 of this draft Ruling, which explains the scope of this Ruling.
[20] Subparagraph (a)(ii) of the definition of ‘superannuation income stream in regulation 995-1.01 of the ITAR 1997.

(ii) do not permit the capital supporting the pension to be added to by way of contribution or rollover after the pension has commenced; and

(b) in the case of rules to which paragraph (9A)(a) applies – the rules also meet the standards of regulation 1.07D.

52. In relation to a superannuation income stream that is an account based pension, the subject of this draft Ruling, the requirements in subregulation 1.06(9A) of the SISR 1994 are as follows:

> Rules for the provision of a benefit (the pension) meet the standards of this subregulation if the rules ensure that payment of the pension is made at least annually, and also ensure that:
>
> (a) for a pension in relation to which there is an account balance attributable to the beneficiary - the total of payments in any year (including under a payment split but excluding amounts rolled over) is at least the amount calculated under clause 1 of Schedule 7; and
>
> …
>
> (c) the pension is transferable to another person only on the death of the beneficiary (primary or reversionary, as the case may be); and
>
> (d) the capital value of the pension and the income from it cannot be used as a security for a borrowing.

53. The definition of a 'pension' under paragraph 1.06(9A)(a) of the SISR 1994 includes two fundamental requirements, being that:

- payment should occur *at least* annually, and
- a minimum amount must be paid to the member each year.

54. These requirements reflect the ordinary meaning of an income stream explained at paragraphs 48 to 50, being a series of periodic (including annual) payments from the member's interest in the superannuation fund.

55. In summary, it is the Commissioner's view that if a member is entitled to a series of periodic (including annual) payments from their interest in the superannuation fund, and that series of payments meets the requirements of subregulation 1.06(1), which includes subregulation 1.06(9A)(a), of the SISR 1994 it is a superannuation income stream.

Relevance of when a superannuation income stream commences and ceases

56. It is necessary to determine when a superannuation income stream commences or ceases as particular consequences flow from its commencement or cessation. Additionally, once the superannuation income stream commences it is payable (that is, there is an obligation to pay superannuation income stream benefits under that superannuation income stream) until such time as that superannuation income stream ceases.

Divisions 301 through to 307 of the ITAA 1997

57. Whether there is a superannuation income stream from which superannuation income stream benefits are being paid is relevant to the superannuation benefit taxing rules set out (primarily) in Divisions 301, 302 and 307 of the ITAA 1997.

58. These Divisions provide for different tax treatment to apply to superannuation income stream benefits in a range of circumstances compared with the treatment that applies to superannuation lump sums.

59. For example, the proportioning rule[21] applies differently depending on whether a superannuation lump sum is paid from an interest that supports (or supported) a superannuation income stream or is paid from an interest that has never supported a superannuation income stream.

60. A further example is the separate interest rule in regulation 307-200.05 of the ITAR 1997. This rule provides that once a superannuation income stream 'commences', an amount that supports the superannuation income stream is always to be treated as a separate superannuation interest.[22]

61. Both these rules are central to the correct identification of the tax free and taxable components of benefits paid from that superannuation interest.

Exempt current pension income provisions

62. Further, context is provided by Subdivision 295-F of the ITAA 1997. Broadly, this subdivision provides two mechanisms for exempting from the assessable income of a superannuation fund, income from those assets of the fund that support the payment of a superannuation income stream(s) by the fund. Thus whether a superannuation income stream is payable, that is, whether it has commenced and not ceased, is relevant to determining if the exemption applies.

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[21] Section 307-125 of the ITAA 1997. The proportioning rule is discussed further at paragraphs 72 to 75 of this draft Ruling.

[22] Further mention of this regulation is at paragraphs 77 to 79 of this draft Ruling.

When a superannuation income stream commences

63. There is no definition of 'commence' or 'commenced' or 'commencement day' as the terms relate to superannuation income streams in either the ITAA 1997 or the ITAR 1997. However, the term 'commencement day' is defined in the SISR 1994 in relation to a pension or annuity. The 'commencement day' for a pension or annuity is the first day of the period to which the first payment of the pension or annuity relates.[23]

64. As the definition of superannuation income stream relies on there being a pension under regulation 1.06(1) of the SISR 1994, it is appropriate that the time at which a superannuation income stream commences for income tax purposes is aligned with the 'commencement day' for such a pension for the purposes of the SISR 1994. The concept of 'commencement day' is used throughout the pension standards set out in regulation 1.06 of the SISR 1994. The concept is also used in regulation 1.07D of the SISR 1994, which places restrictions on the commutation of superannuation pensions, and in Schedule 7 to the SISR 1994, which prescribes the minimum annual payment requirements that must be met for account based pensions.

65. Aligning the approach with that taken for pensions in the SISR 1994, the 'commencement day' for a superannuation income stream is the first day of the period to which the first payment relates.

66. The first day of the period to which the first payment relates must be determined by reference to the superannuation fund rules and other documentation applying to the relevant superannuation income stream. An example of other documentation that is relevant in determining the commencement of a superannuation income stream is the product disclosure statement that may be required to be issued to members by the superannuation fund pursuant to the *Corporations Act 2001*.

67. If the rules of a superannuation fund provide that a superannuation income stream becomes immediately payable on the occurrence of a particular event, the commencement day for the superannuation income stream will be the day on which that event occurs and not before.

68. In all other circumstances, a member will need to apply to the trustee of the fund to receive a superannuation income stream.[24] Therefore, the commencement day cannot be prior to the member's application.

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[23] See the definition of 'commencement day' in subregulation 1.03(1) of the SISR 1994.

[24] Refer to Division 6.3 (cashing of benefits) of the SISR 1994. Regulation 6.21 of the SISR 1994 provides that death is the only circumstance in which it is compulsory for a trustee to pay a member's benefits from the superannuation fund.

69. The commencement day for the superannuation income stream may, however, occur before the due date of the first payment depending on the terms and conditions upon which the superannuation income stream is payable. It is possible for the application date to be the commencement day for the superannuation income stream if it is the first day of the period to which the first payment relates.

70. However, the commencement day cannot occur prior to the day on which the member and the trustee agree to the terms and conditions that will govern the payment of the superannuation income stream.

71. Examples 1 to 3 (paragraphs 25 to 30) illustrate how the commencement day of a superannuation income stream is determined in different circumstances.

Contributions and roll-overs to be made before the superannuation income stream commences

72. The proportioning rule in section 307-125 of the ITAA 1997 first requires the tax free and taxable proportions of a superannuation interest to be determined. These proportions are then required to be applied to any benefit paid from the superannuation interest to ensure that the benefit contains the same proportions of tax free and taxable components as the superannuation interest from which it is paid.

73. Subsection 307-125(3) of the ITAA 1997 refers to the time at which the value of the tax free and taxable components of the superannuation interest must be determined. For superannuation income stream benefits, and lump sums paid from the commutation of superannuation income streams, the value of the tax free and taxable components must be determined at the time when the superannuation income stream commenced.[25] For superannuation lump sums from an interest that has never supported a superannuation income stream, the relevant time is just before the benefit is paid. This timing ensures that all payments from the superannuation income stream have the correct tax free and taxable components. It also assists superannuation funds to report correctly and withhold the correct amount of tax if necessary.

[25] The actual calculation of the tax free and taxable components can be done any time before the first payment from the superannuation income stream is made.

74. It necessarily follows that to ensure the tax free and taxable proportions are correctly determined for a superannuation income stream, the superannuation fund and the member must ensure that all contributions (including roll-over amounts) which are intended to form part of the capital supporting the superannuation income stream have been made before the superannuation income stream commences. A contribution is typically made when the amount is received, or ownership of an asset is obtained, or the fund otherwise obtains the benefit of an amount. It is not enough to agree to make a contribution at a future time.[26]

75. Ensuring all contributions are received before the superannuation income stream commences is consistent with the explicit requirement in subparagraph 1.06(1)(a)(ii) of the SISR 1994,[27] which states that the rules of a superannuation fund must not allow for the capital supporting a pension to be added to by way of contribution or rollover after the pension has commenced.

76. Example 4 (paragraphs 31 to 33) illustrates that the commencement day cannot be before all amounts that are to form the capital of the income stream are paid into the interest.

Effect of treating the amount supporting the superannuation income stream as a separate interest

77. Subregulation 307-200.05 of the ITAR 1997 states that if a superannuation income stream commences, an amount that supports the superannuation income stream is always to be treated as a separate superannuation interest. Subregulation 307-200.05 applies for the purposes of the proportioning rule to ensure all payments made from the interest supporting the superannuation income stream have the same proportions of tax free component and taxable component.

78. It has, however, been suggested that the effect of subregulation 307-200.05 of the ITAR 1997 is that once a superannuation income stream commences, it only ceases once the amount in the relevant interest is exhausted. However, this interpretation does not give due regard to the terms of subregulation 307-200.05 of the ITAR 1997 as they appear in the legislation.

[26] See further paragraphs 10 to 38 and 181 to 210 of Taxation Ruling TR 2010/1 Income Tax: superannuation contributions. This Ruling sets out the Commissioner's view on when a contribution is taken to have been made to a superannuation fund.
[27] Reproduced at paragraph 51 of this draft Ruling.

79. The Commissioner considers that the operation of subregulation 307-200.05 of the ITAR 1997 is directed at ensuring that a separate superannuation interest is identified at the time a superannuation income stream commences. It does not by its terms deem the amount supporting the superannuation income stream to be the superannuation income stream. Nor does it deem all payments from the interest, including those made after the superannuation income stream ceases, to be superannuation income stream benefits.

When a superannuation income stream ceases

80. Neither the ITAA 1997 nor the ITAR 1997 sets out when a superannuation income stream ceases for tax purposes.

81. As outlined at paragraph 51, a superannuation income stream, as relevant to this draft Ruling, must meet the requirements of a pension in 1.06(1) of the SISR 1994. The pension standards contained in the SISR 1994 also do not explicitly prescribe when a pension ceases for regulatory purposes.

82. The Commissioner considers that a superannuation income stream ceases when there is no longer a member who is entitled, or a dependent beneficiary of a member who is automatically entitled, to be paid a superannuation income stream benefit from a superannuation interest that supports a superannuation income stream.

83. Whether a superannuation income stream has ceased must be determined by reference to the relevant superannuation fund's trust deed, the relevant requirements of the SISR 1994 and the particular facts and circumstances of the payment of the member's, or dependant beneficiary's, benefits.

84. The common circumstances in which a superannuation income stream ceases are outlined below.

Failure to comply with the pension rules and the payment standards of the SISR 1994

85. A superannuation income stream, as relevant to this draft Ruling, must meet the requirements of subregulation 1.06(1) of the SISR 1994, and thus the requirements of subregulation 1.06(9A) of the SISR 1994, and if relevant the commutation standards in regulations 1.07D of SISR 1994.[28] If these requirements, as relevant to the circumstance, are not met there is not a superannuation income stream.

[28] See paragraphs 51 and 52 of this draft Ruling.

86. Subregulation 1.06(9A)[29] of the SISR 1994 provides that the rules of the superannuation fund meet the relevant standards if the rules 'ensure' that the payment is made at least annually and 'ensure' that the other requirements as outlined in that subregulation are met.

87. The word 'ensure' is given the meaning in the Macquarie Dictionary as 'to make sure or certain to come, occur, etc'. As the rules of the superannuation fund must 'ensure' that the standards are met it is not enough for the rules of the superannuation fund to simply include a reference to, or reproduce the terms of, those standards. Rather, it is the Commissioner's view that the rules must be met, or given effect to, in practice.

88. If a purported superannuation income stream fails to meet these requirements in an income year, the superannuation income stream will be taken to have ceased at the start of that income year for income tax purposes. Therefore, from that time the interest is no longer supporting a superannuation income stream and the benefits paid from that interest are not superannuation income stream benefits.

89. If in the following income year the relevant rules are again complied with this in effect results in the commencement of new superannuation income stream and the proportioning rule[30] must be applied to that new superannuation income stream when it commences.

90. Example 6 (paragraphs 37 to 39) illustrates the effect of a superannuation income stream not meeting the requirements of the SISR 1994 in an income year.

Exhaustion of capital

91. A superannuation income stream ceases when the capital supporting it has been reduced to nil and the member's right to have any other amounts applied (other than by way of contribution or roll over) to their interest has been exhausted. As there is no capital no further superannuation income stream benefits are payable and the superannuation income stream is at an end.

Commutation

92. A member benefiting from a superannuation income stream may choose to commute their superannuation income stream into a lump sum provided that the commutation meets the superannuation fund's rules for that superannuation income stream and the requirements of regulation 1.07D of the SISR 1994.

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[29] As do subregulations 1.06(2) to (8) of the SISR 1994.
[30] Paragraph 307-125(3)(a) of the ITAA 1997.

93. ‘Commutation’ is an integral concept of the tax and superannuation regulatory regimes that affects the payment of benefits from a superannuation interest supporting a superannuation income stream. As ‘commutation’ is not defined in either the ITAA 1997 or the SISR 1994 it therefore takes its ordinary meaning in the context in which it appears.

94. The Macquarie Dictionary gives the meaning of ‘commute’ as ‘to change (one kind of payment) into or for another, as by substitution’.

95. The concept of commuting a pension entitlement was considered by Deputy President Forgie in *Re Hammerton and Comcare Australia*[31] (*Re* Hammerton*)*. This case considered the character of a payment received on the partial commutation of a pension, that is, whether it retained its character as a pension payment, or became a lump sum payment. It was held by Deputy President Forgie (at paragraphs 47 and 48) that:

> It is implicit in this case that the commutation has had the effect of changing the essential nature of periodical pension payments into something else. That seems to me to accord with what happens when a single payment takes the place of an on-going periodic payment of pension. It also accords with the normal meaning of ‘commute’ i.e. ‘to exchange for another or something else … interchange 2. to change (one kind of payment) into or for another as by substitution … to make a collective payment, esp. of a reduced amount, as an equivalent for a number of payments…’ (Macquarie Dictionary).
>
> It follows that Mr Hammerton has received a lump sum benefit under a superannuation scheme as well as being in receipt of ongoing pension payments.

96. Although *Re Hammerton* concerned a pension, comprised of periodical payments, in the context of the *Safety Rehabilitation and Compensation Act 1988*, the statements made by Deputy President Forgie on the concept of commutation of such a pension are, in the Commissioner’s view, equally relevant to superannuation income streams that are paid in accordance with subregulation 1.06(1) of the SISR 1994.

97. These statements are considered to be equally relevant to a superannuation income stream because, as explained in paragraphs 48 to 55, in order for a superannuation income stream to exist the member must be entitled to a series of periodic (including annual) payments and similarly these periodic payments can be exchanged for a lump sum payment.

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[31] [1995] AATA 63.

98. The concept of commuting a pension entitlement was also considered by Member Allen in *Cooper and Commissioner of Taxation*[32] *(Cooper)*. This case considered whether a lump sum payment of arrears of an invalidity pension, payable under the *Defence Force Retirement and Death Benefits Act 1973* (DFRDB Act), constituted a commutation of the pension. The question of whether the payment was a commutation of a superannuation pension was relevant in determining whether that lump sum payment was an 'eligible termination payment' for the purposes of former paragraph 27A(1)(d) of the *Income Tax Assessment Act 1936* (ITAA 1936). It was held by Member Allen (at paragraph 26) that the relevant payment was not in substitution or exchange for any right Mr Cooper had:

> I agree with those submissions and would add that any commutation must be in accordance with the provisions of the superannuation scheme in question. In my opinion a commutation of a superannuation pension requires a beneficiary to make a conscious decision to exchange future entitlements, or a mixture of past and future entitlements, for some other form of benefit (usually a lump sum) as permitted by the scheme. Mr Cooper made no such decision. Once the Authority had determined that he would be treated as having been retired on invalidity or incapacity grounds he became entitled to receive his arrears from the date of retirement and a future pension. The arrears could only be calculated and paid as a lump sum in the way that it was by the Authority. I have no reason to doubt Mr Barton's evidence of the calculations that he made or the appropriateness of his assumptions. I do not, however, believe that his evidence established that there was a commutation of a pension. ….On the evidence I consider that Mr Cooper received his full entitlement as to arrears and that receipt of arrears did not alter in any way the right to receive the pension in future in the same amount and on the same terms. There was no exchange or substitution of anything. There was no commutation of future pension entitlements and the payment of the arrears by a lump sum was not a commutation of past pension entitlements.

99. The facts of *Cooper* considered a benefit that was accepted as satisfying the requirements for a pension under an earlier version of regulation 1.06 of the SISR 1994. However, the statements made by Member Allen on the concept of commutation are relevant to superannuation income streams that are pensions paid in accordance with the current subregulation 1.06(1) of the SISR 1994.

100. Therefore, and consistent with the ordinary meaning of commutation, the Commissioner considers that a member has commuted their superannuation income stream if, consistent with the superannuation fund rules and the relevant requirements of the SISR 1994, they consciously exercise their right to exchange some or all of their entitlement to receive future, periodic (including annual) superannuation income stream benefits for an entitlement to be paid a lump sum.

[32] [2003] AATA 296.

101. Whether a commutation has been undertaken is a question of fact, evidenced by the member complying with the conditions attaching to a commutation set out in the superannuation fund rules and/or the agreement between the member and the superannuation fund under which the superannuation income stream is provided.

102. It also follows from this view that, before a commutation can be undertaken, the superannuation fund rules and/or the agreement between the member and the superannuation fund, under which the income stream is provided, must clearly set out in advance the total amount of, and the total number of, periodic superannuation income stream benefits to be made to the member each year.

103. The rules and/or the agreement need not specify a fixed dollar amount or more than one payment annually. For example, the member may agree in advance with their superannuation fund that they wish to receive one superannuation income stream benefit payment each year equal in amount to the annual minimum amount required to be paid each year under the SISR 1994. The amount and number of payments may be altered (subject to superannuation fund rules and the SISR 1994 requirements) but any such alteration will not of itself evidence a commutation having been made.

104. The Commissioner considers that a commutation is not capable of being made if the rules or the agreement, under which the superannuation income stream is provided, provides for no more than an unspecified amount to be paid each year at an unspecified time in an unspecified number of payments. This is because in this case it is not possible to distinguish between a superannuation income stream benefit and a payment made as a result of the commutation of the superannuation income stream.

105. Once a valid request to *fully* commute a superannuation income stream is received by the trustee of the superannuation fund, the superannuation fund no longer has a liability to provide a superannuation income stream benefit, as this has been exchanged for the liability to provide a lump sum payment. The superannuation income stream therefore ceases at this time.

106. As the payment resulting from the full commutation is made after the cessation of the superannuation income stream, it is a superannuation lump sum for income tax purposes and cannot count towards the minimum annual payment requirement set out in paragraph 1.06(9A)(a) of the SISR 1994.

Partial commutation

107. In contrast with a full commutation, a partial commutation occurs when a member consciously exercises their right to exchange something less than their full entitlements to receive future, periodic (including annual) superannuation income stream benefits for an entitlement to be paid a lump sum. As there is still an obligation to continue to pay superannuation income stream benefits (either in that income year or later income years) a partial commutation does not result in the cessation of the superannuation income stream. A partial commutation payment is a superannuation lump sum for income tax purposes[33] and a lump sum for the purposes of the SISR 1994.

108. All payments made from a superannuation interest supporting a superannuation income stream count towards the minimum payment requirements in subregulation 1.06(9A) of the SISR 1994, including a payment made as a result of a partial commutation, unless it is rolled over within the superannuation system. This would be the case regardless of whether the partial commutation payment is made in cash or *in specie*.

Death of the member

109. When a member dies they no longer have an entitlement to receive superannuation income stream benefits. The member's remaining entitlements must be paid out of the superannuation fund under the relevant regulations of the SISR 1994. The form of any benefit paid, and who it is paid to, depends on the rules[34] of the superannuation fund, and the relevant requirements of the SISR 1994.

110. For a superannuation income stream that is an account based pension, the superannuation fund rules must ensure that the pension is transferrable to another person (the reversionary beneficiary) only upon the death of the member.[35] Additionally, the superannuation fund's rules will not meet the standard if the pension is transferred or paid to a person who is not a dependant.[36] If a superannuation fund's rules do not comply with these requirements the relevant pension standard is not met and the product is not a pension for SISR purposes and thus is not a superannuation income stream for income tax purposes.

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[33] In applying to exchange future superannuation income stream entitlements for a partial commutation payment the member is taken to have made an election under paragraph 995-1.03(b) of the ITAR 1997 for that payment not to be treated as a superannuation income stream benefit.

[34] For example, the rules of a superannuation fund may permit a binding beneficiary nomination to be made. See subsection 59(1A) of the SISA 1993 and regulation 6.17A of the SISR 1994.

[35] Paragraph 1.06(9A)(c) of the SISR 1994.

[36] Subregulation 1.06(9B) of the SISR 1994. Who is a dependant is set out in subregulation 6.21(2A) of the SISR 1994, see also footnote 6 of this draft Ruling.

111. The cashing of benefits rules in Division 6.3 of the SISR 1994 are consistent with this. Benefits for a dependant can be cashed through a pension or annuity product[37] or a lump sum and for non-dependants only through a lump sum[38].

Payment of superannuation income stream (that is a pension for SISR 1994 purposes) to dependent beneficiaries

112. Although superannuation entitlements are personal and not normally transferable to another individual, the relevant provisions of the SISA 1993 and the SISR 1994, as discussed, recognise that an individual's superannuation benefits can be paid to another person on the individual's death. Thus a superannuation income stream (that is a pension under subregulation 1.06(1) of the SISR 1994) can be transferred to certain dependants[39] on the death of a member.

113. If the entitlement to a superannuation income stream is automatically transferred to a dependent beneficiary on the death of the member the superannuation income stream does not cease. There is a continuing liability to make the payments under that superannuation income stream albeit the beneficiary of those payments has changed.

114. For a superannuation income stream to be considered to have automatically transferred to a dependent beneficiary on the death of a member, the rules of the superannuation income stream must specify this will occur. The rules must specify both the person to whom the benefit will become payable and that it will be paid in the form of a superannuation income stream. The rules may also specify a class of person (for example, spouse) to whom the benefit will become payable. It is not sufficient that a superannuation income stream becomes payable to a beneficiary of a deceased member only because of a discretion (or power) granted to the trustee by the trust deed or governing rules. The discretion (or power) may relate to determining either who will receive the deceased member's benefits, or the form in which the benefits will be payable.

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[37] Paragraph 6.21(2)(b) of the SISR 1994.
[38] Paragraph 6.21(2)(a) of the SISR 1994. The lump sum may be a single lump sum or an interim lump sum followed by a final lump sum.
[39] See subregulation 6.21(2A) of the SISR 1994 and also footnote 6 of this draft Ruling.

115. A superannuation income stream is also considered to have transferred on the member's death if a valid binding death benefit nomination[40] is in place at the time of the member's death that entitles a dependent beneficiary to receive a superannuation income stream. The nomination must be binding on the trustee, in respect of both the beneficiary who will receive the benefit, and the form of the benefit. If the trustee may, or is required to, exercise discretion in respect of either of these conditions, the superannuation income stream is not considered to have been automatically transferred.

116. If there is no entitlement for a superannuation income stream to automatically transfer to a beneficiary on the death of a member, for example, if the trustee has the discretion to pay either a superannuation lump sum or a superannuation income stream to a dependent beneficiary, the superannuation income stream ceases on the member's death. If the trustee ultimately decides to pay the relevant dependent beneficiary a superannuation income stream (that is, a pension that complies with regulation 1.06(1) of the SISR 1994) from the remaining amount in the deceased's interest then at that time a new superannuation income stream commences.

117. Example 5 (at paragraphs 34 to 36 of this draft Ruling) illustrates a situation where a superannuation income stream automatically transfers to a dependant beneficiary.

Lump sum benefits paid to non-dependant beneficiaries

118. A superannuation income stream (that is a pension for the purposes of regulation 1.06(1) of the SISR 1994) cannot be transferred to a non-dependant beneficiary for the reasons explained at paragraph 110. Thus, the superannuation income stream ceases and any remaining entitlement must be paid as a superannuation lump sum.

[40] See subsection 59(1A) of the SISA 1993, regulation 6.17A of the SISR 1994 and SMSFD 2008/3: Self Managed Superannuation Funds: is there any restriction in the Superannuation Industry (Supervision) legislation on a self managed superannuation fund trustee accepting from a member a binding nomination of the recipients of any benefits payable in the event of the member's death?

Appendix 2 – Your comments

119. You are invited to comment on this draft Ruling. Comments are also sought as to what, if any, transitional arrangements are appropriate in implementing the final version of this Ruling (see further at paragraph 41 of this draft Ruling). Please forward your comments to the contact officer by the due date.

120. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	**26 August 2011**
Contact officer:	**Andrew Allan**
Email address:	**andrew.allan@ato.gov.au**
Telephone:	**02 6216 1246**
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Address:	**Australian Taxation Office** **PO Box 900** **Civic Square ACT 2608**

Appendix 3 – Detailed contents list

121. The following is a detailed contents list for this Ruling:

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2010/1; TR 2006/10;
SMSFD 2008/3

Subject references:

- annuities and superannuation pensions
- components of superannuation benefits
- death benefits – superannuation benefits
- death benefits dependant
- exempt income of superannuation funds
- income stream – superannuation benefits
- lump sum – superannuation benefits
- proportionate rule for superannuation benefits
- superannuation
- superannuation benefits
- superannuation contributions
- superannuation fund income
- superannuation pensions
- superannuation, retirement and employment termination
- tax free component of superannuation interest
- taxable component of superannuation benefits
- taxation of superannuation entities

Legislative references:

- ITAA 1997 Subdiv 295-F
- ITAA 1997 Division 301
- ITAA 1997 Div 302
- ITAA 1997 Div 303
- ITAA 1997 Div 304
- ITAA 1997 Div 305
- ITAA 1997 Div 306
- ITAA 1997 Div 307
- ITAA 1997 307-125
- ITAA 1997 307-125(3)(a)
- ITAR 1997 307-200.05
- ITAR 1997 995-1.01
- ITAR 1997 995-1.03(b)
- SISA 1993
- SISA 1993 59(1A)
- SISR 1994 1.03(1)
- SISR 1994 1.06
- SISR 1994 1.06(1)
- SISR 1994 1.06(1)(a)(ii)
- SISR 1994 1.06(2)
- SISR 1994 1.06(8)
- SISR 1994 1.06(9A)
- SISR 1994 1.06(9A)(a)
- SISR 1994 1.06(9A)(c)
- SISR 1994 1.06(9B)
- SISR 1994 1.07B
- SISR 1994 1.07D
- SISR 1994 6.17A
- SISR 1994 6.21
- SISR 1994 6.21(2)(a)
- SISR 1994 6.21(2)(b)
- SISR 1994 6.21(2A)
- SISR 1994 Division 6.3
- SISR 1994 Sch 7 cl 1
- Corporations Act 2001 Div 5 Pt 7.9
- Defence Force Retirement and Death Benefits Act 1973
- Safety and Rehabilitation Act 1988

Case references:

- CIC Insurance Ltd v. Bankstown Football Club Ltd (1997) 187 CLR 384
- Cooper and Commissioner of Taxation [2003] AATA 296
- Re Hammerton and Comcare Australia [1995] AATA 63; 52 ATR 1199; 2003 ATC 2123

ATO references

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