

*Department of the
Parliamentary Library*



INFORMATION AND RESEARCH SERVICES

Bills Digest

No. 17 2001–02

Veterans' Affairs Legislation Amendment (Further
Budget 2000 and Other Measures) Bill 2001

ISSN 1328-8091

© Copyright Commonwealth of Australia 2001

Except to the extent of the uses permitted under the *Copyright Act 1968*, no part of this publication may be reproduced or transmitted in any form or by any means including information storage and retrieval systems, without the prior written consent of the Department of the Parliamentary Library, other than by Senators and Members of the Australian Parliament in the course of their official duties.

This paper has been prepared for general distribution to Senators and Members of the Australian Parliament. While great care is taken to ensure that the paper is accurate and balanced, the paper is written using information publicly available at the time of production. The views expressed are those of the author and should not be attributed to the Information and Research Services (IRS). Advice on legislation or legal policy issues contained in this paper is provided for use in parliamentary debate and for related parliamentary purposes. This paper is not professional legal opinion. Readers are reminded that the paper is not an official parliamentary or Australian government document. IRS staff are available to discuss the paper's contents with Senators and Members and their staff but not with members of the public.

Inquiries

Members, Senators and Parliamentary staff can obtain further information from the Information and Research Services on (02) 6277 2646.

Information and Research Services publications are available on the ParlInfo database.

On the Internet the Department of the Parliamentary Library can be found at:

<http://www.aph.gov.au/library/>

Published by the Department of the Parliamentary Library, 2001

INFORMATION AND RESEARCH SERVICES

Bills Digest
No. 17 2001-02

Veterans' Affairs Legislation Amendment (Further Budget
2000 and Other Measures) Bill 2001

Peter Yeend
Social Policy Group
10 August 2001

Contents

Purpose	1
Introduction	2
Financial implications.	2
Who benefits?	2
Mirror SSA legislation	2
Compensation Recovery	3
Dollar-for-Dollar Reductions and Partners	3
Origins.	4
Financial implications and who benefits.	4
Other legislation.	4
Rationale for hardship provisions	4
Introduction	5
Financial implications and who benefits.	5
Other legislation.	5
Income stream products	5
Popularity of lifetime pensions and annuities	6
Income and Assets Testing	7
Reliability and Dependability of Income Stream Products.	8
Continued and Increasing Diversity of Income Stream Products	8
Commuted or Dissolved Products: Debts and Hardship	9
Main Provisions	10
Endnotes.	10

Veterans' Affairs Legislation Amendment (Further Budget 2000 and Other Measures) Bill 2001

Date Introduced: 28 June 2001

House: House of Representatives

Portfolio: Veterans' Affairs

Commencement:

Sections 1, 2 and 3 - Royal Assent

Part 1 of Schedule 3 – taken to have commenced on 1 July 1995

Other provisions of this Act – taken to have commenced from 20 September 2001

Purpose

There is no singular or central theme to the initiatives proposed in this Bill, rather the Bill provides the legislative basis for a number separate and unrelated Budget 2000 Veterans' Affairs initiatives and other measures related to the *Veterans' Entitlements Act 1986* (VEA).

All of the Schedules proposed in this Bill involve aligning provisions in the VEA with like provisions in the *Social Security Act 1991* (SSA). Many provisions in both Acts for income support payments mirror each other and parity is maintained to ensure consistency and equity. These mirrored provisions commonly refer to income testing, asset testing and treatment of compensation income. All of the income support pensions and allowances, provided under the SSA (except for blind pension), are income and assets tested. The income support payments provided under the VEA that are also income and assets tested are service pension, income support supplement and invalidity service pension.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Schedule 1 – Compensation recovery

Introduction

The amendments proposed to the treatment of compensation arise from measures announced in the 2000-2001 Budget.¹ The measures are proposed in conjunction with mirror compensation measures under the Family and Community Services (F&CS) portfolio, being also announced in the 2000-2001 Budget.² As discussed in the Purpose section above, it is the norm for the compensation rules applied to income support payments provided under both the SSA and the VEA to mirror each other.

Financial implications

The Budget papers estimate the cost of this proposed initiative will be \$0.184m in 2001-2002, \$0.233m in 2002-2003, \$0.228m in 2003-2004 and \$0.299m in 2004-2005.³ The cost estimates for the same measure applied for the Family and Community Affairs Portfolio, were \$3.813m in 2001-2002, \$4.093m in 2002-2003 and \$4.256m in 2003-2004.⁴

Who benefits?

Neither the Explanatory Memorandum nor the Budget papers provide any indication of estimated numbers of persons affected by this initiative. The main income support payments provided under the VEA that are affected are:

- Invalidity Service Pension (ISP) - paid to a veteran with qualifying service, aged less than service pension age (ie. 60 males and 57 females) and is permanently blind or permanently unable to work. ISP is income and asset tested. Some veterans on ISP may also be receiving war disability pension, which is not means tested.
- Income Support Supplement (ISS) - paid in addition to the war widows/ers pension and is income and asset tested. The war widows/ers pension recipients affected would be those under age pension age, ie. 65 for males and 62 for females.
- Partner service pension – paid to the female partner of a service pensioner aged less than age pension age.

Mirror SSA legislation

The mirror legislation for the treatment of compensation against a partner's entitlement under the SSA was provided in the *Family and Community Services Legislation (Simplification and Other Measures) Act 2001*. This Act was passed, without substantial amendment, by the Parliament on 20 June 2001 and received Royal Assent on 30 June 2001. The Bills Digest for this Act is No. 161 of 2000-2001 and is at:

<http://www.aph.gov.au/library/pubs/bd/2000-01/01BD161.htm>

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Set out below is extracts from the Bills Digest for the *Family and Community Services Legislation (Simplification and Other Measures) Act 2001*, discussing the policy issues and the interaction between compensation and income support payments. As stated, these issues and principles apply equally for income support payments provided under the SSA and the VEA and hence the proposed amendments to the VEA in this Bill.

Compensation Recovery

The SSA contains special rules for the treatment of compensation provided as replacement earnings. These special provisions are to ensure that persons, who are able to access income support from compensation, should not at the same time access assistance from government-provided income support. It has been a long-standing view of successive governments that the compensation system has the first responsibility for the provision of income support to those with a compensable illness or injury, not the taxpayer by way of government income support.

The foremost concern of governments has been that there should not be any 'double dipping', ie. receiving compensation for lost earnings from a wrongdoer or insurer while at the same time receiving replacement earnings by way of government income support.

Dollar-for-Dollar Reductions and Partners

Where a person who is receiving compensation receives another compensation affected social security benefit or parenting payment, the compensation affects the rate of payments on a dollar-for-dollar basis. Any excess amount is then held against any partner's income support entitlement on a dollar-for-dollar basis. It would be very common for a person's periodic compensation payments, which are based on their normal weekly earnings, to exceed the partnered rate of most social security payments and to result in a significant reduction in income support made to the person's partner. This treatment has been in place for a considerable period, and the dollar-for-dollar reduction of the partner's income support has been criticised as being too harsh.

For example, as at May 2001 the partnered rate of newstart allowance was \$322.80 per fortnight. A periodic compensation paid at a rate of \$450 per fortnight would reduce the partner's income support payment by the excess of \$127.20 per fortnight. The net rate than paid to the partner would be \$322.80 minus \$127.20 leaving \$195.60 per fortnight.

The effect of the proposed legislative change is to treat any excess payment as ordinary income against the partner's rate and the appropriate income test free areas and tapers are then applied. This is more beneficial than the current dollar-for-dollar deduction.

The results achieved will vary depending on what sort of income support payment the partner is receiving. This is because the income test free area and taper are more generous for pensions than the allowance income test. Most will be allowee partners, receiving one of the allowance payments, ie. newstart allowance, partner allowance, parenting payment (partnered).

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Where the partner is on an allowance payment, any excess partner income reduces the payment rate by 70 cents in the dollar. A different result applies to pension recipients. In the example set out above, the excess of \$127.20 would be reduced to \$89.04. The net rate then payable is \$322.80 minus \$89.04 leaving \$233.76 per fortnight. This is substantially more than the current rate result of \$195.60 per fortnight.

Schedule 2 – returns from unrealisable assets

Origins

This proposed initiative has its origins in the Simplification Package that was announced in the 2000-2001 Budget.⁵ The Simplification Package contained several initiatives aimed at rationalising the treatment of some items under the income and assets tests. The mirror amendments to the Simplification Package, for the income support payments provided under the Veterans' Affairs portfolio, were also announced in the 2000-2001 Budget.⁶

Financial implications and who benefits

The Budget papers detail that for the whole of the Simplification Package the estimated cost to outlays for the Veterans' Affairs portfolio will be \$0.257m in 2000-2001, \$0.009m in 2001-2002, \$-0.164m in 2002-2003 and \$-0.214m in 2003-2004.⁷ There is no individual estimate for this initiative alone.

Other legislation

The like measure for the treatment of income from unrealisable assets for the income support pensions/allowance provided under the SSA was provided for in the *Family and Community Services Legislation (Simplification and Other Measures) Act 2001*.⁸ This Act was presented to the House of Representatives on 24 May 2001, to the Senate on 20 June 2001 and received Royal Assent without substantive amendment on 30 June 2001.

Rationale for hardship provisions

The assets test presumes claimants for income support pensions/allowances with substantial assets, apart from their principal home, use those assets to produce income for their own support. If substantial assets are held, but they produce little or no income, the person is expected to rearrange their financial affairs before calling on the community for income support, through the social security or veterans' affairs systems.

Sometimes a person is unable, or could not reasonably be expected, to rearrange their financial affairs, and in such cases, hardship provisions can be considered.

Hardship provisions may mean that these persons are able to have certain assets disregarded when calculating their pension rate. Assets, which are disregarded for

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

hardship purposes, are called 'unrealisable assets'. A common example may be a farm that cannot be sold at all or even leased.

Schedule 3 – Part 1 – Small superannuation accounts

This proposal is like the amendments in Schedule 2, ie. amendments to the VEA which are designed to mirror and maintain parity with definitions and treatments under the SSA.

Generally, the results are beneficial, especially in terms of small superannuation accounts being defined and treated as a superannuation type investments and therefore gain the beneficial treatment as such, eg. exempt as an asset for those on income support, aged 55 or more and less than retired age.

Schedule 3 – Part 2 – Income streams

Introduction

The proposed amendments to the treatment of income streams was, like Schedule 2, announced as part of the Simplification Package in the 2000-2001 Budget.⁹

Financial implications and who benefits

The estimated costing for this initiative and its impact on Veterans' Affairs payments was presented in the 2000-2001 Budget papers.¹⁰ Neither the Budget papers nor the Explanatory Memorandum provide any indication of the numbers affected.

Other legislation

The like measure for the treatment of income stream products under the SSA was provided for in the *Family and Community Services Legislation (Simplification and Other Measures) Act 2001*.¹¹ This Act was presented to the House of Representatives on 24 May 2001, to the Senate on 20 June 2001 and received Royal Assent without substantive amendment on 30 June 2001.

Income stream products

Some of the text provided in the Bills Digest for the *Family and Community Services Legislation (Simplification and Other Measures) Act 2001* is repeated below.

The proposed changes to the SSA presented in Schedule 2 refer to income stream products and were a part of the Simplification Package announced in the 2000-2001 Budget.¹²

There are two main types of lifetime income stream products - lifetime pensions and lifetime annuities.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

A lifetime *pension* is provided by a superannuation fund and can only be purchased with superannuation monies.¹³ A lifetime *annuity* can be purchased with any monies.

Lifetime income streams are payable for the person's lifetime, paying income payments at least annually. Purchase involves exchanging a lump sum superannuation amount in return for a guaranteed series of future periodic payments.

Separate to lifetime products, which are paid during the purchaser's life, there are also life expectancy products, in which the full dollar amount, plus investment income earned, is paid to the purchaser over the term of the product. The term of the product is usually set to the estimated life expectancy of the purchaser, at the time of purchase. Life expectancies are set for each individual purchaser and are based on the latest Australian Life Tables published by the Australian Government Actuary.

Popularity of lifetime pensions and annuities

Since the early 1990s, allocated pensions and annuities (income stream products) have become the most popular structured private retirement income stream plans in the financial market. Literally billions of superannuation funds (and other funds) have been rolled into (or used to purchase) income stream funds. Also, there are rapidly increasing numbers of self-managed superannuation funds that are being designed to switch from accumulating benefits to income streams. The advantage of income streams is that:

- they can be designed to meet individual needs
- moneys can be pooled into a diverse range of managed investments, responsive to market fluctuations and trends
- savings can be made to last longer
- account balances can rise and fall with fluctuations in pooled fund earnings and market value of investments
- money is not necessarily locked away and there is scope to make capital withdrawals and taxed under lump sum tax rules
- there is capacity to vary income received
- there are tax advantages for income withdrawals, if taken at a steady pace, and
- investment income earned is not taxable.

The income stream fund balance mainly reduces by the regular income payments, any capital withdrawals and ordinary fees and charges.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Income and Assets Testing

In the 1997-98 Budget, the Government announced changes to the pensions and benefits income and assets tests treatment of income stream products.¹⁴

The reforms were mainly in response to the burgeoning use of income stream products by persons of retired age and the increased diversity, design and complexity of these products. The main concern was that some people were able to organise substantial assets into mechanisms that circumvented the income and assets testing arrangements. The other issue was to provide some favourable treatment of income and assets testing towards those investments that were long-term and genuinely providing an income stream in retirement.

The changes were introduced with the passage of the *Social Security and Veterans' Affairs Legislation Amendment (Budget and Other Measures) Act 1997*.¹⁵

Currently, most investments are subject to the income and assets tests. Under the current rules, income stream products are generally caught by both income and assets tests, with some exceptions. For the income test, special rules apply as the income stream payments generally include a return of a part of the capital used to purchase the product. Mostly, it is only the income part, which is counted under the income test. In brief the features of the current treatment arrangements are:

Income stream type	Income test	Assets test
Long-term		
Complying life time/life expectancy with no residual capital*	Gross annual payment less a deduction based on purchase price	Exempt**
Medium-term		
Terms >5yrs Some residual capital value	Gross annual payment less a deduction based on purchase price	Subject to assets test
Short-term		
Terms of <5yrs	Subject to income test under extended Deeming	Subject to assets test

* The prohibition on residual capital value was based on the view that it would be unreasonable to expect taxpayers to support the use of the product for purposes other than a retirement income stream, eg to intentionally leave a lump sum to the purchaser's estate.

** The asset test exemption for long-term products was aimed at providing an incentive for people to use lump sums to purchase an income stream that could be expected to last for the duration of their retirement, rather than relying on the age pension.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Reliability and Dependability of Income Stream Products

In January 1999, the Australian Prudential Regulation Authority (APRA) issued a modification to the Superannuation Industry (Supervision) (SIS) Regulations. The modification introduced tighter prudential requirements for superannuation funds paying pensions.

All superannuation funds paying pensions (other than allocated pensions or those backed wholly by life company annuities) are now generally required to produce an annual actuarial certificate. This certificate must state that there is a 'reasonable degree of probability' that the fund will be able to pay those pensions for the specified term of the product (or as required under the fund's governing rules).

The modification was largely in response to the burgeoning use of superannuation funds into income stream products. The modification had a direct impact on how products are assessed under the income and asset testing rules. Under the SSA, to be defined as an income stream under the means testing rules, products must be provided under one of a number of prudential arrangements.¹⁶ The *Superannuation Industry (Supervision) Act 1993* is one of these arrangements. Products provided under the SIS legislation must meet the requirements of that legislation, including the new prudential requirements. If the new prudential requirements are met, this will also go some way to ensuring that the product is regarded as an income stream under the SSA.

The APRA modification pertains to the reliability and dependability of income stream products. Effectively, the Government in recognising certain classes of investments and providing concessional or favourable income and assets test treatment is also concerned with the amount or level of payments. Arguably, it is in the best interests of both government and individuals to encourage people to use their savings to obtain the best possible retirement income, subject to the level of risk involved being acceptable. However, where people wish to transfer some of their savings, including their retirement savings, to others (for example, members of their family), the policy is that this should not be at the expense of the taxpayer.

Continued and Increasing Diversity of Income Stream Products

Income stream products continue to be a very popular form of investment for the retired aged. One of the features of this popularity has been the increased incidence of self-managed income streams.

This feature poses new problems for decisions about product classification and, flowing from this, the appropriate income and assets test treatment under the SSA.

Where an income stream is purchased commercially, the APRA rules need to be complied with and as a result it is far more likely that the product will run for its intended duration, ie. for the remainder of the investor's life or life expectancy at the time of purchase.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

This security and surety about the product not changing may not apply in relation to self-managed products. These are products where the purchaser of the income stream is also the trustee/manager of the product. With these products, there is far more scope and freedom for the purchaser/trustee to dissolve and re-organise the product at any time. In such cases, the purchaser/trustee may have already received the benefits of assets test exemption for some period, but, the product or products have not run for their originally intended duration, and arguably, did not properly warrant such an asset concession at all.

Commuted or Dissolved Products: Debts and Hardship

Currently, in order to be an 'assets-test exempt income stream', the contract or the governing rules for the product must contain a number of features. These features include a prohibition on residual capital value (as indicated), upper and lower limits on indexation of payment amounts and limits on transfer, commutation and dissolution. The key features for present purposes are that the income stream may only be transferred on the death of the person to a reversionary beneficiary (ie, a person entitled under the contract or governing rules to the remainder of the income stream on the death of the purchaser, etc.). Also the income stream may only be commuted within 6 months of its commencement, or to the person's estate or a reversionary beneficiary (within 10 years of the person's death), or to the extent necessary to cover superannuation contributions surcharge liabilities.

The proposed amendments seek to add an exception to the general prohibition on commutation to allow a person to commute an income stream to the extent necessary to pay a 'hardship amount'. This exception will only operate in very limited cases:

- A person must apply in writing to the Secretary because of 'extreme financial hardship'
- The Secretary must be satisfied that:
 - the circumstances are 'exceptional' and 'could not be reasonably foreseen';
 - the person has insufficient 'liquid assets' that could be realised, and
 - the amount to be commuted is required to meet 'unavoidable expenditure'.

'Unavoidable expenditure' includes 'essential medical expenses', 'essential repairs to the person's principal home' and 'essential household goods'. 'Liquid assets' include shares, managed investments and insurance policies.

Liquid assets able to be realised also includes financial deposits, 'whether or not the amount can be withdrawn or repaid immediately', and amounts due 'and able to be paid', by a person's former employer.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Schedule 4 – Rounding off

As discussed in the Purpose section above, this is another initiative aimed at ensuring parity between the VEA and the SSA in the treatment of identical arrangements.

Main Provisions

Schedule 1 - Items 19 and 25 provide the amendments for the beneficial change in the treatment of excess compensation income, against the entitlement of a partner. Excess compensation will be treated as income under the income test, not as a dollar-for-dollar direct deduction.

Endnotes

- 1 Portfolio Budget Statements 2000-2001, Department of Veterans' Affairs Portfolio, Budget Related Paper No. 1.4B, page 31.
- 2 Portfolio Budget Statements 2000-2001, Department of Family and Community Services Portfolio, Budget Related Paper No. 1.1.8, page 170.
- 3 Portfolio Budget Statements 2000-2001, Department of Veterans' Affairs Portfolio., op. cit., page 31.
- 4 Portfolio Budget Statements 2000-2001, Department of Family and Community Services Portfolio, op. cit., page 170.
- 5 Portfolio Budget Statements 2000-2001, Department of Family and Community Services Portfolio, op. cit., page 168.
- 6 Portfolio Budget Statements 2000-2001, Department of Veterans' Affairs Portfolio, op. cit., page 30.
- 7 Ibid.
- 8 The *Bills Digest* No 161 of 2000-2001 for the 'Family and Community Services Legislation (Simplification and Other Measures) Act 2001' is at <http://www.aph.gov.au/library/pubs/bd/2000-01/01BD161.htm>
- 9 Portfolio Budget Statements 2000-2001, Department of Family and Community Services Portfolio, op. cit., page 168.
- 10 Portfolio Budget Statements 2000-2001, Department of Veterans' Affairs Portfolio, op. cit., page 30.
- 11 The *Bills Digest* for the 'Family and Community Services Legislation (Simplification and Other Measures) Act 2001' is No 161 of 2000-2001., op. cit.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

- 12 Portfolio Budget Statements 2000-2001, Department of Family and Community Services Portfolio, op. cit., page 168.
- 13 Superannuation money commonly means within a superannuation fund and can also refer to lump sums paid as 'eligible work termination payments', for example long-service leave.
- 14 Department of Social Security - Portfolio Budget Statements, 1997-98 Budget Related Paper No 1.14, pages 59 and 60.
- 15 For background on this Bill see Susan Downing, 'Social Security and Veterans' Affairs Legislation Amendment (Budget and Other Measures) Bill 1997', *Bills Digest No. 138 1997-98* at <http://www.aph.gov.au/library/pubs/bd/1997-98/98bd138.htm>
- 16 Sub-section 9.(1) - In this Act, unless the contrary intention appears:
income stream means:
 - (a) an income stream arising under arrangements that are regulated by the Superannuation Industry (Supervision) Act 1993; or
 - (b) an income stream arising under a public sector scheme (within the meaning of that Act); or
 - (c) an income stream arising under a retirement savings account; or
 - (d) an income stream provided by a life insurance business (within the meaning of the Life Insurance Act 1995); or
 - (e) an income stream provided by a friendly society; or
 - (f) an income stream designated in writing by the Secretary for the purposes of this definition, having regard to the guidelines determined under subsection (1E);but does not include any of the following:
 - (g) available money
 - (h) deposit money
 - (i) a managed investment
 - (j) a listed security
 - (k) a loan that has not been repaid in full
 - (l) an unlisted public security
 - (m) gold, silver or platinum bullion.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.