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Date Introduced: 21 February 2002

House: Representatives

Portfolio: Veterans' Affairs

Commencement: Items 1 to 3 of Schedule 1 on Royal Assent. Part 1 of Schedule 3 on 1 July 1995 and all other items in the Bill on 20 September 2001, being the date the mirror changes under the *Social Security Act 1991* came into effect.

Purpose

To amend the *Veterans' Entitlements Act 1986* to:

- modify the rules regarding the treatment of certain veterans' payments, where recipients receive or are entitled to lump sum or periodic compensation payments, so as to apply excess compensation against a partner's rate of income support under the income test, not a dollar-for-dollar deduction
- streamline the deeming exemptions for assets that have been determined as unrealisable under the assets test hardship provisions
- change the treatment of small superannuation accounts to treat them as all other superannuation accounts
- strengthen the rules regarding income and assets tests treatment of income streams, and
    - modify the rounding off rules for calculating the rate of pension from factoring up to the next multiple of 5 cents to factoring up to the nearest one cent.

Background

Alignment of treatment of pensions paid under the *Social Security Act (1991)* with those paid under the *Veterans' Entitlement Act (1986)*

As outlined in the second reading speech,[1] a number of schedules in this Bill are to align the arrangements for income support payments provided under the *Veterans' Entitlement Act 1986* (VEA) with the arrangements that have previously been altered for like payments provided under the *Social Security Act 1991* (SSA).

The service pension is the main income support payment provided under the VEA. The service pension is almost identical to the age pension provided under the SSA in terms of income and asset testing, affect of compensation, rates paid etc. This close alignment ensures consistency and equity between two payments that are paid for the same purpose, that is income support for the retired age. The only two differences between the veterans' service pension and the age pension is the service pension is available five years earlier than the age pension, recognising the extra stresses and strains of war service. Also, any war disability pension paid is not income for the service pension but is income for the age pension.

Not withstanding these two differences, in all other respects the service pension and the age pension are identical, reflecting the aim of ensuring consistency and equity between like payments. Therefore, this Bill proposes mirror changes for payments paid under the VEA that have already undertaken for like payments paid under the SSA.

The income support payments provided under the VEA that are aligned with the income support pensions provided under the SSA are the service pension, the partner service pension, the invalidity service pension and the income support supplement.

Main Provisions

Schedule 1 – Compensation recovery

Background

The VEA (and the SSA) contain 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, cannot 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 support. The foremost concern of governments has been that there should not be any 'double dipping', that is receiving compensation for lost earnings from a wrongdoer or insurer while at the same time receiving government income support.

The compensation affected payments paid under the VEA are invalidity service pension, partner service pension and income support supplement paid to a person under pension age.

The proposed amendments to the compensation provisions in the VEA in Schedule 1 mirror those made to the SSA with the passage of the *Family and Community Services Legislation (Simplification and Other Measures) Bill 2001*. The Bills Digest No. 161 2000-01 refers.[2]

Under the provisions of the VEA (and formerly the SSA), compensation received by a person also otherwise qualified for an income support payment is treated as a dollar-for-dollar reduction. Any excess compensation (which is common) is then also a dollar-for-dollar deduction against any partners' income support payment. This treatment has been in place for a considerable period and has been criticised as being too harsh. It would be 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 then result in a significant reduction in income support made to the person's partner.

The proposed change would be to treat any excess compensation payments against any partner's income support payment as ordinary income under the income test. His is a beneficial change.

Costs/savings

When presented in the 2000-01 Budget papers, this proposal was estimated to cost $184,000 in 2000-01, $233,000 in 2001-02, $228,000 in 2002-03 and $229,000 in 2003-04.[3] While estimated numbers who might benefit from this proposal were not provided in the Budget papers, given the relatively small amount of estimated costs presented, the numbers affected would be small.

Item 4 excludes criminal injury compensation as compensation affecting income support payments provided under the VEA.

Item 19 maintains the effect of periodic compensation against the rate of the compensation recipient but changes the effect on the rate of income support payable to a person's partner.

Recovery of Compensation from Payers and Insurers

Items 33 to **43** refer to the recovery of compensation from insurers/payers and will empower the Repatriation Commission to seek repayment of compensation debts arising out of the VEA directly from insurers. The main benefit of this will be the avoidance of recovery from the individual compensated person, who may have already spent the monies wholly or in part on other debts or expenditures. This proposed change mirrors the change made to the SSA with the passage of the *Family and Community Services Legislation (Simplification and Other Measures) Bill 2000.* The Bills Digest No. 161 2000-01 refers.[4]

Schedule 2 – returns from unrealisable assets

Background - assets test hardship provisions

The assets test presumes pension and benefit claimants 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, a person is expected to rearrange their financial affairs to provide for their own support, before calling on the community for income support through the social security system.

Sometimes a person is unable, or could NOT reasonably be expected, to rearrange their financial affairs. Hardship provisions may mean that these persons are able to have certain assets disregarded when calculating their pension or benefit rate. Assets which are disregarded for hardship purposes are called 'unrealisable assets in the SSA and the VEA. For the asset test hardship provisions to apply the person MUST be:

- in severe financial hardship, AND
- unable to sell or borrow against an asset (or in the case of a pensioner customer it is unreasonable to expect the person to sell or borrow against an asset), AND
- an assets tested affected claimant, ie. the assets exceed the assets test free area or cut-off limit.

Under the current provisions of the VEA (and formerly the SSA), where the value of an asset is disregarded under the asset test hardship provisions, the income from the asset may still be caught by the deemed income provisions. The deemed income provisions do not count the actual income earned from an asset, rather a market linked deemed rate of return for assets and investments like bank accounts, shares, bonds, investments etc.[5]

This deeming of income from an unrealisable asset has seen to be contradictory to the application of asset test hardship provisions, ie. deeming income from a unrealisable asset. Many unrealisable assets will have no income, eg. an unproductive farm that cannot be sold. The proposed change will use the actual rate of return from the asset, if any.

This proposed change mirrors the change made to the SSA with the passage of the *Family and Community Services Legislation (Simplification and Other Measures) Bill 2000.* The Bills Digest No. 161 2000-01 refers.[6]

Costs/savings

For the Veterans’ Affairs portfolio, the Simplification and Other Measures announced in the 2000-01 Budget (Schedules 2, 3 and 4 in this Bill) were estimated to cost $257,000 in

2000-01, $9,000 in 2001-02 and save $164,000 in 2002-03 and save $214,000 in 2003-04.[7] Given the small amounts in dollar terms, the numbers affected would be small.

Item 1 provides for the insertion of an exception rule for the treatment of deemed income from investments/assets to apply for unrealisable assets. **Item 2** inserts a section requiring a formal decision to be made regarding access to the financial hardship rules before the exception inserted by **Item 1** applies.

Schedule 3

Part 1 – small superannuation accounts

As with Schedules 1 and 2, the proposed changes in Schedule 3, are aligning provisions in the VEA with those in the SSA.

The amendments to administration of small superannuation accounts made by the *Small Superannuation Accounts Act 1995*, to centralise the holding and administration of such accounts by the Australian Taxation Office was designed to ensure such small accounts were not lost or swallowed up by takeovers and mergers etc. This especially applies where a small contributor is chasing superannuation contributions made for a short period many years ago.

This change is generally beneficial, as there are asset test exemptions for superannuation and annuities in some circumstances – see Part 2 – income stream products below.

Part 2 – income stream products

The changes to the asset test exemptions for annuities and income stream products, provided for in the SSA, were contained in the *Family and Community Services Legislation (Simplification and Other Measures) Bill 2000.* The Bills Digest No. 161 2000-01 refers.[8] Again, the changes proposed to the VEA in this Bill are to mirror that already provided for in the SSA and were and were a part of the Simplification Package announced in the 2000-2001 Budget.[9]

There are two main types of lifetime income stream products:

- lifetime pensions - provided by a superannuation fund and can only be purchased with superannuation monies;[10] and
- lifetime annuities - can be purchased with any monies.

Lifetime income streams are payable for the person's lifetime, paying income payments at least annually and 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 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 taken from 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 advantages of income streams are:

- 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.

Income stream products - 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.[11] 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.[12]

Currently in the VEA, most investments are subject to both 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 VEA 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.

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 section 5J of the VEA, to be defined as an income stream under the means testing rules, products must be provided under one of a number of prudential arrangements. The *Superannuation Industry (Supervision) (SIS) Act 1993* is one of these arrangements.[13] 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 ensure that the product is regarded as an income stream under the VEA.

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. The APRA modification pertains to the reliability and dependability of income stream products. The Government in providing certain classes of investments with concessional or favourable income and assets test treatment is encouraging their use, but the government is also concerned with the adequacy of amounts and/or level of payments.

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 and the VEA. 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.

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 of the product and 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. 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.

As stated in the Explanatory Memorandum, these amendments are aimed at limiting the abuse of income stream products given their concessional treatment under the income and assets tests.[14]

Costs/savings

For the Veterans' Affairs portfolio, the Simplification and Other Measures announced in the 2000-01 Budget (Schedules 2, 3 and 4 in this Bill) were estimated to cost $257,000 in

2000-01, $9,000 in 2001-02 and save $164,000 in 2002-03 and save $214,000 in 2003-04.[15] Given the small amounts in dollar terms, the numbers affected would be small.

Item 14 sets out the requirements for an income stream product to meet to gains assets test exemptions. Item 20 sets out the hardship test definitions, ie. hardship amount, liquid assets, non-commutation funded income stream and unavoidable expenditure. These definitions mirror those already in the SSA.

Item 21 sets out the requirements for a life expectancy or 15 year minimum term income stream to meet to gain access to assets test exemptions.

Item 30 provides for the raising of a debt during a period where an income support payment has been made and there has been a breach of the governing rules that apply to concessional arrangements in the VEA for income streams.

Schedule 4 – rounding off

This Schedule proposes to change the payment rounding off arrangements to match that which have applied under the SSA since March 2000. The rounding off of payments to the nearest 10 cents is a legacy from when payments were made by cheque posted to a residential address. Posted cheques as a method of payment no longer applies with payments now made by direct deposit to bank accounts using electronic funds transfers. There are also some cost savings to be made for government in no longer having to round off payments up to the next highest 10 cents.

Endnotes

1 House of Representatives, *Hansard*, 21 February 2002, pages 475–476.

2 *Bills Digest* No. 161 2000–01: http://wopared.parl.net/library/pubs/bd/2000-01/01BD161.htm

3 2000-01 Budget - Veterans' Affairs Portfolio Budget Statement, *Budget Paper* No. 1.4B, page 21.

4 *Bills Digest* No. 161 2000–01, op. cit.

5 From 1 July 2001, if you are single and getting either a pension or allowance, the first $33,400 of financial investments is deemed to earn income at 3% per annum and any amount over that is deemed to earn income at 4.5% per annum.

6 *Bills Digest* No. 161 2000–01, op. cit.

7 2000-01 Budget - Veterans' Affairs Portfolio Budget Statement, op. cit.

8 ibid.

9 ibid.

10 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

11 1997-98 Budget - Department of Social Security Portfolio Budget Statement, Budget Related Paper No 1.14, pages 59–60.

12 For background on this Bill see Susan Downing, Social Security and Veterans' Affairs Legislation Amendment (Budget and Other Measures) Bill 1997, *Bills Digest* No. 136 1997–98 at http://www.aph.gov.au/library/pubs/bd/1997-98/98bd138.htm

13 Veterans' Entitlements Act 1986. SECT 5J - *Financial assets* and *income streams* definitions. *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 Commission for the purposes of this definition, having regard to the guidelines determined under subsection (1F);

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.

14 Veterans' Affairs Legislation Amendment (Further Budget 2000 and Other Measures) Bill 2002, Explanatory Memorandum, page 20.

15 2000-01 Budget - Veterans' Affairs Portfolio Budget Statement, op. cit.