



## Family Assistance, Social Security and Veterans' Affairs Legislation Amendment (2005 Budget and Other Measures) Bill 2006

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## Family Assistance, Social Security and Veterans' Affairs Legislation Amendment (2005 Budget and Other Measures) Bill 2006

**Date introduced:** 16 February 2006

**House:** House of Representatives

**Portfolio:** Family and Community Services and Indigenous Affairs and Veterans Affairs.

**Commencement:** There are various different start dates for the Schedules and Parts of Schedules in the Bill. These commencement dates are set out in the Table in Clause 2 of the Bill.

### Purpose

To introduce the legislative changes to give effect to several 2005 Budget initiatives and to several other current initiatives. These measures are:

- Raise the income test free area for the income test that applies for the Family Tax Benefit Part A (FTB-A),
- Index income estimates made by claimants for FTB-A and Family Tax Benefit Part B (FTB-B) and for Child Care Benefit (CCB),
- Modify the definition of 'returns to paid work' as described in the *Family Assistance Act 1999* (FAA) for the FTB-B,
- Provide for the recovery of CCB debts from the claimant's tax refunds as currently is provided for in the recovery of FTB debts from tax refunds,
- Provide for the movement of unallocated child care places from area to area,
- Provide for the backdating of Carer Allowance (CA) claims caring for either a child or an adult for a maximum of 12 weeks,
- Greater clarity in the circumstances where payments may be extended beyond 13 weeks to a person temporarily overseas seeking life-saving medical treatment overseas, and
- Allow for the extension of fixed term income streams and other minor changes to the treatment of income streams in line with similar tax treatment changes for income streams.

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## Background

### Schedule 1 – Family Tax Benefit Part A (FTB-A) income free area

#### Introduction

This initiative was announced in the 2005-06 Budget.<sup>1</sup> The government claims the purpose of raising the FTB-A income test free area threshold is to help low income families earn more money. The threshold increase is a part of the Welfare to Work initiatives announced in the 2005-06 Budget and is designed to address the barriers faced by families in attempting to increase their earnings from employment and at the same time seeing decreases in government assistance and having to pay more tax.<sup>2</sup>

#### Cost

The government estimates this threshold increase will cost \$1.1 billion over four years and this is made up of \$0.9 million in 2005-06, \$364 million in 2006-07, \$371.7 million in 2007-08 and \$378.9 million in 2008-09.<sup>3</sup>

#### What is FTB-A?

The FTB income supplement payments for families with dependent children (FTB-A and FTB-B) were introduced from 1 July 2000, as the then new income supplement payments for families with children. They were introduced as a part of the A New Tax System (ANTS) changes.<sup>4</sup> FTB-A and FTB-B replaced a range of income supplement and tax assistance arrangements for families, being Family Allowance, Family Tax Payment Parts A and B, Family Tax Assistance Parts A and B, Guardian Allowance, the Dependant Spouse Tax Rebate and the Sole Parent Tax Rebate.

#### Who can get FTB-A?

FTB-A is payable to a person if they:

- have a dependent child under 21 (including a foster child), or
- have a dependent full time student aged 21 to 24, and
- have income under a certain amount, and are living in Australia, and
- are either an Australian citizen, a New Zealand citizen, the holder of a permanent visa or the holder of certain temporary visas.

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## The FTB-A income test

### Adjusted taxable income

The FTB-A income test looks at the adjusted taxable income of the family and where income is below upper cut-off limits (see Table 2 below), either a part-rate or a full rate of FTB-A can be paid. The rate of FTB-A is dependent on the level of family income and how many qualifying children the family has and the ages of the children.

### Income test free area

The FTB-A income test has a free area. This is the amount of annual income a family can have before the maximum FTB-A rate is reduced. Currently, for the 2005-06 year the FTB-A income test free area is \$33 361.

### Income test taper and base payment rate

Income above this amount reduces the maximum FTB-A rate by 20 cents in every dollar until the payment rate reaches the base rate of FTB-A (see Table 1 below).

### Income test cut-off limit

FTB-A stays at that base rate until family income reaches \$86 213 a year (plus \$3 431 for each child after the first). Thereafter the FTB-A base rate is reduced by 30 cents for every dollar over that amount until payment reaches nil (see Table 2 below).

**Table 1: Actual annual family income limit beyond which only base rate of FTB-A is paid (\$pa) – 2005-06 year<sup>5</sup>**

		<b>No Children aged 13 - 15 years</b>			
<b>No Children 0 - 12 years</b>	<b>Nil</b>	<b>One</b>	<b>Two</b>	<b>Three</b>	
<b>Nil</b>		\$50 260	\$67 160	\$84 059	
<b>One</b>	\$45 479	\$62 378	\$79 278	\$96 177	
<b>Two</b>	\$57 597	\$74 496	\$91 396	\$108 295	
<b>Three</b>	\$69 715	\$86 614	\$103 514	\$120 413	

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Table 2: Actual annual family income limit at which FTB-A stops

(\$pa) – 2005-06 year

		No Children aged 18 - 24 years		
No children 0 - 17 years	Nil	One	Two	Three
Nil		\$93 465	\$104 147	\$133 870*
One	\$92 139	\$102 821	\$113 503	\$125 013
Two	\$101 495	\$112 177	\$123 687	\$135 196
Three	\$101 495	\$122 361*	\$133 870*	\$145 380*

\* Income limit is higher than stated for three children aged 13 - 15.

#### FTB-A income test free area threshold increase

For the 2005-06 financial year the FTB income test free area is \$33 361 per annum. This proposal is to increase this free area to \$37 500 per annum to take effect from 1 July 2006 and so will therefore apply to the 2006-07 year. This one-off increase to the free area is higher than if the normal annual indexation of the income test free area to the Consumer Price Index (CPI) had taken place. The Explanatory Memorandum states that if the CPI indexation had taken place this would have seen the free area increase to a projected \$34 310 for the 2006-07 year.<sup>6</sup> This higher FTB-A income test free area will thereafter continue to be indexed to movements in the CPI – see below.

#### Indexation of the FTB-A income test free area

Currently the FTB-A income test free area is indexed to movements in the CPI once a year (1 July).<sup>7</sup> The indexation is to CPI increase in the 12 month period ending on the preceding December. This Bill does not make any changes to this indexation arrangement and therefore the new higher free area will also continue to be indexed annually to the CPI.

#### Adjustments to the FTB income tests since FTB was introduced in 2000

The FTB payments (FTB-A and FTB-B) have seen substantive adjustments to their income testing arrangements since they were introduced in July 2000, as a part of the ANTS package of initiatives.<sup>8</sup> For FTB-A the major change was the reduction in the FTB-A income test taper rate from 30 per cent down to 20 per cent, announced in the 2004-05 Budget, that took effect from the 2004-05 year.<sup>9</sup> The biggest single adjustment to the FTB-B was announced in the 2004-05 Budget, in which the FTB-B income test free area

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was doubled to \$4 000 a year and the income test taper rate was reduced from 30 per cent down to 20 per cent.<sup>10</sup>

It is no coincidence this proposed one-off increase in the FTB-A income test free area was announced in the 2005-06 Budget, complementing the Welfare to Work initiatives also announced in the Budget.<sup>11</sup> The government is concerned that if it is asking FTB recipients to work more, to be more self-supporting, they should remove or reduce some of the financial disincentives to earning more from employment. This refers to the high effective marginal tax rates (EMTR) faced by FTB recipients as they commence to work, or work more hours, earning increasing levels of income and at the same time government assistance is removed and they are required to pay more tax.<sup>12</sup> The National Centre for Social and Economic Modelling (NATSEM) studies indicate that for some, after government financial assistance is withdrawn and more tax paid, a person, can be left with only 20 or 30 cents in their hand for each extra dollar earned.<sup>13</sup>

### The current FTB-A recipient mix and income testing

The table below shows the number of customers in receipt of FTB Part A for each of the financial years 2001-02 to 2004-05 by rate of payment.<sup>14</sup>

<b>FTB (A) Fortnightly Instalment Customers by Payment Type</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>
<b>FTB (A) payment type</b>	As at 28/06/2002	As at 27/06/2003	As at 25/06/2004	As at 24/06/2005
<b>(a) Total</b>	1 795 355	1 783 423	1 809 122	1 828 495
<b>(b) Maximum Rate</b>	620 354	615 207	615 831	610 995
<b>(c) Broken Rate</b>	431 552	427 482	423 531	536 838
<b>(d) Basic Rate</b>	708 709	701 280	721 391	617 879
<b>(e) Tapered Base Rate</b>	34 233	39 277	46 968	62 549
<b>Unknown</b>	507	177	1 401	234

Comments on the table:

- The reduction in the numbers on the maximum rate mirrors the overall reduction in the numbers on working age income support payments like Newstart Allowance over the same period. This reflects the reduced numbers of unemployed and increased employment participation rates. It also reflects the fact that the rate and income test limits for FTB-A are indexed once a year to the CPI, whilst average weekly earnings (AWE) have been increasing at a greater rate over the period and so less persons are entitled to the maximum rate because their incomes have increased.
- The numbers on the broken rate have increased by over 100 000 in the period 2001-02 to 2004-05, especially in the last year. The decline to the 2003-04 year reflects increased earnings by FTB-A recipients. The last year increase reflects the reduction

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in the FTB-A income test taper rate from 30 per cent down to 20 per cent, announced in the 2004-05 Budget, that took effect from the 2004-05 year.<sup>15</sup>

- The numbers on the basic rate was increasing in the first three years reflecting the CPI and AWE relationship described above. The sharp drop in the 2004-05 year reflects the reduced taper rate to 20 per cent allowing more on to the broken rate.

#### Comment on the impact of the raising of the FTB-A income test free area

The proposed increase in the FTB-A income test free area will mainly see families who qualify for a broken rate of FTB-A receive an increase in assistance. This is because the raising of the free area will see a greater amount of their income being disregarded. For those families on maximum rate FTB-A (as their income is below the free area), the raising of the free area does not provide any immediate increase in assistance. There is the potential for families on maximum rate to benefit if they earn more income and their income exceeds the free area limit. These families will be able to earn more income and still receive maximum rate FTB-A and will also be able to receive more income before they reach the level where they are only entitled to the basic rate. The government claims around 400 000 families will get an average \$24 a fortnight boost to their rate of FTB-A.<sup>16</sup>

#### Schedule 2 – Indexing estimates of adjusted taxable income for family tax benefit and child care benefit purposes

##### Introduction

The legislative amendments presented in Schedule 2 propose to allow the use of an estimate of a claimant's adjusted taxable income that has been indexed to average weekly earnings (AWE). This income estimate could then be used to determine a rate of FTB-A, FTB-B or CCB.

##### Origins, costs and savings

This initiative was announced in the 2005-06 Budget and is estimated to cost \$18.6 million over four years made up of \$3.5 million in 2005-06, \$10.2 million in 2006-07, \$2.9 million in 2007-08 and \$1.7 million in 2008-09.<sup>17</sup> It is anticipated to reduce the level of overpayments by \$115.2 million over four years.<sup>18</sup> The cost of \$18.6 million over four years is entirely in administrative costs and assumes the initiative does not result in any change in the net level of assistance provided to FTB or CCB recipients. The peak cost year is in 2006-07, being the first full year the initiative will be used. The projected savings of \$115.2 million over four years will be realised through more accurate payments of FTB and CCB to recipients and therefore less overpayments and so less debts to be raised and recovered.

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### FTB - requirements for income estimates

FTB can be paid in two ways. One, by way of fortnightly payments during the year with the payment rate based on the claimant's estimate of their income for that year. Secondly, FTB can also be paid at the end of the year by claiming in the tax return and the amount paid is based on the actual adjusted taxable income for the year past. Obviously the second method does not require an income estimate as the year has passed and the actual adjusted taxable income is known. The fortnightly instalments payment method requires the claimant to make an estimate of their income for the coming year.

The majority (95 per cent) of FTB-A recipients take their payments fortnightly during the year. The table below shows the number of families receiving fortnightly instalment FTB-A as at 28 May 2004 and ATO lump sum FTB-A payment for 2002-03 as at 28 May 2004.<sup>19</sup>

Age of FTB A children	Number of families receiving fortnightly instalment FTB A as at 28 May 2004 *	Number of families who received FTB A through ATO lump sum for 2002-03 as at 28 May 2004*
0-5	866 917	31 212
6-12	979 026	44 257
13-15	505 437	27 007
16-18	190 535	21 900
19-21	51 131	5 732
22	2 445	369
23	995	172
24	346	70
<b>Total</b>	<b>1 806 157*</b>	<b>92 876*</b>

Note: \*The customer count is the number of customers with at least one child in that age group, thus a single customer may be counted in more than one category. However, the total number of customers counts each customer once only.

### CCB - requirements for income estimates

CCB can be paid in two ways. One, the claimant can claim CCB as a lump-sum payment at the end of the year in their tax return (as per FTB) and the amount paid is based on the actual adjusted taxable income for the year past. Secondly, the claimant can claim the CCB to be provided during the year and this is done by way of reduced fees charged by the child care provider. The reduced child care fee method of receiving CCB requires the claimant to make an estimate of their income for the coming year. Based on this income estimate a CCB rate assessment is made and the entitlement is advised to the child care provider by Centrelink and the provider reduces their fee by that amount.

### Estimates of income by claimants are often underestimated

At present, as outlined in the Explanatory Memorandum, estimates of income are only provided by the claimant.<sup>20</sup> There isn't the legal capacity for the Secretary to provide an

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income estimate. Estimates by claimants are often not updated from year-to-year and are inherently conservative. Conservative, as a lower estimate can realise a higher rate of FTB or CCB during the coming year. The amendments in this Schedule of the Bill will empower the Secretary to apply an income estimate, based on the previous years actual income indexed to AWE. This should see lesser number of overpayments, debts raised and cost savings. The cost savings will be in the administrative cost of processing debts and chasing repayments and also in the number of debts that are never recovered.

### Schedule 3 – Returns to paid work

#### Background

FTB-B is paid to a sole parent or to the lowest income earner of a partnered couple. The income test for FTB-B is based on only the claimant's income, so for a sole parent it regards the sole parent's income. For partnered couples, the FTB-B income test is based on the lowest income earner of couple and the highest income earner's income is disregarded.

Amendments were made to the application of the FTB-B income test with the passage of the *Family and Community Services Legislation Amendment (Family Assistance and Related Measures) Act 2005*.<sup>21</sup> Normally, the FTB income test (both for FTB-A and FTB-B) looks at the annual income of the claimant to set an annual rate of entitlement. The passage of the amendments to the *Family Assistance Act 1999* (FAA) in 2005 addressed the situation where a parent who would face the prospect of a FTB debt if they returned to the workforce part way through a financial year. As said above, FTB-B eligibility is assessed on an annual basis in line with an estimate of income made at the start of the financial year. Commencing paid employment part way though a year can mean that eligibility for FTB-B for the whole year is lost or at least that entitlement is reduced. Any payments already received can become an overpayment and then a debt.

The 2005 changes ensured that the parent returning to work retains eligibility for FTB-B for the part of the financial year before they return to work. Their income will only reduce entitlement for the period after they return to work. The changes significantly reduced the return to work disincentives faced by parents in this situation.

#### Definition of 'returns to work'

Schedule 3 proposes to amend the definition of 'returns to work' in the FAA so that persons who have a child and take paid leave, then return to work, then take unpaid leave, then return to work for a second time should not gain the benefit of being entitled to FTB-B up until they start work for the second time.

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## Comment

This is a minor change to the application of the FTB-B income test and will probably not affect many FTB-B recipients.

## Schedule 4 – Recovery of child care benefit debts

### Background

Debts can commonly arise where payment of CCB is based on an estimate of annual income and the estimate understates the level of income actually received during the year. Once the assessment of tax is done at the end of the year and the actual adjusted taxable income for the year known, if too much CCB was paid based on the income estimate, then the excess payment is an overpayment and a debt.

### Origins and savings

The government announced in the 2005-06 Budget the proposal to tap into FTB reconciliation top-up payments and tax refunds to clear CCB debts.<sup>22</sup> Under the current FAA legislation, tax refunds and end-of-year top-up payments cannot be drawn upon to offset CCB debts arising from previous year. At present only FTB debts owing from previous years can be offset using tax refunds and end-of-year top-up payments.

It is estimated this measure will reduce debts by \$47.1 million over four years and cost an extra \$4.7 million to administer over four years made up of \$2.8 million in 2005-06, \$1.1 million in 2006-07, \$0.4 million in 2007-08 and \$0.4 million in 2008-09.<sup>23</sup>

## Schedule 5 – Reducing allocation of child care places

### Background

The Explanatory Memorandum provides a succinct background to the purpose of the proposed amendments in Schedule 5.<sup>24</sup> There is no limit on long day care places that can receive government funding assistance by way of CCB paid to a parent, as long as compliance with State/Territory and local government requirements are met. Some other forms of child care services, that can attract a government subsidy by way of payment of CCB, are subject to Government control, as the expenditure for these places is set in the Budget context. So unless there is an allocated child care place to the service provider, the place can not attract the CCB payment subsidy. Services subject to this 'approved place' funding refer to:

- family day care services,
- in-home services,
- occasional care services, and

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- outside school hours care services.

The origins of the need for government 'approved places' for these types of services lie with governments wanting to keep control of cost.

The number of 'approved places' allocated to an individual service provider for these types of services is usually based on use and demand in the past. However, as explained in the Explanatory Memorandum<sup>25</sup> demand and take-up can vary and the proposed changes in this Schedule are designed to provide greater flexibility to respond to changes in demand and use by allowing approvals for unused places to be transferred to other providers with excess demand.

## Schedule 6 – Carer allowance backdating provisions

### Introduction

Carer Allowance (CA) is an income supplement payment provided to a person providing care to a child or an adult at home. The person being cared for must meet minimum disability requirements so that the care requirements are substantive. There are two main types of CA payments; CA - caring for a child and CA – caring for an adult. It is tax free and income and assets test free and the current rate is \$94.70 per fortnight.

Currently, the commencement date for the start of payment for CA – caring for a child can be backdated for up to 52 weeks prior to the date of claim. Likewise, the commencement date for the start of payment for CA – caring for an adult can be backdated for up to 26 weeks prior to the date of claim. The proposal in Schedule 6 of the Bill is to amend the *Social Security Act 1991* (SSA) to reduce the commencement date for the start of payments to 12 weeks prior to the date of claim for both CA – caring for a child and also for CA – caring for an adult.

### Background

CA – caring for a child has its origins in the Handicapped Child Allowance (HCA) introduced in December 1973. HCA was introduced as a financial support to carers of a child with substantial care requirements who were caring at home. It was at a time when increasing numbers of parents were caring for children with substantial disabilities at home rather than having the child placed in an institution. HCA was replaced by the Child Disability Allowance (CDA) from November 1987. The CDA payment was subsequently replaced by the CA - caring for a child in the 1997-98 Budget as a part of the Carer Package.<sup>26</sup>

At the same time as CA replaced CDA in the 1997 Carer Package, there was also the replacement of the Domiciliary Nursing Care Benefit (DNCB) program with CA – caring for an adult.<sup>27</sup> DNCB was a government income supplement payment to a person caring for a frail aged person with a disability who required a sufficient level of care that would otherwise see them qualifying for nursing home admission.

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## Previous attempts to limit the backdating of the date of commencement of payment prior to the date of lodgement of the claim for CA

The government first announced an intention to reduce the backdating of the start date of payment for CA (or CDA as it was then called) in the in the 1996-97 Budget.<sup>28</sup> The initiative was to reduce the backdating period from 12 months down to 3 months. This initiative was not subsequently passed by the Parliament. The second attempt was in the Carer Package presented in the 1997-98 Budget, where the proposal was to limit the backdating of the start date of payment to 6 months prior to the lodgement of the claim.<sup>29</sup> Likewise, notwithstanding the substantive initiatives in the Carer Package were agreed to by the Parliament, the backdating section of the Carer Package for the new CA – caring for a child was not passed by the Senate. The CA – caring for a child backdating provisions remained at up to 12 months and the new CA – caring for an adult were set at up to 6 months.

## Origins of the backdating of the start date for the commencement of payment for CA?

For the predecessors of the CA – caring for a child, being the HCA and the CDA, there have been backdating provisions of 12 months since they were introduced. Why? The main justification concerns very young and/or newly born children where it may take a substantive period of time to actually realise and diagnose that the child has a disability. Equally it may take some time to differentiate between the extensive care requirements for a very young child as opposed to the care requirements arising from the child's disability. For some disabilities (like autism), it may take a substantive period to diagnose the child's condition and the extent of the severity of the condition and to then develop, and understand the impact of the condition on the child and then therefore their care requirements. Likewise, some conditions, while they may be diagnosed at an early stage, their manifestation in the child varies tremendously between individuals and it may take some time to establish what the impact is. This especially applies for very young children.

The backdating provisions also provided some relief to claimants who did not lodge their claim in a timely manner. When providing care to a child with a substantial disability manifesting in substantial care requirements, a claim for HCA/CDA/CA was not always in the forefront of the parent's mind. Awareness of the existence of the HCA/CDA/CA was not extensive and claims were often delayed due to lack of knowledge of the existence of the payment.

## Schedule 7 – Portability and Medical Treatment Overseas Program

### Background

The government announced in the 2003-04 Budget the proposal to reduce the period for which persons could be paid an income support or income supplement payment while overseas from 26 weeks down to 13 weeks. This was given effect with the passage of the

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*Family and Community Services and Veterans' Affairs Legislation Amendment (2003 Budget and Other Measures) Act 2003.*<sup>30</sup>

In some circumstances, section 1218C of the SSA allows for the discretionary payment for more than 13 weeks.<sup>31</sup> This might occur where a person is prevented from returning to Australia before the end of the portability period, for one of the reasons specified in section 1218C of the SSA. For example if the person or a family member of the person is:

- involved in a serious accident,
- seriously ill,
- hospitalised, or
- the victim of a robbery or serious crime.

Or if the person is:

- involved in custody proceedings,
- required to remain overseas in connection with criminal proceedings, other than in respect of a crime alleged to have been committed by the person,
- unable to return because of war, industrial action, or social or political unrest in which the customer is not willingly participating,
- unable to return because of natural disaster, or
- if a family member dies.

**Proposed amendment to the SSA to allow payment for more than 13 weeks while receiving medical treatment overseas**

Schedule 7 of the Bill proposes to insert a new 1218C and 1218D into the SSA to allow the discretionary payment for more than 13 weeks where the person is receiving financial assistance under the Medical Treatment Overseas Program provided for under the *National Health Act 1953*.

**Schedule 8 – Income streams (social security) (Part 1) and Schedule 9 – Income streams (veterans)**

**Introduction**

The amendments to the SSA presented in Schedule 8 and the amendments to the *Veterans Entitlements' Act 1986* (VEA) presented in Schedule 9 have the same origins and purpose concerning alterations to the treatment of income streams under the income and assets tests. So the comments below refer to both Schedules.

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#### Alignment of income and assets test provisions in the SSA with the VEA

The fact that the provisions in Schedule 9 of the Bill amending the VEA are the same as provisions in Schedule 8 amending the SSA is because there are like income support payments provided under both acts that have been kept in alignment. The Service Pension is the main income support payment provided under the VEA and it is almost identical to the Age Pension provided under the SSA in terms of income and asset testing, effect of compensation and payment rates. 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.<sup>32</sup> 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 veterans' war service. Notwithstanding 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.

The income support payments provided under the VEA that have their means testing arrangements (income and assets tests) aligned with the income support payments provided under the SSA are the Service Pension, the Partner Service Pension, the Invalidity Service Pension and the Income Support Supplement. The like income support payments provided under the SSA are the Age Pension, the Disability Support Pension, the Widows Pension and the Parenting Payment – Single.

#### Income stream products

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. Billions of dollars in superannuation funds (and other funds) have been rolled into (or used to purchase) income stream funds. With this growth there has also been a rapid increase in the numbers of self-managed superannuation funds that are being designed to switch from accumulating benefits to income streams. The advantages of income stream products (depending on the product) 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,
- money is not necessarily locked away and there is scope to make capital withdrawals and taxed under superannuation lump-sum tax rules (allocated pensions only),
- there is capacity to vary income received,
- there are tax advantages for income withdrawals if taken at a steady pace where the income stream is superannuation funds based and tax advantages (for example no capital gains tax) can be realised, and

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- investment income earned but not distributed is not taxable.

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

#### Allocated pension

An allocated pension is a superannuation account from which a series of regular payments can be drawn upon in retirement. The payments must lie between specified monetary limits set by factors in the Superannuation Industry (Supervision) Regulations 1994. An allocated pension can be turned into a lump-sum (that is, cashed out or commuted) at any time and is assessed against the lump-sum Reasonable Benefit Limit<sup>33</sup> only. Allocated pensions are subject to the pensions assets test.

#### Annuity

An annuity is a contract between a provider (usually a large life insurance company or superannuation fund) and a person who receives a regular series of specified payments, at specified times, over a specified period in return for a large initial premium. Depending on the date of purchase it is fully or partially exempt as an asset for the pensions assets test.

#### Term allocated pension (also known as Growth Pensions or Market Linked Pensions)

Term allocated pensions have a similar account arrangement to an allocated pension, but investors receive payments for a fixed period based on their life expectancy. Other points include:

- the pension's annual income payments are worked out on the basis of the account balance at the start of the year (like an allocated pension) by a set formula (unlike allocated pensions where you can choose from a range of payment levels for a given account balance),
- there is no residual capital value at the end of the pension's term (except in limited circumstances),
- the pension cannot be commuted to a lump-sum (except in limited circumstances) which means investors cannot access any of their capital,
- the pension is partially (50 per cent) exempt from the SSA and VEA assets test, and
- the pension is assessed under the more generous Reasonable Benefit Limit.

#### 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.<sup>34</sup> 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

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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 measures were provided for in the *Veterans' Affairs Legislation Amendment (Further Budget 2000 and Other Measures) Act. 2002*.<sup>35</sup>

### **Why have concessional income or assets test or tax arrangements for income stream products?**

Currently in the SSA and VEA, most investments are subject to both the income and assets tests. However, there are special concessional rules for income stream products.<sup>36</sup> Arguably, it is in the best interests of both government to encourage people to use their savings to obtain the best possible retirement income, subject to the level of risk involved being acceptable. The Government, in providing certain classes of investments with concessional tax and/or income and assets test treatment is encouraging their use, but the government is also concerned with the adequacy of returns and the level of payments. It is also concerned that the income stream lasts for an appropriate period of time to justify the concessional treatment. The government is also concerned that the products are not primarily designed and constructed to avoid appropriate tax and/or income support means testing arrangements.

### **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 Australian Prudential Regulatory Authority (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; that is for the remainder of the investor's life or life expectancy at the time of purchase.

### **Self-managed products**

This security and surety about the product not changing to justify its concessional assets test treatment may not apply in relation to self-managed income stream 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 test concession at all. Further, 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 other

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taxpayers as higher rates of social security/veterans' affairs pensions are provided as would otherwise be the case.

#### **2004-05 Budget announcement – changes to requirements for small non-arms length superannuation funds**

As referred to in the Explanatory Memorandum,<sup>37</sup> the government did announce changes to the requirements for small non-arms length superannuation funds.<sup>38</sup> Arising from concerns about the inflexibility of these 2004-05 changes, a Department of Treasury review paper<sup>39</sup> recommended more flexibility for the treatment of income streams. The amendments presented in Schedules 8 and 9 of the Bill are to amend the SSA and the VEA respectively to:

- Extend the maximum allowable term over which life expectancy and market-linked investments can be paid, and
- To prescribe the amount of flexibility that will be allowed for a one-off extra ordinary withdrawal from the standard regular withdrawal amount prescribed in the investment. The variation allowed will be plus or minus 10 per cent from the standard regular withdrawal amount.

Extend the maximum allowable term over which life expectancy and market-linked investments can be paid

This amendment is not surprising and is probably appropriate given the increased longevity of the population.

Prescribing the amount of flexibility that will be allowed for a one-off extra ordinary withdrawal from the standard regular withdrawal amount prescribed in the investment - plus or minus 10 per cent from the standard regular withdrawal amount

This amendment is mainly aimed at the use of large one-off withdrawals from a self-managed income stream products to get around the pensions income test rules for income stream products.

Currently, an allocated pension is required to provide the recipient with a set annualised income otherwise it is not recognised for the APRA or SSA and VEA rules. For the pension income test this annualised income is regarded as income (less a deduction based on purchase price) and counted over a year (for example \$1 200) to arrive at an annual rate of pension. The annual rate of pension derived is then divided by 26 to arrive at a fortnightly rate of pension payment.

Under the current annual income and annual pension rate rules, where for example a self-managed the trustee/recipient advises that he/she wants to significantly increase the rate of annual payments from their income stream product, a new annual rate of pension is then

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calculated or even perhaps payment cancelled. For example, the income stream annual income could be increased from \$1 200 per year to \$20 000 per year. Then shortly afterwards a large one-off withdrawal (\$770 or \$20 000 divide by 26) could be made. Then immediately afterwards the trustee/recipient could advise that the previous rate of payments (\$1 200 per year) is returning and again an annualised rate of pension would be recalculated. During the short period that the \$770 was withdrawn, pension may not have been payable or significantly reduced but thereafter, after advising of the return of the regular \$1 200 per year payments the pension rate is returned to the previous rate for the remainder of the year. What has happened is a large amount of money has been received as a one-off payment but this is not recognised in the annual rate of pension for virtually the entire year.

To address this issue the amendments in Schedules 8 and 9 propose that withdrawals can only vary by plus or minus 10 per cent from the regular set annualised income rate, for the income stream to continue to receive the concessional income and asset test treatment.

## Schedule 8 - Part 2

The amendments to the SSA in **Schedule 8 Part 2** are to allow the splitting of an income stream between two former partnered couples, if the splitting has been subject to an order made by the Family Court under the *Family Law Act 1975* (FLA). These amendments recognise that the FLA has been amended to allow the splitting of income stream payments. The *Family Law Amendment (Annuities) Act 2004* was the legislation that made these changes.<sup>40</sup>

## Main provisions

**Item 2** sets out the commencement dates for the various Schedules and Parts in the Bill.

### Schedule 1 – Family Tax Benefit Part A (FTB-A) income free area

**Schedule 1** presents amendments to the FAA.

**Item 1** sets the new FTB-A income test free area to \$37 500. **Item 3** sets the timing for the new income test free area to the 2006-07 year.

### Schedule 2 – indexing estimates of adjusted taxable income for family tax benefit and child care benefit purposes

**Schedule 2** presents amendments to the FAA.

**Item 1** defines indexed actual income. **Item 2** defines indexed estimate.

**Item 5** empowers the use of an indexed estimate of income where a notice requesting an estimate has been issued and not responded to by the claimant. **Item 6** sets out the

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procedure for actually calculating the indexed estimate. **Item 10** allows the setting of a FTB rate paid by instalments using the indexed estimate. **Item 13** does the same as **Item 10** but for CCB. **Item 14** sets out the process for calculating an indexed estimate for CCB.

#### Schedule 3 – Returns to paid work

**Schedule 3** presents amendments to the FAA.

**Items 1 and 2** amends the definition of engaging in paid work in the FAA. **Item 3** details that the new definition of returns to paid work is to apply from the 2005-06 year.

#### Schedule 4 – Recovery of child care benefit debts

**Schedule 4** presents amendments to the FAA.

**Item 1** removes from the FAA the provision that prevented the recovery of CCB debts from a tax refund. **Item 2** allows the recovery of a CCB debt from a tax refund so long as it is a debt determined on or after 1 July 2006 and the tax refund is determined on or after 1 July 2007.

#### Schedule 5 – Reducing allocation of child care places

**Schedule 5** presents amendments to the FAA.

**Item 4** empowers the recall of unused allocated child care places from a provider and the circumstances in which this can be done. **Item 5** inserts notification requirements for information about allocated child care places on service providers. **Item 6** requires the Schedule 5 amendments to apply to allocated child care places whenever they were allocated.

#### Schedule 6 – Carer allowance backdating provisions

**Schedule 6** presents amendments to the SSA.

**Item 1** amends the backdating provisions in the SSA for CA – caring for a child from 52 weeks to 12 weeks. **Item 2** amends the backdating provisions in the SSA for CA – caring for an adult from 26 weeks to 12 weeks.

#### Schedule 7 – Portability and Medical Treatment Overseas Program

**Schedule 7** presents amendments to the FAA and the SSA.

**Item 1** amends the FAA to allow the discretionary extension of payment of FTB beyond 13 weeks while the recipient is overseas where the person is receiving financial assistance

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under the Medical Treatment Overseas Program provided for under the *National Health Act 1953*.

**Items 2**, amends the SSA to allow the discretionary extension of payment of various payments under the SSA beyond 13 weeks while the recipient is overseas where the person is receiving financial assistance under the Medical Treatment Overseas Program provided for under the *National Health Act 1953*.

**Item 4** amends the SSA so that if the person has gone overseas and they have less than two years residency in Australia prior to departure, the normal restriction on non-portability of payments within the first two years of residence doesn't apply. This only applies where the person is receiving financial assistance under the Medical Treatment Overseas Program provided for under the *National Health Act 1953*.

**Item 6** amends the SSA to apply to a person who has previously been a resident in an Australian territory and not a resident of Australia. Where this person has gone overseas and they have less than two years residency in Australia prior to departure, the normal restriction on non-portability of payments within the first two years of residence doesn't apply. This only applies where the person is receiving financial assistance under the Medical Treatment Overseas Program provided for under the *National Health Act 1953*.

## Schedule 8 – Income streams (social security)

**Schedule 8** presents amendments the SSA.

### Part 1 – Amendments commencing 1 January 2006

**Items 2 to 7** extend the periods an income stream life expectancy for a person can be accepted as applying by up to 5 years over the number of years that would be normally set up to the age of 100. **Item 13** inserts into the SSA the provisions to require that variations in the rate of regular payments do not vary by more than plus or minus 10 per cent.

**Item 14** details that amendments for extending the life expectancy years applies to income streams purchased after 1 January 2006. It also prescribes that the amendments referring to variations in regular payments refer to income stream payments provided after 1 January 2006 regardless of when they were purchased, so it has some retrospective elements in its effect.

### Part 2 – Amendments commencing on the day after Royal Assent

**Item 24** sets the life time expectance rules for an income stream product jointly owned by two persons. This would occur after a separation and the ownership split between now separated partners. The life expectancy period will basically be set at that which applies for the partner with the longest life expectancy.

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## Schedule 9 – Income streams (veterans)

**Schedule 9** presents amendments the VEA.

**Items 2 to 7** extend the periods an income stream life expectancy for a person can be accepted as applying by up to 5 years over the number of years that would be normally set up to the age of 100. **Item 13** inserts into the VEA the provisions to require that variations in the rate of regular payments do not vary by plus or minus 10 per cent.

## Concluding comments

This Bill contains a very varied collection of amendments to three different acts, the SSA, the FAA and the VEA. Generally the proposed amendments will be seen as beneficial, especially Schedule 1 – FTB-A income test free area, Schedule 2 – indexing estimates of adjusted taxable income, Schedule 5 - reducing allocation of child care places and Schedule 7 portability and medical treatment overseas program.

Some proposed amendments may not be seen as beneficial, namely Schedule 6 – carer allowance backdating provisions. The proposed reduction of the backdating provisions for CA from 12 and 6 months down to a universal 3 months is a significant change and not the first time the government has attempted to make a change in this area.

Schedules 8 and 9 – income stream provisions are another chapter in on-going changes to the treatment of income streams. This area is both complex and the subject of regular changes to the SSA and VEA rules, as the use and application of income stream products change in the community. To a degree the rules in the SEA and the VEA respond to the on-going variability in these products and their use, very much like the tax rules play a catch-up game. The aim of governments in the past has been to retain the integrity of the VEA and the SSA to ensure what are essentially welfare payments are targeted to those who are in the most need.

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## Endnotes

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- 1 Department of Treasury, Budget Paper No. 2 – Budget Measures 2005-06, Family Assistance – increase Family Tax Benefit Part A income threshold, Commonwealth Government, Department of Treasury, Canberra, 10 May 2005, p. 165. <http://www.budget.gov.au/2005-06/bp2/html/index.htm>
- 2 Senator the Hon. Kay Patterson, Minister for Family and Community Services, *Families win \$24 a fortnight increase in family tax benefit payments*, media release, Canberra, 10 May 2005. [http://www.facs.gov.au/internet/minister1.nsf/content/budget2005-06\\_2ftbincrease.htm](http://www.facs.gov.au/internet/minister1.nsf/content/budget2005-06_2ftbincrease.htm)
- 3 Department of Treasury, Budget Paper No. 2 – Budget Measures 2005-06, Family Assistance – increase Family Tax Benefit Part A income threshold, op. cit.
- 4 Lesley Lang, Dale Daniels and Peter Yeend, 'A New Tax System (Family Assistance) Bill 1999', *Bills Digest No. 175 1998-99*, Parliamentary Library, Canberra, 10 May 1999.
- 5 Centrelink, 'A guide to Australian Government payments', 1 January – 19 March 2006, C0029.0601, Canberra, 6 January 2006. <http://www.centrelink.gov.au/internet/internet.nsf/publications/co029.htm>
- 6 Explanatory Memorandum, Family Assistance, Social Security and Veterans' Affairs Legislation Amendment (2005 Budget and Other Measures) Bill 2006, para 1, p. 3. <http://parlinfoweb.parl.net/parlinfo/browse.aspx?NodeID=163>
- 7 *A New Tax System (Family Assistance) Act 1999*, Schedule 4 Part 2 Sub-section 3(1) Item 13. <http://www.facs.gov.au/faact/faasch62.htm#FAA-Schedule4-Clause3>
- 8 Lesley Lang, Dale Daniels and Peter Yeend, 'A New Tax System (Family Assistance) Bill 1999', *Bills Digest No. 175 1998-99*, op. cit.
- 9 2004-05 Budget, Budget Paper No. 1.8, Department of Family and Community Services, *Portfolio Budget Statements*, p.p. 52-53. op. cit.
- 10 2004-05 Budget, Budget Paper No. 1.8, Department of Family and Community Services, *Portfolio Budget Statements*, p.p. 54. <http://www.budget.gov.au/2004-05/pbs/html/index.htm>
- 11 Dale Daniels and Peter Yeend, Employment and Workplace Relations Legislation Amendment (Welfare to Work and Other Measures) Bill 2005, *Bills Digest No. 70 2005-06*, Parliamentary Library, Canberra, 6 December 2005. <http://www.aph.gov.au/library/pubs/bd/2005-06/06bd070.pdf>
- 12 Matthew Toohey and Gillian Beer, 'Is it worth working now? The financial impact of increased hours of work for mothers under Australia's New Tax System', National Centre for Social and Economic Modelling, *Conference Paper CP 2003 – 022*, December 2003, Canberra. <http://www.natsem.canberra.edu.au/publication.jsp?titleID=CP0322>  
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- 13 *ibid.*

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- 14 Senator the Hon. Kay Patterson, Minister for Family and Community Services, *Answer to a Question on Notice*, from Senator Chris Evans asked on 26 September 2005, Senate Hansard, 7 November 2005, p. 231. <http://www.aph.gov.au/hansard/senate/dailys/ds071105.pdf>
- 15 2004-05 Budget, Budget Paper No. 1.8, Department of Family and Community Services, *Portfolio Budget Statements*, p.p. 52-53. <http://www.budget.gov.au/2004-05/pbs/html/index.htm>
- 16 Senator the Hon. Kay Patterson, Minister for Family and Community Services, *Families win \$24 a fortnight increase in family tax benefit payments*, op. cit.
- 17 Department of Treasury, Budget Paper No. 2 – Budget Measures 2005-06, Family Assistance – increase Family Tax Benefit Part A income threshold, Commonwealth Government, Department of Treasury, Canberra, 10 May 2005, p.p. 163 – 164. <http://www.budget.gov.au/2005-06/bp2/html/index.htm>
- 18 *ibid.*
- 19 Senate Community Affairs Legislation Committee, 2004-05 Budget Estimates, 31 May-4 June 2004, *Answers to Estimates Questions on Notice*, Family and Community Affairs portfolio, Question No. 97, p. 118. [http://www.aph.gov.au/Senate/committee/clac\\_ctte/estimates/bud\\_0405/vol1\\_fac nov04.pdf](http://www.aph.gov.au/Senate/committee/clac_ctte/estimates/bud_0405/vol1_fac nov04.pdf)
- 20 Explanatory Memorandum, Family Assistance, Social Security and Veterans' Affairs Legislation Amendment (2005 Budget and Other Measures) Bill 2006, para 1, p. 7. <http://parlinfoweb.parl.net/parlinfo/browse.aspx?NodeID=163>
- 21 Dale Daniels, 'Family and Community Services Legislation Amendment (Family Assistance and Related Measures) Bill 2005', *Bills Digest No. 182 2004-05*, Parliamentary Library, Canberra, 14 June 2005. <http://www.aph.gov.au/library/pubs/bd/2004-05/05bd182.pdf>
- 22 Department of Treasury, Budget Paper No. 2 – Budget Measures 2005-06, Family Assistance – increase Family Tax Benefit Part A income threshold, Commonwealth Government, Department of Treasury, Canberra, 10 May 2005, p. 166. <http://www.budget.gov.au/2005-06/bp2/html/index.htm>
- 23 *ibid.*
- 24 Explanatory Memorandum, Family Assistance, Social Security and Veterans' Affairs Legislation Amendment (2005 Budget and Other Measures) Bill 2006, p. 25. <http://parlinfoweb.parl.net/parlinfo/browse.aspx?NodeID=163>
- 25 *ibid.*
- 26 Department of Treasury, Budget Paper No. 1.14, 1997-98 Budget, *Department of Social Security Portfolio Budget Statements 1997-98*, Canberra, 13 May 1987, p.p. 71-75.
- 27 *ibid.*
- 28 Department of Treasury, Budget Paper No. 1.14, 1996-97 Budget, *Department of Social Security Portfolio Budget Statements 1996-97*, Canberra, 20 August 1996, p. 84.

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- 29 Department of Treasury, Budget Paper No. 1.14, 1997-98 Budget, *Department of Social Security Portfolio Budget Statements 1997-98*, op.cit.
- 30 Peter Yeend, 'Family and Community Services and Veterans' Affairs Legislation Amendment (2003 Budget and Other Measures) Bill 2003', *Bills Digest No. 43 2003-04*, Canberra, 8 October 2003. <http://www.aph.gov.au/library/pubs/bd/2003-04/04bd043.pdf>
- 31 Section 1218C(1) Extension of person's portability period.

The Secretary may extend the person's portability period for the payment if the Secretary is satisfied that the person is unable to return to Australia because of any of the following events:

- (a) a serious accident involving the person or a family member of the person;
- (b) a serious illness of the person or a family member of the person;
- (c) the hospitalisation of the person or a family member of the person;
- (d) the death of a family member of the person;
- (e) the person's involvement in custody proceedings in the country in which the person is located;
- (f) a legal requirement for the person to remain outside Australia in connection with criminal proceedings (other than criminal proceedings in respect of a crime alleged to have been committed by the person);
- (g) robbery or serious crime committed against the person or a family member of the person;
- (h) a natural disaster in the country in which the person is located;
- (i) political or social unrest in the country in which the person is located;
- (j) industrial action in the country in which the person is located;
- (k) a war in the country in which the person is located.

**1218C.(2)** The Secretary must not extend the person's portability period under subsection (1) unless:

- (a) the event occurred or began during the period of absence; and
- (b) if the event is political or social unrest, industrial action or war-the person is not willingly involved in, or willingly participating in the event.

32 There is no universal definition of the retired aged. Retired aged generally refers to people of age pension age – 65 for males and currently 63 and ½ for females. However it could include persons who have reached their superannuation access age which is currently age 55.

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33 Reasonable benefit limits (RBL) are the maximum amount of retirement and termination of employment benefits that a person can receive over their lifetime at concessional tax rates. The limits include:

- Lump-sum reasonable benefit limits, and
- pension reasonable benefit limits.

Retirement and termination of employment benefits are:

- eligible termination payments (ETPs)
- superannuation pensions (including allocated pensions), and
- immediate annuities (including allocated annuities) that have been purchased by rolling over superannuation money.

These benefits are paid when a person leaves employment, retires or reaches a certain age.

34 Department of Treasury, Budget Paper No. 1.14, 1997-98 Budget, *Department of Social Security Portfolio Budget Statements 1997-98*, Canberra, 13 May 1987, p.p. 59-60.

35 Peter Yeend, Veterans' Affairs Legislation Amendment (Further Budget 2000 and Other Measures) Bill 2002, *Bills Digest No. 161 2000-01*, Parliamentary Library, Canberra, 13 March 2002. <http://www.aph.gov.au/library/pubs/bd/2001-02/02bd109.htm#Contact>

36 For social security purposes an income stream purchased before 20 September 2004 is asset-test-exempt if the product meets the following conditions:

- it is payable for life or a term that is at least equal to a person's life expectancy at the date of purchase, and
- the payments are made at least annually, and
- the payments may vary upwards in response to indexation, but may only be varied downwards in response to allowable commutations, and
- the income stream's annual indexation is capped at the greater of 5 per cent per annum, or CPI plus 1 per cent, and
- there is no residual capital value, and
- the income stream's purchase price is returned to the pensioner over their life expectancy at the time of purchase, or the term of the product, and
- except in limited circumstances the income stream is non-commutable, and
- the income stream can ONLY be transferred to a reversionary beneficiary on the death of the primary beneficiary, or another reversionary beneficiary on the death of the first reversionary beneficiary (or if there is no other reversionary beneficiary, to their estates), and

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- the amount payable to the reversionary beneficiary cannot exceed the amount paid to the primary beneficiary immediately before their death, and
- the income stream cannot be used as security for borrowing

For asset-test-exempt status, a life expectancy product must be purchased at or after retirement age.

If an income stream is purchased after 20 September 2004, the criteria by which lifetime complying pensions/annuities qualify for a 50 per cent exemption under the assets test are the same as for those purchased before 20 September, with the exception that the 'guarantee period' for pensions/annuities purchased after 20 September may be the lesser of the individual's life expectancy, or 20 years.

37 Explanatory Memorandum, Family Assistance, Social Security and Veterans' Affairs Legislation Amendment (2005 Budget and Other Measures) Bill 2006, p. 35. <http://parlinfoweb.parl.net/parlinfo/browse.aspx?NodeID=163>

38 Department of Treasury, Budget Paper No. 2 – Budget Measures 2004-05, Superannuation – improving the integrity of the superannuation system, Commonwealth Government, Department of Treasury, Canberra, 11 May 2005, p. 37. <http://www.budget.gov.au/2004-05/>

39 Department of Treasury, 'Review of the provision of pensions in small superannuation funds – discussion paper', Canberra, 21 January 2005. <http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=1029>

40 Morag Donaldson, Family Law Amendment (Annuities) Bill 2004, *Bills Digest No. 39 2005-06*, Parliamentary Library, Canberra, 23 November 2004. <http://www.aph.gov.au/library/pubs/bd/2004-05/05bd039.htm>

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