LCG 2017/D3 - Superannuation reform: Transfer Balance Cap - Superannuation death benefits

Page status: **draft only – for comment**

Superannuation reform: Transfer Balance Cap – Superannuation death benefits

Relying on this draft Guideline

This draft Guideline describes how the Commissioner will apply the law in the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016* (the Act).

If you rely on this draft Guideline in good faith, you will not have to pay any underpaid tax, penalties or interest in respect of matters covered by the draft Guideline if it does not correctly state how a relevant provision applies to you.

Table of Contents **Paragraph**

What this draft Guideline is about

1. This draft Guideline clarifies how superannuation income streams that are superannuation death benefits (death benefit income streams) are dealt with under the transfer balance cap provisions.[1]

All references are to the *Income Tax Assessment Act 1997* (ITAA 1997), unless otherwise stated.

Superannuation death benefits

2. If you have amounts remaining in superannuation (a superannuation interest) when you die, your death creates a compulsory cashing requirement for the superannuation provider. This requires the superannuation provider to cash your remaining superannuation interests to your beneficiaries as soon as practicable.[2] The payment of your superannuation interests after your death is called a superannuation death benefit.[3]

3. Superannuation death benefits can be cashed:

- to your beneficiary or beneficiaries as superannuation lump sums that are paid out of the superannuation system
- to your dependant beneficiary or beneficiaries as superannuation income streams that are retained in the superannuation system[4], or
- to your dependant beneficiary or beneficiaries using a combination of the two.

4. For the purposes of determining who can be paid a death benefit income stream, a dependent beneficiary[5] in respect of the deceased member means:

- a spouse
- a child under 18 years of age
- a financially dependent child who is under 25
- a child who is disabled irrespective of their age,[6] and
- a person who was in an interdependency relationship with the deceased.

5. Where no superannuation income stream is cashed to a dependant beneficiary and a superannuation death benefit is paid out of the superannuation system as a superannuation lump sum, a transfer balance credit does not arise in the beneficiary's transfer balance account.

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[1] General guidance on the transfer balance cap is provided in LCG 2016/D9 *Superannuation Reform: transfer balance cap*. Modifications also apply with respect to child recipients of death benefit income streams; see paragraphs 3.266 to 3.294 of Explanatory Memorandum to the Act.

[2] See regulation 6.21 of the *Superannuation Industry (Supervision) Regulations 1994* (SISR) and regulation 4.24 of the *Retirement Savings Accounts Regulations 1997* (RSAR).

[3] Subsections 307-5(1) and (4).

[4] It has been proposed that the SISR and RSAR be amended so that this option is limited to death benefit income streams that are in the retirement phase. See the Exposure Draft of *Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulations 2017* which sets out the draft amendment to subparagraphs 6.21(2)(b)(i) and 6.21(2)(b)(ii) of the SISR and subparagraphs 4.24(3)(b)(i) and 4.24(3)(b)(ii) of the RSAR.

[5] See section 10 of the *Superannuation Industry (Supervision) Act 1993* (SISA) and subregulation 6.21(2A) of the SISR.

[6] Reference to 'disabled' means a disability of a kind described in subsection 8(1) of the *Disability Services Act 1986*.

However, where the deceased member's interest is retained within the superannuation system and cashed to a dependant beneficiary in the form of a death benefit income stream, a credit arises in the dependant beneficiary's transfer balance account.[7]

Reversionary and non-reversionary death benefit income streams

6. A death benefit income stream can either be a reversionary or non-reversionary. A reversionary death benefit income stream is a superannuation income stream that reverts to the reversionary beneficiary automatically upon the member's death. That is, the superannuation income stream continues with the entitlement to it passing from one person (the member) to another (the dependant beneficiary). A non-reversionary death benefit income stream, on the other hand, is a new superannuation income stream(s) created and paid to the dependant beneficiary or beneficiaries.

7. The term 'automatic' means that the entitlement to receive the superannuation income stream passes immediately upon the member's death to the beneficiary.[8] The superannuation income stream reverts in this manner because the rules of the fund or the agreement/standards under which the superannuation income stream is provided expressly provide for reversion, as opposed to the superannuation provider exercising a power or discretion to determine an amount in the beneficiary's favour.[9] A binding death benefit nomination, by itself, does not make a superannuation income stream reversionary.

8. Death benefit income streams are non-reversionary if the superannuation provider has the power or discretion to determine:

- to whom the death benefit is paid
- to determine the form in which the death benefit will be paid (for example as a superannuation lump sum or a superannuation income stream), or
- the value of the death benefit paid.

9. This may include circumstances where:

- there is no nominated reversionary beneficiary
- the deceased has nominated multiple beneficiaries in respect of their superannuation interest
- there is a nominated beneficiary, but the direction to the superannuation provider does not legally require the provider to pay the death benefit to the nominated individual, or
- there is a nominated beneficiary but the rules of the fund or of the superannuation income stream do not provide that the superannuation income stream may revert to another upon the member's death.

However, a death benefit income stream is not precluded from being reversionary if the rules under which the superannuation income stream is provided set the value of a reversionary death benefit income stream. That is, the rules of the fund or the superannuation income stream may allow for a superannuation income stream to revert to a dependant beneficiary but, for example, limit the value to a set percentage of the amount that was payable to the deceased member.

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[7] Items 1 or 2 of the table in subsection 294-25(1).

[8] This does not preclude the superannuation provider from undertaking necessary administrative steps such as obtaining bank account details and confirming that the reversionary beneficiary is a dependant beneficiary.

[9] This is consistent with Taxation Ruling TR 2013/5 *Income tax: when a superannuation stream commences and ceases* (see paragraphs 126 and 127 of the ruling for more information).

Transfer balance credit that arises for reversionary death benefit income stream[10]

10. If you are the recipient of a reversionary death benefit income stream, you are a reversionary beneficiary and a transfer balance credit arises in your transfer balance account. The time at which the credit arises is:

(a) for death benefit income streams commencing before 1 July 2017

- the later of 1 July 2017 or the last day of the period of 12 months beginning on the day the death benefit income stream first became payable, and

(b) for death benefit income streams commencing on or after 1 July 2017

- at the end of the period of 12 months beginning on the day (the starting day) when you started to be the retirement phase recipient of the death benefit income stream.

11. As a reversionary beneficiary automatically becomes entitled to the death benefit income stream on the death of the original superannuation member, the day the death benefit income stream first becomes payable to the reversionary beneficiary (the starting day) is the date of the death of the original superannuation member.

12. The reason for the 12 month delay is to give the reversionary beneficiary sufficient time to adjust their superannuation affairs before any consequences, such as a breach of their transfer balance cap, take effect. This is explained further in paragraph 29 of this draft Guideline.

13. However, if you are the dependant beneficiary in receipt of a reversionary capped defined benefit income stream, you should note that though there may be a 12 month delay when the credit arises in your transfer balance account, this does not mean that the income tax consequence of receiving defined benefit income[11] is also delayed. That is, if the defined benefit income you receive from the reversionary income stream, either on its own or in combination with other defined benefit income received, exceeds your defined benefit income cap during the first 12 months, then you may have to pay more income tax on that income.[12]

14. The transfer balance credit that arises in the reversionary beneficiary's transfer balance account is equal to the value[13] of the superannuation interest that supports the death benefit income stream:

(a) for death benefit income streams commencing before 1 July 2017

- the value just before 1 July 2017, and

(b) for death benefit income streams commencing on or after 1 July 2017

- the value on the 'starting day'.

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[10] Item 1 or 2 of the table in subsection 294-25(1).

[11] Subsection 303-2(2).

[12] See paragraphs 27 to 63 including example 6 of LCG 2016/D10 *Superannuation reform: defined benefit income streams - non commutable, lifetime pensions and lifetime annuities* for further information on consequences of exceeding the defined benefit income cap.

[13] The value of capped defined benefit income streams is the 'special value' of the superannuation interest. For further information on 'special value' see paragraphs 10 to 13 of LCG 2016/D10.

Example 1: Reversionary death benefit income stream commencing before 1 July 2017

15. *Larissa commenced a pension on 1 October 2000. The rules of the pension allow for it to revert to a dependant beneficiary. Larissa passed away on 1 January 2017. Brad is Larissa's spouse and is the reversionary beneficiary of this pension.*

16. *As Brad is a reversionary beneficiary, Larissa's pension automatically becomes payable to Brad on the date of Larissa's death (1 January 2017).*

17. *The value of the superannuation interest that supports the reversionary pension just before 1 July 2017 is $1 million.*

18. *A transfer balance credit arises in Brad's transfer balance account 12 months from the day that the reversionary income stream first became payable to Brad (1 January 2018).*

19. *The transfer balance credit is equal to the value of the superannuation interest that supports the reversionary pension just before 1 July 2017 ($1 million) and not the value of the superannuation interest when the transfer balance credit arises (1 January 2018).*

Example 2: Reversionary death benefit income stream commencing after 1 July 2017

20. *Theodor commenced a pension on 1 October 2017. The rules of the pension allow for it to revert to a dependant beneficiary. Theodor passed away on 1 January 2018. Valerie is Theodor's spouse and is the reversionary beneficiary of this pension.*

21. *The value of the superannuation interest that supports the reversionary pension on 1 January 2018 is $1 million.*

22. *As Valerie is a reversionary beneficiary, the 'starting day' of the death benefit income stream is the date of Theodor's death (1 January 2018).*

23. *Accordingly, a transfer balance credit arises 12 months from this date (1 January 2019) in Valerie's transfer balance account.*

24. *The transfer balance credit is equal to the value of the superannuation interest that supports the reversionary pension on the 'starting day' ($1 million) and not the value of the superannuation interest when the transfer balance credit arises (1 January 2019).*

Transfer balance credit that arises for non-reversionary death benefit income stream

25. If you are the recipient of a non-reversionary death benefit income stream, a transfer balance credit arises in your transfer balance account on the later of 1 July 2017, or when you start to be the recipient of the death benefit income stream (that is, when you become entitled to be paid the death benefit income stream).

26. The transfer balance credit is the value of the superannuation interest that supports the death benefit income stream:

(a) for death benefit income streams commencing before 1 July 2017

- the value just before 1 July 2017, and

(b) for death benefit income streams commencing on or after 1 July 2017

- the value when the death benefit income stream commences.

27. This value may include any investment earnings that accrued to the deceased member's interest between the date of death and the date the death benefit income stream commences. It may also include other amounts, for example from the deceased member's accumulation interest or an amount paid under a life insurance policy held by the

superannuation provider in respect of the member, if the superannuation provider has made a decision to pay these amounts out as a death benefit income stream.

The addition of other amounts to the superannuation interest that previously supported the member's superannuation income stream may have different transfer balance and income tax consequences depending on to whom the death benefit income stream is paid.[14]

Example 3: Non-reversionary death benefit income stream commencing before 1 July 2017

28. *Terence commenced a pension worth $1,400,000 on 1 October 2000. The rules of the pension do not provide that it may revert to another person on Terence's death. Terence passed away on 1 January 2017.*

29. *At the time of Terence's death, he also has $400,000 in an accumulation interest. The value of the superannuation interest supporting the pension on 1 January 2017 is now worth $1,000,000. The total of Terence's remaining superannuation interests at the time of his death is $1,400,000.*

30. *Aurelia is Terence's spouse and the only beneficiary. She is advised on 15 January 2017 that she is entitled to all of Terence's remaining superannuation interest. Aurelia is paid the $1,400,000 as a death benefit income steam which commenced on 15 January 2017. The death benefit income stream is made up of the $1,000,000 interest that was supporting Terence's pension at his death and the $400,000 accumulation interest.*

31. *The value of the superannuation interest that supports the death benefit income stream just before 1 July 2017 is $1,300,000.*

32. *On 1 July 2017, Aurelia commences to have a transfer balance account and a transfer balance credit arises in respect of the death benefit income stream equal to the value of the superannuation interest that supports the death benefit income stream just before 1 July 2017 ($1,300,000).*

Example 4: Non-reversionary death benefit income stream commencing after 1 July 2017

33. *Nathaniel commenced a pension worth $1,400,000 on 1 October 2017. The rules of the pension do not provide that it may revert to another person on Nathaniel's death. Nathaniel passed away on 1 January 2018.*

34. *The value of the superannuation interest supporting the pension at the time of Nathaniel's death, 1 January 2018, is $1,300,000. Nathaniel had no other superannuation interests.*

35. *Malena is Nathaniel's spouse and only beneficiary and is advised on 15 June 2018 that she is entitled to all of Nathaniel's remaining superannuation interest. During the period between Nathaniel's death and the death benefit income stream commencing to be paid to*

[14] See section 294-200 in respect of transfer balance cap modifications for child recipients. Also subregulations 995-1.01(3) and (4) of the *Income Tax Assessment Regulations 1997* which extends the earnings tax exemption in Subdivision 295-F where an interest that supported a superannuation income stream is paid as a superannuation death benefit, but only where the interest that supported the superannuation income stream is not added to, other than by way of investment earnings (not including insurance proceeds). Further, regulation 307-125.02 of the *Income Tax Assessment Regulations 1997* also provides an alternative basis for applying the proportioning rule. In circumstances where additional amounts, like insurance proceeds, are added to the interest from which the death benefit income stream will be commenced, this regulation ensures that those additional amounts are excluded from the concessional proportioning treatment.

Malena, $1000 of investment earnings accrued to the interest bringing its value to $1,301,000. The value of the superannuation interest supporting the death benefit income stream when it commences on 15 June 2018 is $1,301,000.

36. *A transfer balance credit arises in Malena's transfer balance account on 15 June 2018 and the transfer balance credit is equal to the value of the superannuation interest supporting the death benefit income stream on 15 June 2018 ($1,301,000).*

Excess transfer balance

37. The transfer balance credit that arises in your transfer balance account as a result of receiving a death benefit income stream may cause you to exceed your transfer balance cap.[15]

38. To reduce your excess transfer balance so that you no longer exceed your transfer balance cap you can choose to either commute fully or partially the death benefit income stream or, if you have one, a superannuation income stream you already have in the retirement phase. If you choose to commute your own superannuation income stream, the commuted amount can, if you choose, remain within the superannuation system as an accumulation phase interest.

39. If, however, you choose to commute the death benefit income stream, the commuted amount cannot be retained as an accumulation phase interest and the commuted amount must be paid out of the superannuation system to you as a death benefit superannuation lump sum. This is because the superannuation regulatory provisions[16] require that death benefits are cashed out of the superannuation system as soon as practicable.

Example 5: Excess transfer balance- reversionary death benefit income stream

40. *Heather is in receipt of a pension of which the supporting superannuation interest is worth $1,000,000 at the time of her death on 1 August 2017. This pension reverts to Heather's spouse, John, who is already in receipt of his own pension and who had a transfer balance of $800,000 prior to Heather's death.*

41. *On 1 September 2017, John is advised that he became the recipient of Heather's pension at the time of her death. As a reversionary beneficiary, a transfer balance credit of $1,000,000 will arise in his transfer balance account on 1 August 2018. If John does nothing, his transfer balance on 1 August 2018 will be $1,800,000 and will exceed his transfer balance cap ($1.6 million).*

42. *To prevent an excess transfer balance, John can:*

(a) partially commute the reversionary pension by $200,000 (the amount that will exceed his transfer balance cap) and take this as a death benefit lump sum out of the superannuation system, or

(b) partially commute his own pension by $200,000. In respect of this $200,000 John has the choice of either;

- *taking this as a superannuation lump sum out of the superannuation system, or*

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[15] For account based pensions refer to paragraphs 70 to 107 of LCG 2016/D9 *Superannuation reform: transfer balance cap* for more information on exceeding your transfer balance cap. For defined benefit income streams refer to paragraphs 27 to 63 of LCG 2016/D10 for more information on exceeding the defined benefit income cap.

[16] See regulation 6.21 of the SISR and regulation 4.24 of the RSAR.

- *transferring the amount to an accumulation phase interest and leaving it in the superannuation system.*

43. *On 1 July 2018, John partially commutes his pension by $200,000 and chooses to transfer that amount to an accumulation phase interest. On that date, a debit arises in his transfer balance account for that amount bringing his transfer balance down to $600,000.*

The $1,000,000 credit in respect of the reversionary pension arises in John's transfer balance account on 1 August 2018 bringing his transfer balance to $1,600,000. Consequently John has not exceeded his transfer balance cap. The value of the credit that arises in John's transfer balance account will be the value of the superannuation interest supporting the reversionary pension when he started to be the recipient of the reversionary pension on Heather's death ($1,000,000) regardless of the value of the superannuation interest supporting the reversionary pension on 1 August 2018.

Superannuation death benefits as superannuation roll-over benefits

44. From the 1 July 2017, the definition of a roll-over superannuation benefit is amended to allow a superannuation lump sum death benefit for dependant beneficiaries to be rolled over.[17]

45. This amendment provides more flexibility for dependants receiving death benefits, allowing them to roll them over to their choice of superannuation fund. A death benefit that is rolled over is considered non-assessable non-exempt income of the dependant.[18]

46. However, benefits that are specified in the regulations[19] are specifically carved out from being a roll-over superannuation benefit under the income tax provisions. It has been proposed that the *Income Tax Assessment Act Regulations 1997* be amended so that only superannuation death benefits paid to dependant beneficiaries of the deceased member qualify as a roll-over superannuation benefit.[20]

47. The proportioning rule continues to apply to the roll-over death benefit – that is the death benefit comprises the same tax-free and taxable components it had prior to the rollover.

48. Qualifying as a roll-over superannuation benefit under the income tax provisions does not enable the amount to remain in an accumulation phase interest or be mixed with the dependant beneficiary's own superannuation interest. This is because the interest that supports the death benefit income stream continues to be subject to the compulsory cashing condition in the regulatory provisions. As such it must be cashed from the system, either as a death benefit lump sum or, where allowed, a death benefit income stream as soon as practicable.

Commissioner of Taxation
13 February 2017

[17] Paragraph 306-10(a).
[18] Section 306-5.
[19] Regulation 306-10.01 of the *Income Tax Assessment Regulations 1997.*
[20] See the Exposure Draft of *Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulations 2017* which sets out the draft amendment to regulation 306-10.01 of the *Income Tax Assessment Regulations 1997*.

Your comments

49. You are invited to comment on this draft Guideline. Please forward your comments to the contact officer by the due date. In particular, we welcome comments on further interpretative issues that have not yet been raised in this draft Guideline.

Due date:	**10 March 2017**
Contact officer:	**Stephen Lau**
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Telephone:	**(02) 9374 5038**

References

ATOlaw topic(s)	Superannuation ~~ Income tax - individuals (superannuation) ~~ Other
Legislative references	ITAA 1997 ITAA 1997 294-25(1) ITAA 1997 294-200 ITAA 1997 Subdiv 295-F ITAA 1997 303-2(2) ITAA 1997 306-5 ITAA 1997 306-10(a) ITAA 1997 307-5(1) ITAA 1997 307-5(4) ITAR 1997 306-10.01 ITAR 1997 307-125.02 ITAR 1997 995-1.01(3) ITAR 1997 995-1.01(4) SISA 10 SISR RSAR Disability Services Act 1986 8(1)
Related Rulings/Determinations	TR 2013/5; LCG 2016/D9; LCG 2016/D10
Other references	Explanatory Memorandum to Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016 Exposure Draft of Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulations 2017
BSL	Superannuation