Law Council
OF AUSTRALIA

12 October 2016

Superannuation Tax Reform
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: jessica.carew@treasury.gov.au

Dear Jessica

Consultation on the Superannuation reform package - tranche 2

I am pleased to enclose a submission prepared by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia.

The Committee would welcome the opportunity to discuss the submission further. In the first instance, please contact:

- Ms Michelle Levy, Chair, Superannuation Committee T: 02 9230 5170 E: michelle.levy@allens.com.au; or
- Ms Heather Gray, Chair, Tax Subcommittee of the Superannuation Committee T: 03 9603 3608 E: heather.gray@hallandwilcox.com.au.

Yours sincerely

Jonathan Smithers
Chief Executive Officer

Consultation on the Superannuation reform package - tranche 2

Treasury

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Acknowledgement

This submission has been prepared by the Law Council of Australia's Superannuation Committee (**the Committee**), which is a committee of the Legal Practice Section of the Law Council of Australia.

The Committee’s objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Committee makes submissions and provides comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

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Submission

1. The Committee's response to the Superannuation reform package - tranche 2 (the **Package**) is guided by our objectives as identified above.

2. The Committee has only made comments below where the Committee has identified issues within its remit.

Preliminary

Consultation period

3. As a preliminary point, the Committee considers that the consultation period allowed, for what is a very significant reform package, is too short. The consultation period (27 September to 10 October) effectively spans 9 business days, taking into account the public holiday for most jurisdictions that fell during the period. In most places, the period also fell in whole or in part in school holidays, when many people (including some of our Committee members) take leave. The main piece of draft legislation, the exposure draft Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (the **Primary Bill**) is 85 pages long, and the accompanying exposure draft Explanatory Material (the **Explanatory Material**) is 126 pages long. The draft legislation and the Explanatory Material are detailed, technical and complex, and introduce many new concepts.

4. The Committee submits that a longer and more realistic consultation period needs to be allowed if the consultation process is to be of real value.

5. The Committee continues to be concerned that the issue of legislation in tranches makes it difficult to consider comprehensively the interaction of aspects of a complex legislative package.[1] For example, the Government has announced a new proposal in relation to the making of non-concessional contributions, draft legislation for which has not yet been released. Presumably, aspects of this legislation will interact to some extent with provisions included in tranche 2. There are also several areas where the Explanatory Material foreshadows further consultation and the making of amendments to the *Superannuation Industry (Supervision) Regulations 1994* (**SISR**) (see for example paragraphs 1.72 to 1.74 of the Explanatory Material). These amendments will of course have a substantive bearing on the operation of elements of the package.

Timing issues

6. The Committee notes that some of the changes set out in the Package will require substantial changes to be made to administration systems. For example, funds that operate pension divisions will need to implement changes that will allow transition to retirement pensions (**TTR**s):

   - to be separately identified within the division
   - to have different tax treatment applied

[1] A point the Committee made previously in respect of the *Stronger Super* reform package.

- to commence to be treated on the basis that an entitlement to exempt current pension income (ECPI) will arise immediately upon the member in receipt of each TTR satisfying a 'retirement phase' condition of release.

7. Further, assets may need to be segregated accordingly and underlying investments reviewed.

8. These (and other changes that will be required) are significant matters from an administration perspective. The Committee notes that where administration changes are made without adequate lead time, there is a risk of errors arising. Costs can also be higher than would otherwise be the case, as additional resources may need to be brought in where existing teams have insufficient capacity to take on the additional work within a compressed timeframe.

9. The Committee recommends that Treasury consult with the industry and, in particular, the main providers of administration services, to determine whether the industry will be able to realistically accommodate a start date of 1 July 2017 without undue risk.

10. Communications and reporting obligations should also be factored into meeting the 1 July 2017 deadline – including restructuring pension product offerings and pension application forms – including for reversionary pensions, income stream insurance, binding death benefit nomination forms and review of periodic reporting (that will also then need to comply with enhanced complex fee disclosure measures).

Minor error

11. In example 1.2, after paragraph 1.41 of the Explanatory Material, we think that the sentence 'As such, Amy can now contribute $850,000 without breaching her personal cap.' should read 'As such, Amy can now transfer $850,000 without breaching her personal cap.'

Schedule 1 - Transfer balance cap

Complexity, forced commutations and maintaining a record of the transfer balance account

12. As a preliminary point, the Committee considers that the transfer balance cap regime is extremely complicated, and queries how readily fund members will be able to understand the principles and operation of the measure. 51 pages of the Primary Bill, and 63 pages of the Explanatory Material are devoted to this topic. In the Committee's view, a measure of this complexity cannot be consistent with the subsidiary objective of superannuation set out in the explanatory materials to the *Superannuation (Objective) Bill 2016*, being that the superannuation system 'be simple, efficient and provide safeguards'.

13. The Committee also queries whether the use of the terms 'debit' and 'credit' in relation to the transfer balance account, which have well established meanings in accounting terms, creates the potential for confusion.

14. Further, the Committee notes that if the Package is passed in its present form, trustees will effectively be unable to offer a 'taxable pension'. This is because any pension that meets the pension rules under SISR will be a superannuation income

stream for tax purposes, and will count towards the transfer balance cap[2], which then leads to the prospect of a commutation authority and forced commutation. However, trustees may consider it in the best interests of their members that they be able to offer members who have reached their transfer balance cap the option of taking a second, 'taxable' pension. There seems to be no policy reason why trustees should not be able to do so. It may be that trustees will develop quasi-income stream products that are designed so as not to be 'pensions' for SISR purposes, and therefore not to qualify as superannuation income streams for tax purposes, in order to offer 'taxable' pensions for their members. However, this would seem to introduce a further level of complexity and some artificiality that would not be required if a simpler approach were taken to meeting the Government's policy objective of (to simplify somewhat) taxing superannuation fund earnings on retirement income accounts with assets or value above a legislated level.

15. The Committee queries whether a simpler and more readily understandable method of implementing the Government's policy should be considered.

16. One option might be to further consider whether funds should report to the Australian Taxation Office (**ATO**) the earnings on all account based pension interests of their members, and members might then be individually assessed to tax at 15% on the part of the earnings above an amount determined according to a formula based on a notional $1.6 million balance (indexed). Members would of course be able to withdraw amounts from their superannuation interests in order to pay the tax, or could be required to do so in a manner similar to that in which members are required to withdraw funds from superannuation to pay an excess non-concessional contributions cap liability or release authorities are applied for the purposes of the Division 293 tax. Such an approach would avoid the considerable complexity that arises around forced commutations, the need for a transfer balance account to be maintained, the difficulty for funds in seeking to explain the regime to their members, and the difficulty for members in complying with the transfer balance cap.

17. Another alternative option would be to treat all account-based income streams in a manner similar to capped defined benefit income streams, where income received by the individual is taxed to the extent it exceeds $100,000 per annum. The Committee understands this is a significant shift from the $1.6 million cap measure as announced, but it is generally reflective of the policy position and would ensure better commensurate treatment across defined benefit interests and account based income streams.

18. It seems unlikely that fund members will be able, over what may be a lengthy period of 30 years or more during which multiple pensions are started and are commuted (partially and fully) and other events, such as family law payment splits may arise, to keep track of their transfer balance account as well as other important key thresholds – such as the personal transfer balance cap, highest transfer balance and the used and unused cap space. This will be made considerably more difficult for members with multiple accounts across multiple funds – with even more complexity if members are also in receipt (or have been in receipt) of one or more capped defined benefit income streams.

19. There is no obligation imposed on any person under the Primary Bill to establish and maintain a record of a transfer balance account. The Primary Bill simply provides that

[2] Noting that subregulation 995-1.03 of the *Income Tax Assessment Regulations* is to be deleted and so it seems that there will be no scope to take a series of drawdowns and not elect for them to be treated as superannuation income stream benefits.

‘You have a transfer balance account if you are the retirement phase recipient of a superannuation income stream.’ (proposed section 294-15 *Income Tax Assessment Act 1997* (**ITAA97**)). However, the ultimate burden of the consequences of a transfer balance account exceeding the cap is imposed on the member, with this creating a de facto obligation on the member to maintain an account. Many individuals will require professional assistance to do so and will be effectively required to pay for that assistance.

20. Superannuation funds will be unable to provide much assistance to members in this regard, as they will have details only of their members’ pensions within that fund.

21. By implication, the Commissioner of Taxation (**Commissioner**) will maintain a record of the transfer balance account for all relevant fund members, as it is only by doing so that the Commissioner will be in a position to make an excess transfer balance determination in respect of a member.

22. The Committee recommends that there be a clearly expressed obligation on the Commissioner to establish and to maintain a record of the transfer balance account for each person who the Commissioner becomes aware is the retirement phase recipient of a superannuation income stream, and to provide such a person, on an annual basis and on their request at any time, with details of that record. The Committee notes however that the Commissioner will only be able to provide reliable data if all superannuation funds report on the commencement and commutation of pensions in real time. The Committee queries if it is intended to impose such an obligation on funds and, if so, through what mechanism? If the measures are to proceed by 1 July 2017, the Committee considers it is important that details of these reporting and record keeping obligations be issued for industry comment as soon as possible.

23. These issues would be avoided if either of the alternative approaches identified above is taken up instead.

Debit events - fraud

24. It is proposed that members would be entitled to a debit in their transfer account balance if they suffer a loss as a result of a fraud or dishonesty and an individual has been convicted of an offence. Admittedly, this is a special case that would rarely arise. For completeness, however, the Committee notes that the requirement for an actual conviction would disadvantage victims of a fraud in cases where there is a delay in prosecution (which could be several years and be subject to appeal) or where no offender is ever brought to justice. The Committee queries whether a conviction should be a threshold requirement, and suggests that the Commissioner should have power to accept, upon the submission of evidence, that a fraud has occurred in the absence of a conviction.

25. The Committee also notes that, in many cases, a member might initially suffer a loss but might subsequently receive compensation under the auspices of an insurer, an operational risk reserve or industry levy. To the extent that a member is subsequently compensated, there would appear to be no need for a debit (and so perhaps an earlier debit might need to be reversed), bearing in mind that any such compensation might be less than the full amount of loss suffered.

26. The Committee queries whether similar protection (in the form of a debit in the transfer account balance) ought to be afforded in cases where recipients of a capped

defined benefit income stream are adversely affected following the insolvency of a defined benefit fund or another provider of a life pension or annuity.

27. Similarly, the Committee queries the assumption in paragraph 1.183 of the Explanatory Material that a defined benefit member would never suffer a loss as a result of fraud or dishonesty. While this might be unlikely, in extreme cases, it is theoretically possible that the fund could be left insolvent following a fraud or dishonesty event, whether as a direct consequence or as a consequence of a combination of events.

Child dependants

28. The Committee notes that special rules are proposed for children to receive death benefit income streams without prejudice to their future retirement needs. However, there are a number of aspects of these measures about which the Committee has concerns:

- It is highly likely that there will be implementation and administrative difficulties in the administration of these measures where a superannuant who is a member of multiple funds dies and there is trustee discretion and/or a dispute in relation to the payment of the death benefits (including as to the amount which particular dependants should receive and the form in which it ought be paid). In some cases these matters mean that death benefits are delayed for periods in the order of two to three years or more. It is important that these measures do not prevent trustees from providing payment to and in respect of surviving spouses, children and other financial dependants in circumstances where they have lost their only source of financial support – in many instances trustees have been prepared to make an initial payment (whether being represented as the first instalment of an income stream or an initial lump sum) to cover immediate financial needs.

- In regard to these difficulties, the Committee notes that the examples in the Explanatory Material do not address partial payments of death benefits to surviving spouses as well as to dependent children or where there may be a delay in the determination of how benefits will be paid from one fund, in terms of what that means for the trustee discretion being exercised in relation to death benefit distribution from another fund .Such examples would be helpful. For instance, if example 1.39 were modified so that Craig leaves his $2 million superannuation death benefit in 50/50 shares between his surviving second spouse and his 12 year old daughter Eliza from his first marriage – and the trustee pays Eliza an $800,000 pension and cashes out $200,000 as a lump sum and the decision is later overturned by a court or the Superannuation Complaints Tribunal (**SCT**) to reduce Eliza's entitlement to $500,000 – and his surviving spouse (with an infant child) receive a $1.5 million share – how would the caps then be treated and modified?

- Further, examples of how these child death benefit measures will operate where a child is the recipient of one or more reversionary capped defined benefit income streams as well as being entitled to one or more account-based income streams would be helpful, as the intersection between defined benefit income streams and account based income streams for the modified operation of the cap is likely to be more complex.

- The requirement for excess amounts to be cashed out of the superannuation system as a lump sum will be problematic in many cases because of the infancy of a child (and there being a need for the lump sum to be paid to or for the benefit of the child). As mentioned above, “taxable pensions” should be able to be provided in the superannuation system and without trustees having to resort to creating pensions that fall outside the SISR pension standards .

- The Committee recommends that trustees be given statutory immunity from liability in respect of any changes made to adapt superannuation offerings to align with these new measures – for example, complying with a commutation authority may be difficult in view of the legal capacity issue mentioned above.

- The terms and conditions governing reversionary pensions to children will have been ‘purchased’ (and in some cases backed by life insurance policies with premiums that have been paid over a period of time) by members and the requirement to commute portions of these products significantly changes their value to the member (and beneficiaries). The Committee suggests that some form of transitional accommodation is required to address circumstances where the imposition of the new rules would reduce the value of a product that has been purchased under the existing rules.

- As a minimum, the Committee suggests that some grandfathering or transitional relief should apply to death benefit pensions already being paid to or for the benefit of a child on 1 July 2017.

- There does not appear to be sufficient or obvious rationale to treat child recipients of a death benefit pension differently depending upon whether their parent has a transfer balance account at the time of death – in the Committee’s view the $1.6 million cap should be applied as the relevant cap in all cases.

- The operation of the cap where there are multiple child recipients of a death benefit income stream should also be further examined. The application has a potentially discriminatory effect on children who also have other siblings in receipt of a pension[3] (and would therefore operate to encourage a cashing out of death benefits to minor children – which should be re-examined from a public policy perspective).

- If the proposed measures remain then further modification of SISR will be required to increase the number of lump sum payments that might be permitted to be made in respect of a death benefit beyond two instalments – particularly if a commutation authority has been received after a death benefit pension under SISR has commenced for a child and initial and final lump sum payments have also been made.

- The Committee also questions whether there should be scope for dependants who are not children of the deceased superannuant, but are generally minors (for example, in an interdependency relationship or a young surviving spouse) should be similarly treated – noting that the reference to regulation 6.21(2A) of

[3] Note that a sole child of a superannuant who receives a death benefit income stream (prior to the superannuant having commenced an retirement phase income stream) will be entitled to the full $1.6 million cap; however, if the same superannuant had two or more children the $1.6 million cap is pro-rated according to the respective death benefit distribution to each child.

SISR in proposed section 294-160 requires the recipient to be a “child of the member”.

Commutation

29. The Primary Bill contemplates that a superannuation income stream provider issued with a commutation authority must within 30 days after the commutation authority is issued pay by way of commutation of the specified superannuation income stream a superannuation lump sum equal to the lesser of the reduction amount stated in the commutation authority and the maximum available release amount for the superannuation interest that supports the specified superannuation income stream (proposed section 136-80 *Taxation Administration Act 1953* (**TAA**)).

30. This provision creates the prospect of compulsory commutation. The Committee submits that it is not required by the announced policy and creates a multiplicity of difficulties that would not arise if it were to be dispensed with.

31. The Explanatory Material states that a superannuation income stream provider should make reasonable efforts to consult with the individual on whether they wish the commutation amount to remain in the superannuation system or whether they wish it to be paid to them as a superannuation lump sum (paragraph 1.131). The Explanatory Material goes on to state that in determining how to deal with an amount that remains in superannuation, the superannuation income stream provider should consult with the member and where this is not possible continue to act in the interests of the member, which may require the provider to set up an accumulation interest without the consent of the member) (paragraphs 1.132).

32. The Committee considers that a 30 day period for the commutation to be made is too short. It does not allow sufficient time for the trustee to contact the member and obtain the member’s instructions as to whether the commuted amount is to be added to accumulation or paid out. The Committee suggests that 60 days would be a more realistic period.

33. Further, the Committee considers that trustees should not be placed in a position of needing to consider, on a case by case basis, what approach would be in the best interests of a particular member. The requirement to do so would add to costs and administrative complexity in circumstances where trustees are unlikely in any event to be in possession of information about the member that would have a bearing on the trustee’s decision. The Committee recommends that the legislation include a clear obligation on trustees that have been unable to obtain the instructions of the member, to transfer the proceeds of the commutation into an accumulation account for the member.

34. In these circumstances the Committee notes that there may be a need to amend the *Corporations Act 2001* (Cth) to enable accumulation accounts to be established for members in these circumstances (without a member application being made to the trustee/provider).

35. A further implication for compulsory commutation relates to the fact that superannuation funds overwhelmingly offer a choice of investment options and it is common for members (even account-based pension members) to select multiple investment options. A commutation in these circumstances would therefore typically involve a trustee, first, deciding which (pension) investment option to source the commutation from and, secondly, which (accumulation) investment option to invest

the proceeds in. Both decisions would potentially expose a trustee to the risk of a complaint being made by an aggrieved member/beneficiary.

36. For example, if the commutation was sourced from an investment option which subsequently experienced strong investment performance, a member might opportunistically complain (with the benefit of hindsight) that the trustee erred in selecting to source the commutation from that investment option rather than from another.

37. Similarly, if the proceeds from the commutation are invested in an investment option that subsequently loses value, the member might subsequently claim that the proceeds ought to have been invested in a more defensive option, such as a cash investment option.

38. Trustees will need to consider how the proposed rules would interact with existing drawdown strategies. For example, a member may have invested part of their pension account in a cash option and part in a growth option, with the intention that their next few pension payments would be sourced from the cash option, on the basis that their next few pension payments would be insulated from short term market volatility. If the commutation were to be sourced from the cash option (which might be the trustee's obliged course of action), this would likely exhaust the amount invested in the cash option and defeat the purpose of the member's chosen drawdown strategy.

39. For these reasons, the Committee suggests that consideration be given to creating a safe-harbour which protects trustees in circumstances such as these where the trustee has, in good faith, adopted and applied a policy governing how these circumstances would be managed. Note that this should not impose a duty on trustees to form a view on what is in the best interests of the individual member, because these would be macro policies and in practice would involve a degree of automation.

Death benefits

40. The Committee notes that death benefit pensions cannot be commuted with the proceeds held in accumulation after 6 months – under regulation 6.21 of SISR a death benefit must be "cashed" and taken either as a lump sum or as an income stream as soon as practicable after the member dies. There is no provision for the recipient of a death benefit pension to move this into accumulation after 6 months have elapsed. Consequently, the recipient of a death benefit pension, where this causes the transfer balance cap to be exceeded, will be required to take the excess amount out of the superannuation system altogether. This seems to the Committee to be inconsistent with the announced policy, which was framed on the basis that pension amounts in excess of $1,600,000 could be converted to accumulation and continue to be held within superannuation. See, for example Superannuation Fact Sheet No 2 issued following the 2016 budget papers.

41. For those whose excess transfer balance arises from a death benefit, application of the new rules will result in a very considerable change to their tax treatment, in that the excess amount will not simply be taxed at standard superannuation rates, but will become subject to marginal rates of tax outside of the superannuation system. Further, such a requirement may disturb any arrangement whereby a pension has a second reversionary, in that the expectations of such reversionary may be defeated by a compulsory commutation that was not in contemplation when the pension was established.

42. The Committee queries whether these consequences are intended, and suggests that the rules relating to death benefits should be amended at the least to allow a death benefit pension to be commuted and the proceeds held in accumulation where the commutation is required under a commutation authority. Transitional rules should apply for pensions already in payment that have a second reversionary. Alternatively, the concept of a “taxable pension” treated similarly to a TTR, as mentioned above, could apply to these excess amounts. Alternatively again (and more simply), the commutation requirement could be dispensed with.

43. Proposed section 294-40 1TAA97 will apply such that a person who has ever exceeded the transfer balance cap will be unable to receive the benefit of indexation of the transfer balance cap. The Committee queries whether this is appropriate where the transfer balance cap has been exceeded by reason of receipt by the individual of a death benefit pension, and suggests that this circumstance should be disregarded for the purposes of this provision.

Defined benefits

44. When calculating the special value of capped defined benefit income streams, the Committee notes that adopting a flat multiplier of 16 is a somewhat blunt approach that in different circumstances could yield differing and unintended consequences.

45. For example, the Committee understands that some funds presently offer pension members the opportunity to purchase a life pension of approximately $100,000 per annum for around $1 million. Under the proposed rules, such a pension would completely exhaust the individual’s lifetime transfer balance cap, even though – in actual fact – they had not contributed a full $1.6 million to a pension product. This may discourage members from taking income stream products, which would appear to be counter to other Government initiatives.

46. Further, the discrepancy between the actual cost of a life pension and the deemed cost could be magnified in other circumstances, for example, where the relevant member has a known relatively short life expectancy.

47. The Committee therefore suggests that, in circumstances where a life pension is purchased for an identifiable purchase price, consideration be given to introducing scope for valuing the pension either at the actual purchase price or the special value.

48. Generally, the Committee is concerned about the complexity of these measures for defined benefit income streams where members may have multiple accounts across multiple funds where some may be capped defined benefit income streams and others are more common account based pensions. The likelihood of members being in a position to understand and keep track of these multiple arrangements – including the differing impact for valuing, crediting and debiting the transfer balance account for defined benefits.

Schedule 2 - Concessional superannuation contributions

Part 3 - Superannuation guarantee charge

49. These changes assist where a single employer's contribution would otherwise exceed the concessional contributions cap.

50. At present there are persons with multiple employers who routinely exceed their existing concessional contributions cap and this position is likely to grow from July 2017 with the introduction of the new lower cap.

51. Effectively requiring taxpayers to exceed the concessional contributions cap, with the resulting administrative inconvenience for the member, funds and the ATO, seems to the Committee to be unnecessary, wasteful of resources and inconsistent with policy.

52. The Committee recommends that the opportunity be taken to expand Part 3 of Schedule 2 to allow employees with multiple employers to be entitled to request one or more of their employers to cash out the contribution to the extent that the contribution taken with other contributions made in respect of the employee would be in excess of the concessional contributions cap. The Committee notes that a similar regime applied in respect of the old 'Reasonable Benefit Limit' rules where contributions would have taken the employee over those limits.

Schedule 6 - Catch-up concessional contributions

53. The provisions seem to the Committee to achieve the policy objectives and it is assumed the requirement that the total superannuation balance is less than $500,000 is a "cost" saving measure. It will be essential that members are able to obtain from the ATO accurate and reliable information about their total superannuation balance, which is unlikely to be ascertainable by the member themselves from their own records. Presumably the ATO will include in its processes a search for lost superannuation attributable to the member (which would appear to be included in a total superannuation balance as defined), and balances held in eligible rollover funds. The Committee notes in that regard that those members who have a transfer balance account will be particularly challenged in determining whether they are entitled to use the carry forward provisions. The Committee comments above about the difficulties members are likely to face in keeping track of a transfer balance account.

54. Proposed new section 291-20(4) of ITAA97 would require an individual's unapplied 'unused concessional contributions cap' for each of the previous 5 financial years to be used to increase their concessional contributions cap 'but not by more than' the concessional contributions for the year that would otherwise be excessive. We suggest it would be clearer and more direct to refer to increasing their concessional contributions cap 'by the amount of' the excess.

55. The Committee suggests that it may be useful to improve the Explanatory Material, where Examples 6.2, 6.3 and 6.4 illustrate the available unused caps. These appear to be the amount of the unused cap arising in any one particular year. For clarity and to avoid confusion, the Committee suggests that an additional row be included in each table showing the cumulative total of available unused caps.

56. For example, in Example 6.2, Layla makes a contribution of $40,000 in 2023/24 and the table suggests she has zero available unused cap. While this is true in the sense

that there is no unused cap arising in that year, it might be misleading for some readers who would rightly think that Layla still has $60,000 of unused cap from the four previous years. A similar situation arises in Example 6.3. Example 6.4 seems to attempt to show a running balance of cumulative unused cap but, unless the Committee misunderstands the table, there appears to be an error in the table. The table suggests that in 2018/19 and 2019/20 that Jason has zero remaining unused cap space to carry forward. However, in the Committee's view the remaining cap space ought to be $20,000 for 2018/19 and $40,000 for 2019/20.

Schedule 8 - Innovative income streams and integrity

57. The Committee welcomes the commitment to introducing clear legal concepts to encourage certainty of tax concessional treatment for innovative 'deferred super income stream' products.

58. The Committee notes that further necessary detail (and the effectiveness therefore of the relief to facilitate innovation) awaits the flagged regulations to the *Superannuation Industry (Supervision) Act 199*3 (Cth) – in particular definitions and/or conditions for what will qualify as 'deferred superannuation income streams'. The Explanatory Material notes this point and refers to standards to come in the SISR to include and recognise certain 'guaranteed annuities and group self-annuities' that meet certain standards as 'deferred superannuation income streams (**Longevity Pensions**). The Committee looks forward to providing input regarding these draft regulations in due course.

59. The Committee notes that the detail of the rules concerning Longevity Pensions has not yet been released. The Committee expects that further consideration will need to be given to tax and social security treatment issues once further thought has been given to these rules. In particular, the Committee notes that encouragement of Longevity Pensions innovation (including guaranteed annuities and group self-annuities that meet certain standards), that will commence when a member turns, say, 70/80 years of age, may require tailoring of the tax provisions and review of social security treatment to promote the intended product innovation across a level playing field.

60. If such pensions are included at full value within the transfer balance cap, individuals may be forced to choose between the establishment of a Longevity Pension and the establishment of an account based pension at their preferred level - rather than using a Longevity Pension type product to supplement an account based pension. It would seem consistent with announced policy that the rules should operate so as to encourage individuals to use Longevity Pensions to reduce the risk of their having to rely on the age pension in their later years, and the Committee considers that the tax and social security rules should not work against this goal.

61. The Committee also queries whether the requirement that a member must have satisfied a "nil" condition of release before the assets supporting a Longevity Pension become eligible for ECPI treatment will make establishing such products earlier in the individual's life less attractive and more complex than necessary in the lead in period to expected retirement on or after reaching preservation age.

62. Rather, it would appear to be consistent with policy for the tax rules, and simpler to innovate, understand and administer (without putting expected tax treatment at risk) to encourage providers and individuals to offer simple tax-exempt Longevity Pensions in the years leading up to retirement by permitting their establishment at any time after an individual reaches age 60 with a requirement that Longevity Pension income

benefits could not commence to be paid prior to age 65 or a member otherwise satisfying a ‘retirement phase’ condition of release.

Schedule 9 - Anti-detriment provisions

63. Many death benefits are not paid within 2 years of death of a member even when there is no dispute. In many cases this is due to the requirement for trustees to be satisfied that they have properly discharged their duties in the exercise of their discretion relating to a death benefit distribution.. Where there are complex family circumstances, completion of the necessary enquiries to identify beneficiaries often takes many months or more. The gathering of information about each potential beneficiary’s circumstances, and the obtaining of submissions from claimants, can also be a lengthy process.

64. Where there is a dispute and the matter is referred to the SCT or litigated, the benefit might not be paid for many years. The Committee notes that the average time for a disputed death benefit to be dealt with by the SCT, to the point of issue of a determination, is currently approximately 2 years.

65. It is not clear to the Committee why beneficiaries whose payment is delayed beyond 2 years through no fault of their own should lose the advantage of application of the anti-detriment provisions in effect at the time of the relevant member’s death. The Explanatory Material indicates that this is to avoid ‘uncertainty and compliance costs that would result from indefinitely retaining the income tax deduction in respect of members that pass away prior to 1 July 2017 where payment of benefits to beneficiaries is significantly delayed’.

66. The Committee cannot see how retaining the provisions for members who die before 1 July 2017 could give rise to any uncertainty. Further, funds already have systems in place to manage anti-detriment payments. Retention of those systems until all death benefits outstanding at 1 July 2017 have been paid seems to us to be a minor inconvenience.

67. On the other hand, the imposition of a 2 year deadline is likely to lead to ‘hard cases’; where a payment is made just outside that period and the beneficiaries receive a lesser payment as a result. Aggrieved beneficiaries are likely to make complaints to the SCT, arguing that the trustee should have moved more quickly to pay the benefit, knowing of the financial implications. Equally, trustees will find themselves under pressure to make a decision and to make payment as the 2 year deadline approaches, and this could also lead to complaints from aggrieved beneficiaries.

68. The Committee therefore submits that the repeal of the anti-detriment provisions should apply in respect of all benefits paid because of the death of a member on or after 1 July 2017.

69. If, however, it is thought essential that there be an end date, the Committee submits that 2023 (6 years) would be more appropriate, and would deal with the overwhelming number of cases where a member dies before 1 July 2017.

Excess transfer balance tax (Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016)

70. The Committee notes that excess transfer balance tax will be 15% of the relevant person's annualised notional earnings on their excess transfer balance for the financial year, or 30% where the person has previously been liable to pay excess transfer balance tax.

71. According to the Explanatory Material:

> 1.151 …An individual who breaches their transfer balance cap after receiving an assessment in an earlier financial year most likely believes their actual earnings will exceed the national earnings rate. Imposing a higher rate of taxation is designed to discourage such behaviour.

72. The Committee disagrees that individuals who breach the transfer balance cap are likely to do so deliberately based on a belief that they can 'arbitrage' earning rates. There is of course no evidence as yet regarding fund member behaviour in relation to these new rules. However, the Committee considers it is far more likely that breaches of the transfer balance cap will arise because of:

- difficulty faced by fund members in understanding and applying the rules – especially across multiple funds and multiple accounts and where capped defined benefit income streams and deferred pensions are in place;
- fund members relying on factual information (including from the ATO) regarding their transfer balance cap that proves to be incorrect;
- the fund member receiving a death benefit pension;
- mistake.

73. The Committee suggests, based on the experience of its members with the excess contributions tax regime, where the overwhelming majority of breaches of the caps occurred by reason of mistake, that cases where an individual is seeking to 'game' the rules by deliberately breaching the transfer balance cap are likely to be extremely rare. On this basis, the Committee considers that application of a 30% excess transfer balance tax rate for second and subsequent breaches will in most cases punish individuals who have tried in good faith to work within a difficult and complex regime.

74. The Committee recommends that the excess transfer balance tax rate should in all cases be 15%.

Exposure Draft Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 released for consultation on 7 September 2016

Schedule 1 - Deducting personal contributions

Schedule 1, item 4, paragraph 290-155(1)(a) - defined benefit funds

75. This proposed section provides that personal contributions cannot be deducted if they are made to "a Commonwealth public sector superannuation scheme in which you have a defined benefit interest". The draft explanatory memorandum explains the rationale for this condition by reference to the significant costs which would be incurred if these funds had to restructure to accommodate deductibility of personal contributions. However, these are not the only funds which may encounter difficulties if they had to accommodate deductible personal contributions. Accordingly, paragraph 2.17 of the Explanatory Material goes on to state that the amendments "**will** also include any State, Territory or private sector defined benefit superannuation funds that advise the Government they face similar difficulties and request to be included in this category to avoid incurring significant costs to restructure their scheme rules" (emphasis added).

76. The Committee questions how or where those additional funds will be accommodated within proposed section 290-155(1)? Will they be prescribed in regulations, as facilitated by proposed section 290-155(1)(c)?

77. Alternatively, the Committee submits that a blanket exclusion drafted into the legislation in relation to all personal contributions in respect of an individual's member contribution obligation which goes toward funding his or her defined benefit interest could be more simple and easy to administer rather than expecting submissions to Government from every affected State, Territory and private sector defined benefit fund. Alternatively, such funds could be permitted to elect for themselves whether they will permit deductible personal contributions to be allowed in respect of an individual's member contribution obligation in respect of their defined benefit interest.

78. Affected individuals would not necessarily be disadvantaged by such an exclusion (whether blanket or by the fund's own election) because many funds allow for a defined benefit member to have a voluntary accumulation account in addition to their defined benefit, and so deductible personal contributions could be credited to those accounts.

Schedule 1, item 4, paragraph 290-155(1)(b) - untaxed funds

This proposed section provides that personal contributions must not be made to "a superannuation fund that would not include the contribution in its assessable income under section 295-190". The draft explanatory memorandum explains this condition as relating to untaxed funds. That is, if deductible personal contributions were permitted to untaxed funds, then the contribution would not be taxed either in the hands of the fund or its members.

The Committee questions whether the cross-reference to section 295-190 is correct as it does not seem to relate to untaxed funds. Rather, section 295-190 deals with particular amounts such as personal contributions and roll-over amounts which are included in the assessable income of certain superannuation entities (ie, if the amounts specified are included in the entities' assessable income then the section is not dealing with untaxed funds).

Contacts

The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact:

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