Consultation on the Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 and the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016

Economics Legislation Committee

17 November 2016
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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Introduction

1. The Committee’s response to the Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016 and the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 is guided by its objectives as identified above.

2. The Committee made detailed comments to Treasury as part of Treasury’s consultation process in respect of Exposure Drafts of the Bills. The Committee reiterates some of those comments in this submission.

Complexity

3. The Committee considers that the legislation as a whole is extremely complicated, and queries how readily fund members will be able to understand the principles and operation of the new measures.

4. In particular, in the Committee’s view, the complexity of the transfer balance cap regime is not 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’.

5. While the Committee understands the Government’s imperative to finalise the legislation and move towards implementation, the adoption of this unduly complex regime will:

   - burden the superannuation industry with increased administration and compliance costs into the future, at a time when there is increasing pressure on funds to reduce fees - and these costs will be borne by all fund members regardless of whether their contributions or benefits are at a level to engage the new rules
   - create a requirement for every Australian who commences a pension to have a transfer balance account created and maintained in respect of them, with a corresponding burden on the Australian Taxation Office (ATO), notwithstanding that the vast majority of Australians are not expected to reach the transfer balance cap
   - create uncertainty and concern for individuals seeking to understand the taxation implications of their retirement savings plans, and for many this will be at a time when individuals are elderly.

6. The new measures, including the reduction to the annual non-concessional contributions (NCC) cap and interaction with an individual’s total account balance being tested against the general transfer balance cap, will require individuals to track their total superannuation balance across all their superannuation interests (including across multiple funds) in order to avoid inadvertent breaches of the new excess NCC cap measures.

7. As regards the transfer balance cap regime, 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 commuted (partially or fully) and other events, such as family law payment splits which 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.

8. These measures are inherently complex, but will need to be applied correctly by individuals who wish to make non-concessional contributions, to successfully use the “bring forward” facility, and commence and manage pensions.

9. Such individuals will require accurate and ‘real time’ information to support them in taking such steps, and the Committee understands that the ATO will seek to inform individuals of their annual total superannuation interests and their personal transfer balance cap, and to warn individuals who it appears are likely to soon exceed the various caps, according to the ATO records held. The accuracy of this information will of course depend on the accuracy and the timeliness of the reports lodged by the members’ superannuation funds. In any event, applying this information successfully within the context of a fund member’s own circumstances will require considerable knowledge and expertise.

10. The Committee submits that it should not be necessary for an individual to be required to incur costs in engaging an adviser in order to be able to:

- understand the fundamental features of tax law that they will be required to comply with when saving for retirement; and
- understand the extent to which they can contribute actively towards their retirement savings.

**Timing**

11. 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 (TTRs):

- to be separately identified within the division
- to have different tax treatments applied
- to commence to be treated on the basis that an entitlement to exempt current pension income will arise immediately upon the member in receipt of each TTR satisfying a ‘retirement phase’ condition of release.

12. Further, assets may need to be segregated accordingly and underlying investments reviewed for tax effectiveness.

13. 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.

14. The Committee recommends that there be consultation 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.
15. 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).

Non-concessional contributions

16. Prior to Budget night 2016, some self managed superannuation funds (SMSFs) had put in place limited recourse borrowing arrangements (LRBAs) that were structured on the basis that loan repayments would be funded in whole or in part by additional contributions by fund members. Those strategies relied on the ability of members to utilise the concessional and non-concessional caps in place at that time. Further, some SMSFs are faced with restructuring related party LRBAs to bring these within the ‘safe harbour’ guidelines set out in Practical Compliance Guideline 2016/5 issued by the ATO in April 2016. Such restructuring may require that members make non-concessional contributions to bring loan to value ratios within the safe harbour guidelines.

17. Assistant Treasurer Kelly O’Dwyer MP announced after Budget night that persons who would otherwise be disadvantaged in respect of existing LRBAs by the new rules would be protected. The Committee understands that the Bill does not include special protections on the basis that the proposals regarding limitations on non-concessional contributions were changed after Budget night to allow more generous non-concessional contribution limits than the previously announced lifetime cap. However, SMSFs with fund members who have already reached the $1.6 million contribution limit (which may have been due to investment performance and appreciating value of property purchased by the fund) may still be significantly disadvantaged if existing strategies relied on those members being able to make additional non-concessional contributions. These LRBA terms may extend over significant time-periods and many would have been carefully structured with detailed cash-flow analysis over 10 to 20 year periods which may now be disrupted with adverse consequences.

18. The Committee recommends that transitional relief be provided for SMSFs and members in these circumstances.

Release Authorities

Need for a safe harbour

19. The Committee considers that a clear and express “safe harbour” provision is required to protect trustees in dealing with release authorities – particularly where release authorities are mandatory, in the absence of instructions from the member.

20. Such trustees may need to make decisions about matters such as the investment option from which an amount is to be released. As a practical matter, it is unlikely that a trustee will be able to make such a decision based on an informed consideration of the affected member’s circumstances. The trustee will not know, for example, whether the member has other interests in other superannuation funds, and how such amounts are invested, or the timeframe over which the member is likely to require access to their funds. In any event, the trustee’s duty is to exercise its powers in the best interests of the beneficiaries as a whole and not on a member by member basis.
21. Provision should be made so that a trustee that complies with a mandatory release authority is protected where the trustee has in good faith adopted and applied a policy governing how these circumstances would be managed. Such a policy would be developed based on the interests of the beneficiaries of the fund as a whole. This is important to protect the trustee from claims and complaints where the trustee is compelled to redeem a member’s investments from one or more investment options to satisfy a release authority required at law and where no specific and valid member instructions have been received.

Commissioner’s discretion

22. Under proposed section 131-15(2) of the *Taxation Administration Act 1953* the Commissioner may issue a release authority where an excess non-concessional contributions determination has been issued (or a notice has been issued in respect of such a determination under section 131-5(4)(b)) and the member has not made a valid request for the release of amounts in respect of that determination.

23. The Explanatory Material explains that:

12.57 The amendments also introduce a new circumstance in which mandatory release may occur — where the individual has excess non concessional contributions and has not notified the Commissioner about the amount that they want to be released.

12.58 Previously, if an individual did not make an election about the release of an amount upon receiving an excess non-concessional contributions determination, no amount would be released from their superannuation at that time.

12.59 This was almost always to the individual’s detriment. If the amount was not released, the whole value of the contribution was subject to excess non-concessional contributions tax at a rate equal to the highest marginal income tax rate on the income of an individual (47 per cent in 2017-18). Further, as outlined above, the amount of this excess non concessional contribution tax liability would then need to be released from the individual’s superannuation interests.

12.60 Given the seriousness of this consequence, it is preferable that it only apply to an individual that has specifically chosen this outcome, rather than applying by default.

12.61 The amendments change this default position, allowing the Commissioner to release the amount of an individual’s excess non concessional contributions in the absence of a request by the individual. [Schedule 10, item 1, subsection 131-15(2)]

12.62 This position is only a default. An individual may still choose for no amount to be released by requesting the Commissioner not release an amount. This request will prevent the Commissioner from seeking the release of the full amount of the excess non concessional contributions. However, it will not affect any subsequent mandatory release relating to the consequential excess non concessional contribution tax liability.

24. Given this explanation, the Committee queries why the Commissioner should not be bound to issue a release authority in these circumstances? It is not clear what criteria the Commissioner would apply in deciding whether or not to exercise this discretion, and the Committee cannot readily envision circumstances in which the Commissioner would be in a position to know the individual’s circumstances. Rather, the Committee expects that the Commissioner would need to rely on the principle expressed above, which is that the non-release of the relevant amount from superannuation would be ‘almost always to the individual’s detriment’. On that basis, the Committee suggests that this provision should require the Commissioner to issue a release authority in the
circumstances described in proposed section 131-15(2) of the *Taxation Administration Act 1953*.

25. Further, the Committee notes that this default measure is intended to operate only in circumstances where the individual has not made an active choice - they have not notified the Commissioner of an amount to be released, being either nil (that is, they have actively determined that they want the relevant amount to stay in the superannuation system), or some other amount in accordance with section 131-10.

26. The legislation as drafted does not make clear that a request under section 131-5 can include a 'nil' request, and the Committee submits that an ordinary (or even an expert) reader would not deduce from sections 131-5 and 131-10 that a person who did not want any amount to be released would as a practical matter have to make a request for the release of an amount, with the amount specified as nil.

27. At the least, the Committee recommends that section 131-5(2)(a) be amended to read:

   (a) notifying the Commissioner of the total amount to be released (which may be nil); and

28. It is also relevant to note that the new lower caps, new thresholds and more complex bring-forward rules are likely to give rise to an increase in the number of excess non-concessional contribution assessments.

### Superannuation Guarantee

29. The Committee submits that the proposed changes to the NCC cap measures should cause a review of the superannuation guarantee (SG) legislation as it applies to individuals who will have SG contributions paid into superannuation only to then be required to have those amounts later released.

30. The application of the $1.6 million total account balance as an absolute cap beyond which there can be no further NCCs will make this issue more common for individuals who have significant superannuation savings and who receive SG contributions from numerous employers, taking them above the $25,000 concessional contribution cap. Those excess SG contributions will then be deemed to be NCCs.

31. The Committee acknowledges that there may not be substantial numbers of individuals affected by this scenario. However it would clearly be a 'reduction of red tape' measure to allow such individuals to opt-out of the SG system.

32. For simplicity and efficiency of the superannuation system, consideration might be given as to whether it should be available to all individuals with a total superannuation account balance in excess of the general transfer balance account cap to opt-out of SG altogether.

33. A similar option was available to individuals when the SG legislation was introduced in 1992, but was changed following the 2007 'simpler super' reforms.

### Death benefits

34. The Committee notes that death benefit pensions cannot be commuted with the proceeds held in accumulation after six months - under regulation 6.21 of the *Superannuation Industry (Supervision) Regulations 1994* 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 six 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 $1.6 million 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.

35. 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, there may be significant detriment to current elderly pensioners who have an income stream set in place to support their retirement or nursing home costs and medical expenses. Such pensioners may not be in a position to now make radical changes to structures that were set in place when they retired – potentially 20 plus years ago.

36. This is a significant (and unannounced) change to the policy settings, which currently allow a spouse, dependent child up to age 25 or financial dependant to retain death benefits they receive within the superannuation system if they take these benefits by way of a pension.

37. The Committee notes here that the provision of death benefits to a legal personal representative or to dependants falls within the core and ancillary purposes contained in section 62 of the Superannuation Industry (Supervision) Act 1993 (the ‘sole purpose test’). It is appropriate that fund members should put in place arrangements for the support of their dependants should those members die while they still have a balance within superannuation.

38. The Committee 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 death benefit pensions already in payment that have a second reversionary. Alternatively, the concept of a “taxable pension” treated similarly to a transition to retirement pension under the proposed new rules could apply to these excess amounts.

Contacts

39. 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:

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