Superannuation reform package - tranche two

10 October 2016

AIST Submission

AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $700 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

Contact

David Haynes, Executive Manager Policy & Research 03 8677 3803

Tom Garcia, Chief Executive Officer 03 8677 3800

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

1 Executive summary

In brief:

The second tranche of superannuation reform will implement a transfer balance cap at retirement of $1.6 million, a reduction in the concessional contributions cap to $25,000 p.a., catch-up concessional contributions, removal of anti-detriment provisions, and changes to taxation of retirement income streams. AIST notes considerable complexity for transfer balance caps, but generally supports most measures. We continue to oppose measures to reduce the concessional cap, especially for over 50s.

AIST generally supports the program of reform that has been proposed by the Government as part of the measures related to the 2016 Budget. We believe that the measures go a considerable way to addressing problems of equity and sustainability in the superannuation system.

Our comments in this submission primarily relate to the Exposure Draft of the Exposure Draft *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* (the "Exposure Draft", the "Draft Bill") as well as its accompanying Explanatory Material (EM), however we have also commented briefly on the Exposure Draft of the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulation 2016*.

In our submission, we have noted that there are considerable impediments to implementation of the Transfer Balance Cap, including with regards to both time and costs. Even if the legislation passes both houses of Parliament before the end of March 2017, there will be a great deal of work required in order to merely ensure that funds are able to report retirement income stream information to the ATO accurately.

We have also noted problems with the method proposed to calculate transfer balance account balances and consider that the notion of personal transfer balance caps makes this system unduly complicated. We have proposed an alternate method which we believe will better meet the intended aims with regards to maintaining proportions used and unused constant.

In addition, we consider that there are disproportionate penalties for errors, in cases where the transfer balance cap is breached and otherwise, and have highlighted shortcomings with regards to the operation of defined benefits.

AIST does not support the reduction in the concessional contributions cap to $25,000 and has taken the opportunity in this submission to especially argue that transitional arrangements should be extended to people aged over 50 as at Budget night, as these Australians have not been in a position to benefit from changes to superannuation which came into effect relatively recently.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

We accept that the removal of anti-detriment provisions may remove a routinely misunderstood aspect to superannuation, however we are cautious to note that there may be unintended consequences upon their removal.

AIST supports the provisions for catch-up contributions for members with less than $500,000 in their superannuation as at the start of a financial year, as well as the administration changes proposed in Schedule 10 of the Exposure Draft.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

2 Recommendations

2.1 Schedule 1, *Exposure Draft Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* – Transfer Balance Cap

AIST does not oppose this measure, and is generally supportive of the superannuation reform package. Having stated that, there are significant structural, transitional and implementation issues that have to be addressed by Government in order for the measures contained in this Exposure Draft Bill, and in particular the transfer balance cap, to achieve its policy objective.

While the Government has emphasised that very few people will be impacted by this measure, processes, business rules and system changes need to be made by all superannuation funds. This an expensive and time-consuming process, and means that the costs will be borne by all superannuation fund members, and not just the few who are directly impacted by the measures. Clarity and certainty must be provided by the legislative framework, and the comments made by AIST in this submission are aimed at achieving this.

2.1.1 Insufficient time for implementation

Superannuation funds are unlikely to be able to fully implement this measure by 1 July 2017 if the establishing legislation and regulation has not passed both houses of parliament by the end of 2016. The basis for this comment is set out below.

Most superannuation funds (regardless of whether they have insourced or outsourced administration) require at least an initial month or two to analyse, assess and scope the operational, process and system changes needed. It is noted that many superannuation funds and administrators operate on more than one administration platform, and that changes will need to be made to each.

Most superannuation funds and administrators make major changes to their systems on the basis of one to four release cycles each year. The specific business requirements for each release need to be settled four to six months ahead of the release date, in order that system analysis and testing can be undertaken. Minor changes can be made through patches, but these legislative changes do not fall into that category.

This change program requires support from software providers and vendors, who will not generally commit to the development work required until there is certainty about the legislative change requirements.

2.1.2 Cost of implementation

Extrapolating from information provided by AIST members, it is estimated that the system changes required to give effect to changes emanating from the 2016 Federal Budget will cost in the order of $60 million, with other costs of around $30 million; a total implementation cost of around $90 million. By far the largest part of this spend will be on implementing the transfer balance cap, with managing proportions being the most difficult element.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

If the implementation timeline is contracted as a result of legislative delay, the cost implications are likely to be significantly greater, with the cost naturally being greater the longer the delay.

2.1.3 Reporting to and from the ATO

Successful implementation also requires the upgrading of reporting to and from the ATO, and obligation to report more frequently. This is being undertaken as part of the ATO's Member information eXchange project (MiX), with the ATO requiring labels of *amount transferred to pension* and *amount rolled out of pension phase* for this measure.

For pensions being rolled out, the ATO can obtain the amount from the individual's PAYG record for that financial year, while amounts being transferred in to pensions could be reported when a pension account is opened in the MiX Service.

While the ATO is undertaking design-level consultations with the superannuation industry, this consultation should be extended to ensure that the implementation of MiX has regard to the policy and practical requirements of the transfer balance cap and the removal of the work test for personal superannuation deduction eligibility.

2.1.3.1 Absence of Tax File Numbers (TFNs)

We note that since 1 July 2007, there has been no requirement to collect TFNs for members in retirement income streams, due to the removal of taxation of payments after age 65. We question how the collection of existing retirement income stream balances as at 1 July 2017 will be completed by the ATO without this information.

We would also point out that even if Royal Assent was gained by April next year, there is no guarantee that retirees are going to provide their TFNs to their funds in time.

In addition to this, TFNs will now also need to be collected for all new retirement income streams, as well as new and existing reversionary arrangements, family law splits, death benefit income streams and a variety of others. Ideally, super funds should be able to collect TFNs immediately.

2.1.4 Intention of this measure

We note and welcome the intended purpose of this measure as stated in paragraph 1.1 of the Explanatory Material to the Exposure Draft (EM), which is to limit access to the earnings tax exemption contained in the retirement phase of superannuation.

The Transfer Balance Cap is designed to perform this function by limiting the amount that people can transfer into the retirement phase of superannuation to $1.6 million from 1 July 2017. It is also, as announced jointly by the Treasurer and Minister for Revenue and Financial Services on 15 September 2016, entwined with a ceiling balance ("total superannuation balance") across a taxpayer's total superannuation

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

holdings beyond which no further non-concessional contributions would be allowed. We note that there is no discussion of this function that the cap will play.

We additionally note that this is why there has been no mention of Transition To Retirement (TTR) arrangements, which also presently enjoy an exemption on earnings tax, due to end on 30 June 2017. However, the EM is silent on how these arrangements will work. We strongly recommend that details with regards to these be included in the EM to the Bill once it is introduced to Parliament in order to ensure that the questions below are appropriately resolved:

- Will account balances in TTR income streams as at 30 June 2016 be credited to one's transfer balance account and therefore affect one's personal transfer balance cap?
- Will commutations or rollovers out of TTR arrangements after 30 June 2016 trigger corresponding debits to transfer balance accounts?
- Will income payments out of TTR income streams affect one's transfer balance account?

We have assumed that the answer to the questions above is "no", however we recommend that this be made clear to ensure that no confusion arises.

2.1.5 The Transfer Balance Account

We note that credits to this account, are to be triggered by transfers into income streams in the retirement phase, whereas the definition of payments that will trigger debits to the account includes commutations.

This creates interesting product implications for superannuation providers, where it may no longer be in the interests of their members to allow income payments in excess of required minimum drawdown percentages. For example:

Example

It is July 2019 and Alex is a retiree who is 68 years of age and is drawing her minimum 5% from her account-based pension with Boone Industries Staff Super Fund. After a review of her expenses, she decides that she will need an additional 2% drawn down.

Boone Industries Staff Super Fund facilitates her requested increase as follows:

- No change to Alex minimum drawdown of 5%; and
- A regular series of commutations amounting to 2% p.a. of Alex' account balance.

These payments are paid together. The regular commutations of 2% p.a. debit Alex' transfer balance account correspondingly.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

2.1.6 Allowances for children receiving death benefits as income streams

AIST supports allowances for children who receive death benefits in the form of an income stream, to ensure that their ability to commence income streams unhindered by previous transfer balance accounts when they retire. We note however that where death benefit income streams are commenced in excess of the transfer balance account (as exemplified by Examples 1.39 and 1.40), the excess amounts must be paid as lump sums and removed from the superannuation system.

Importantly, trustee discretion may apply in determining whether a dependent is paid an income stream or a lump sum. We therefore query the wisdom of directing trustees to pay amounts as lump sums where they had previously determined it is in the best interests of beneficiaries to be paid by way of an income stream.

2.1.7 Indexation of the personal transfer balance cap

Paragraph 1.40 of the EM states the intentions behind the method used for indexing the unused part of an individual's personal transfer balance cap. However, the first sentence of the paragraph clearly states the intention to hold the proportions which are used and unused constant, which is inconsistent with the method used.

The prescribed method has the effect of inflating the unused proportion compared to the used portion. This is best explained in an example (next page):

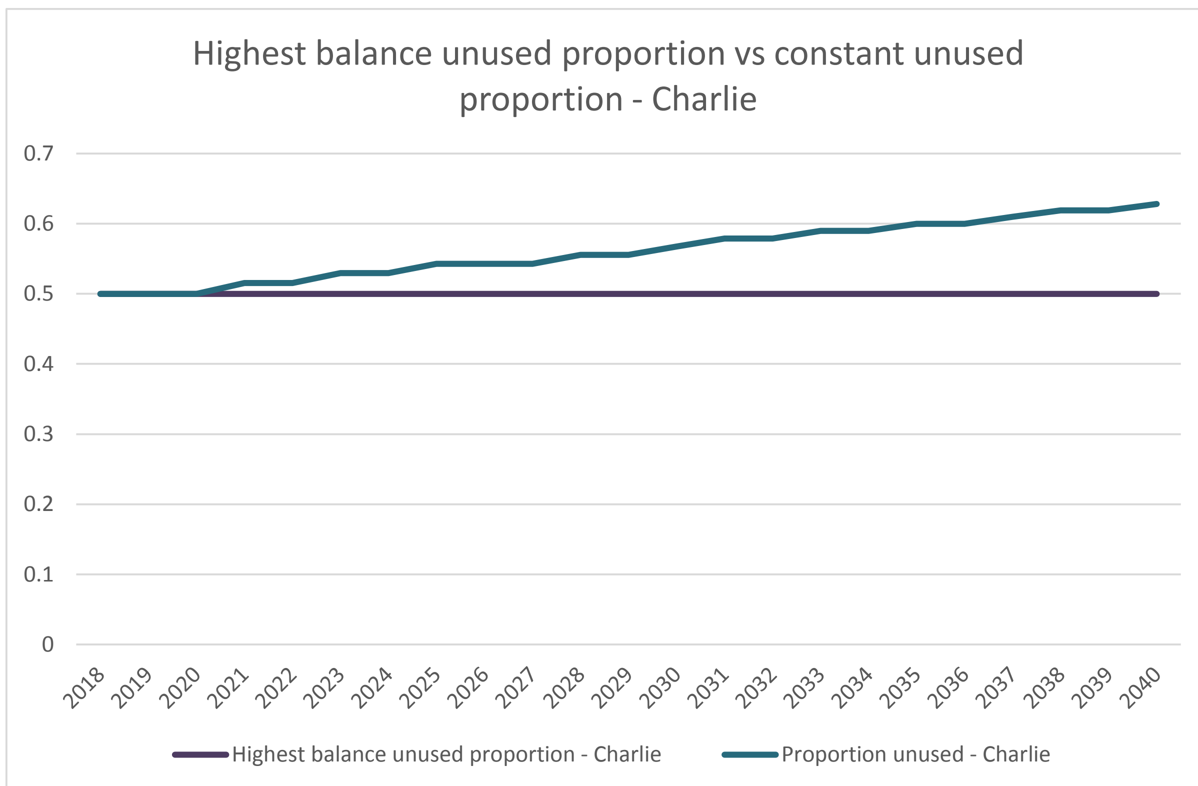
Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

Example

In July 2017, Charlie transfers $800,000 of his superannuation into a new retirement income stream, using half his transfer balance cap. Assuming he makes no lump sum commutations or further credits to his transfer balance account, as well as CPI increases of 2.5% p.a., the proportion unused increases over the next few years, relative to Charlie's used portion:



In addition to the inconsistency explained above, we believe that the method prescribed by the Exposure Draft is unnecessarily complicated.

A far simpler method for calculating the balance one's unused proportion would be to use a straightforward proportioning of the ordinary transfer balance cap. This would need to be coupled with a corresponding indexation of one's transfer balance account in line with the ordinary transfer balance cap. It would do away with the need for individual transfer balance caps and be consistent with the notion of proportioning as described in paragraph 1.40. Although this has the disadvantage that the method contained in this exposure draft limits indexation to the highest balance unused proportion we believe that making debits to a linked account (conceptually similar to an offset account) which is not indexed would resolve this.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

But most importantly, it would replicate the calculation of the unused proportion as proposed in this exposure draft. We have illustrated with the examples below:

Example

In July 2017, Desmond commences a retirement income stream with $800,000. His transfer balance account is credited with $800,000, leaving an unused proportion of $800,000.

In July 2027, the transfer balance cap has been indexed to $2,000,000. Indexation of Desmond's transfer balance account has therefore increased to $1,000,000, leaving an unused proportion of $1,000,000. Desmond makes a lump sum commutation of $500,000.

Desmond's transfer balance account remains unchanged at $1,000,000, however his commutations account balance would be debited by $500,000, leaving him with an overall unused proportion of $1,500,000.

In July 2030, the transfer balance cap increases again to $2,200,000. Desmond's transfer balance account balance of $1,100,000, together with the offsetting debit balance in his commutations account of $500,000 would result in $1,600,000 available for investment in retirement income streams.

Example

Also in July 2017, Eloise commences a retirement income stream with $1,600,000. Her transfer balance account is similarly credited with $1,600,000 equal to the transfer balance cap.

With the transfer balance cap indexed to $2,000,000 in July 2027, indexation of Eloise's transfer balance account has therefore also increased to $2,000,000. Eloise also makes a lump sum commutation of $500,000.

Eloise's transfer balance account would also remain unchanged at $2,000,000, and her commutations account balance would be debited by $500,000, leaving her with an overall unused proportion of $500,000.

In July 2030, the transfer balance cap increases again to $2,200,000. Eloise's transfer balance account balance of $2,200,000 would not allow for additional retirement income streams to be purchased on their own, however, the offsetting debit balance in her commutations account of $500,000 would still be available for investment in retirement income streams, should she have the resources to do this.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

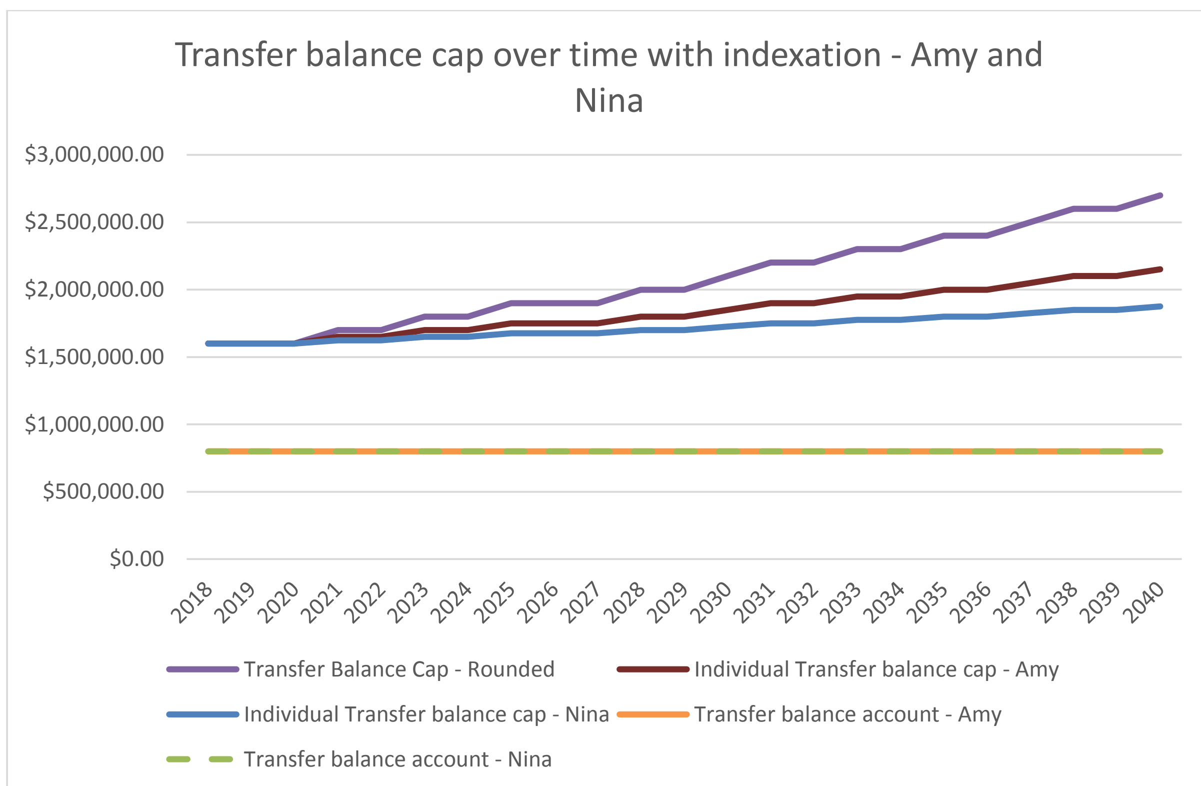
AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

2.1.8 Penalties for errors

The EM contrasts the situations of Amy and Nina (in Examples 1.2 and 1.3), who, by a very minor series of events end up in a largely similar situation where they have a net investment of $800,000 in retirement income streams. However, Nina is punished for the error of over-investing in retirement savings products relative to Amy.

If we place Amy and Nina on an equal footing where both of them have $1.2 million in superannuation, it can be seen that there are adverse implications if Amy only purchases a retirement income stream for $800,000, whereas Nina purchases one for $1.2 million, with a subsequent commutation of $400,000 (we can assume that Amy has made an equivalent lump sum withdrawal of $400,000 from her super account in the accumulation phase):



As can be seen, assuming indexation of 2.5% p.a., we can see that even though Amy and Nina's transfer balance account remains identical into the future, Nina is punished for her mistake of moving all her super into a retirement income stream relative to Amy. This is inequitable and allowance should be made for this.

2.1.9 Modifications for reversionary arrangements

The EM makes it clear that regardless of the transfer balance account balance of the primary income stream recipient, the cap used for reversionary arrangements is that of the reversionary beneficiary. This

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

raises some interesting questions, particularly if the primary pensioner had used only a very small proportion of their transfer balance cap.

2.1.10 Notional earnings on excess transfer balance breaches

We note that the notional earnings is charged at the same rate as the general interest charge as specified at section 8AAD of the *Taxation Administration Act 1953*. The purpose of the general interest charge is to compensate for late payments of tax, superannuation guarantee contributions and other amounts.

In this case, the general interest charge is being used as a proxy for interest in order to calculate a tax liability, rather than penalise a late payment. We believe that this is both an inappropriate use of the general interest charge as well as being unnecessarily punitive, and that a better rate for the calculation of this would be one that more realistically substituted for investment earnings.

We also note that with current reporting, it could take up to 90 days for a fund to report to the ATO amounts that will credit a member's transfer balance account. The ATO will then need to issue a determination within 14 days. If the general interest charge is compounding daily for a full 90 days, the member could potentially be up for a considerable amount of money as a result of this delay. Again, we would recommend a more realistic proxy for fund earnings.

2.1.11 Defined benefit issues

The proposed solution for defined benefit members where the equivalent income stream for the purposes of the Transfer Balance Cap is one-sixteenth. Firstly, we note that this factor does not take into account the age of the income stream recipient. To explain this better, due to the reduced life expectancy, the present value of an income stream of $100,000 for a recipient aged 65 is going to be higher than that for a recipient aged 70. A variety of funds incorporate commutation values into their defined benefit multiples which take this difference into account, yet this proposed formula does not consider a recipient's age.

In addition, a variety of different features built into defined benefits can have a substantial impact on valuations used by funds. These features can include different methods of indexation, alternate reversionary arrangements and guaranteed periods. We believe the difference that these features can make is worthy of being included in the valuation rules for the purposes of tax.

We consider that any differences in taxation need to be undertaken with extreme care, as this could drive member decisions at retirement. As can be seen above, if a member wishing to avoid tax took a reduced pension at age 65, rather than a larger one at age 70, it is possible that they may be compromising their standard of living in retirement as a response to potential taxation. This would be an issue, if such a decision was not in their interests.

We note that concerns regarding defined benefits will be raised in considerably deeper detail by AIST's member funds in their submissions.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

2.2 Schedule 2, Exposure Draft *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* – Concessional superannuation contributions

AIST does not support the reduction in contribution caps to $25,000 per year from 1 July 2017, and is especially opposed to the reduction of the current $35,000 cap for individuals aged over 50 years of age.

AIST continues to assert that the transitional arrangements for this measure are flawed in that they (in combination with the catch up concessional contributions measure) specifically disadvantage a particular age cohort. That is, employed individuals who will be aged over 50 years as at 1 July 2016.

A justification given for the change to the concessional caps is that they are poorly targeted. However, the gap in time between the reduction on concessional caps and the introduction of catch up provisions for concessional contributions mean that there is a consequential gap in the measures available to assist individuals with low superannuation balances at the very time they are most likely to take action to redress this superannuation shortfall.

It is noted that the Government has also announced the deferral of the proposed catch up measure until 1 July 2018, meaning the first catch up will not be available until the 2019/2020 financial year. As a consequence, people in their fifties who were looking to increase their low account balances have reduced capacity to do so, especially over the 2017/2018 and 2018/2019 financial years.

AIST continues to assert that this requires a transitional policy response from the Government. AIST proposes that individuals aged over 50 years of age as at Budget night 2016 be able to make concessional contributions of $35,000 per year.

The implementation of reduced concessional contribution caps involves relatively low system, process and compliance costs, and can be implemented relatively quickly. However, the lower caps are likely to result in superannuation funds receiving a greater number of pre-tax contributions that exceed the cap.

This may be ameliorated to an extent by the speedy and efficient implementation of the MiX project, so that superannuation fund members receive accurate and update information on MyGov about all of the concessional and non-concessional contributions they have made.

2.3 Schedule 6, Exposure Draft *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* – Catch-up concessional contributions

AIST supports the proposed methodology for the determination about whether or not an individual has a total account balance of less than $500,000. That is, that a total balance of less than $500,000 in one financial year is a threshold determinant for making additional concessional contributions in the next year.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au

2.4 Schedule 8, Exposure Draft *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* – Innovative income streams and integrity

AIST supports measures to encourage innovative retirement income products. Schedule 8 to the Exposure Draft amends the *Income Tax Assessment Act 1997* so that only income streams that are in the retirement phase are able to benefit from the earnings tax exemption, noting that regulations are to be drafted in order to define deferred income streams as being in the "retirement phase". AIST notes the equivalence as described at paragraph 8.35 where the deferred income stream qualifies for the exemption from retirement or age 65 as a reasonable compromise.

2.5 Schedule 9, Exposure Draft *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* – Anti-detriment provisions

The anti-detriment provisions were introduced in 1988 in order to ensure that dependents in receipt of superannuation monies after the death of a member were not adversely affected by taxation of superannuation. These are an important part of the superannuation system, and were designed to ensure that spouses and dependent children were entitled to a refund of taxation.

Although we support the intended benefits of anti-detriment payments, AIST accepts that this was an optional transitional feature which was inconsistently applied by super funds, and was often misunderstood by members and their financial advisers.

We note that there may be unintended consequences from the removal of this feature. Since the Simpler Super reforms in 2007, recontribution strategies have been a well-documented way of partly reducing the tax payable on death benefits payable to children. The absence of anti-detriment payments may potentially be an incentive to utilise these strategies more.

2.6 Schedule 10, Exposure Draft *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* – Administration

AIST supports the provisions aimed at streamlining the administration of the Division 293 tax regime. The changes to end benefits will mean that members who receive end benefits from defined benefit funds will no longer need to notify the ATO that they have received a payment from their funds, making things simpler for taxpayers.

In addition, we welcome the changes set out in Part 2 of Schedule 10, which will allow the ATO to combine assessments into the one notice. This will reduce the confusion from taxpayers who were subject to both a Division 293 assessment and an excess contributions tax assessment which would arrive separately. We additionally welcome the room provided to ensure that other income tax assessment notices can be included. This will provide certainty and simplicity to taxpayers.

Copyright © 2016 Australian Institute of Superannuation Trustees
ABN 19 123 284 275

AIST
Australian Institute of Superannuation Trustees
Ground floor 215 Spring St
Melbourne VIC 3000

P 61 3 8677 3800
F 61 3 8677 3801
T @aistbuzz
E info@aist.asn.au
www.aist.asn.au