



File Name: 200816

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The Treasury
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26 May 2008

Dear Sir/Madam,

Payment of Temporary Residents' Superannuation to the Australian Government

The Association of Superannuation Funds of Australia Ltd (ASFA) is pleased to provide comments on the consultation paper *Temporary Residents and Superannuation*.

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, which include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80% of superannuation savings.

This submission is in two parts. The first part considers the broad thrust of the Policy. The second part addresses the proposed administration arrangements.

In summary ASFA considers that:

- The Policy should be reconsidered as it contains a number of serious issues that deserve further investigation before any changes are made.
- If the Policy is to proceed and the policy objective is to target temporary residents as a 'lost member' issue then the measure should be prospective and targeted at new temporary residents who depart the country without cashing their benefits.

Should you have any queries on the content of the submission please contact our Acting Director, Policy and Best Practice, Ross Clare, on (02) 9264 9300.

Yours sincerely,

Ross Clare
Acting Director, Policy and Best Practice

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The Association of Superannuation Funds of Australia

SUBMISSION

Payment of Temporary Residents' Superannuation to the Australian Government

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COMMENTS ON THRUST OF POLICY

ASFA notes that the policy initiative was announced by the former Government as a revenue measure to:
..... enable the Government to establish a register of temporary residents' superannuation, making it easier for them to locate and claim their superannuation.

A subsidiary reason given was to:

..... ameliorate the problem of small balances becoming lost in the superannuation system and potentially being eroded by fees and charges.

A consequence of the policy was noted as an increase in the underlying cash balance of the Commonwealth by some \$877 million in net terms over the Forward Estimates.

ASFA has the following broad concerns:

- Rather than targeting specific problem-accounts, the government has adopted a broad-brush approach
- A significant number of superannuation fund members will suffer a loss of benefits
- There may be adverse impacts on the Australian labour market
- There is an element of retrospective taxation in the proposal
- The measure does nothing to improve the retirement living standards of retirees
- The measure will impose additional costs on every APRA regulated superannuation fund in Australia
- The measure may breach the Constitution.

Each of these concerns is further expanded upon below.

Broad-brush approach

The consultation document states that the primary policy driver is the desire to reduce the impact of departed temporary residents' unclaimed superannuation on the continuing growth in the number of unclaimed superannuation accounts.

It is very much a broad-brush approach to require the account balances of all temporary residents to be paid to the Australian Taxation Office on the chance that the money will remain unclaimed following the person's departure from Australia.

If the concern is with lost accounts of departed temporary residents then the accounts of departed temporary residents should be the focus of the measure.

The consultation document notes that:

In many cases, Australian residents who work temporarily in foreign countries cannot access their compulsory social security or employer pension contributions upon permanent departure from the country.

While this may be a valid statement, it should be noted that:

- Australia's social security benefits are funded from general taxation, not specific levies on individuals
- SG contributions are taxed in the hands of the receiving fund
- The Policy requires payment to the ATO of not just the SG contributions, but also any voluntary member after-tax contributions, salary sacrifice and additional employer contributions as well as the associated fund earnings.

In summary, although the Policy is supposedly targeted at the SG contributions of departed temporary residents its scope is far broader.

Loss of benefits for members

Out of the range of benefits lost to members there are two key areas of concern: Insurance cover and investment earnings.

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Insurance cover

Temporary residents come to Australia for a variety of reasons. Some are backpackers visiting Australia on a visa that permits them to work, some are employees transferred within a multi-national business for a set period of time, some are recruited to address the executive talent shortage, while others, such as 457 visa holders, are hired overseas to meet specific skill shortages.

These temporary residents work in a variety of industries, some of which may carry a significant degree of risk of injury. Under choice of fund rules to come into effect from 1 July 2008 an employer default fund arrangement must offer a prescribed minimum level of life insurance cover. Typically, employer SG contributions in respect of temporary residents are made to the employer default fund and in many cases the insurance cover is automatic. It may be the only insurance cover the employee has.

However, should the employer SG contributions be paid to the ATO then there will be no insurance cover for those employees.

On the other hand, for many of these temporary residents whose contributions are paid to a default fund, the transfer of their benefits to the ATO generally will result in the automatic closure of their account and termination of the insurance cover.

In summary, the proposed Policy runs counter to existing policy that ensures all members in default fund arrangements should have access to a minimum level of life insurance cover.

Investment earnings

Investment earnings of affected accounts will be significantly diminished. Superannuation fund earnings generally fluctuate in accordance with market conditions. This is to be expected as superannuation is a long term investment. However, where money is transferred to the ATO during or immediately after a period of negative returns, any paper losses will be realised and locked in.

As the ATO will not pay interest on amounts they hold unless the temporary resident becomes a permanent resident, the member's retirement savings will be permanently eroded.

Adverse impacts on the Australian labour market

Australia receives significant benefit from the presence of temporary residents with professional, technical and managerial expertise. On departure from Australia, many of these people have chosen to leave their money in the Australian system until retirement, confident in the stability and strong international reputation of Australia's superannuation system.

The Policy change will force those leaving Australia before age 50 to either withdraw their benefits under the "temporary resident permanently departing Australia" (DASP) condition of release or have the benefits confiscated by the Commonwealth. Withdrawing under the DASP condition of release will see the benefits subject to the 30% withholding tax. In effect, their superannuation contributions and investment earnings will have been taxed at the top marginal tax rate.

In terms of lost members, it is extremely unlikely that people salary sacrificing into super and making voluntary contributions will become lost members other than under the 'inactive member' test. Subjecting these people to the proposed arrangements will not impact on the overall lost member problem.

More importantly, ASFA members providing specialist remuneration packaging and advisory services advise that the proposal will either result in a decrease in the number of employees coming to Australia, or an increase in employment costs for Australian business as the inbound employee seeks higher remuneration to compensate for the policy change.

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Retrospective application

Australian Governments' have a long history of not introducing retrospective taxation. The introduction of capital gains tax is but one example.

Within the superannuation / social security framework, the grand-fathering of existing favourable arrangements has also been a feature of new measures. This principle has been amply demonstrated in the changes to the asset test exemption for superannuation pensions.

ASFA understands that many temporary residents have contributed money to superannuation with the intention of leaving it within the Australian system until they have met a condition of release other than the DASP condition of release. This course of action was planned under current legislation and in many cases with financial advice.

Where these people are forced to withdraw their benefits under the DASP provisions under penalty of forfeiture, the action will result in an imposition of tax that is substantially more than was their original reasonable expectation. In the majority of cases the effective tax rate will exceed their personal income tax rate when employed in Australia.

In the absence of an opportunity for these people to undo their previous actions, the effect of the change is the imposition of a retrospective tax.

Additional costs on APRA regulated superannuation funds

Section 1017B(1A) of the Corporation Act requires a product issuer to notify to a product holder:

- (a) any material change to a matter, or **significant event** that affects a matter, being a matter that would have been required to be specified in a Product Disclosure Statement for the financial product prepared on the day before the change or event occurs.

The material change to the treatment of the superannuation of temporary residents requires notification to all prospective superannuation fund members and all existing fund members who are temporary residents.

The difficulty faced by fund trustees is that they have no knowledge of which members are affected by the proposed Policy.

The result is that unless an APRA regulated fund is absolutely certain that no current members are temporary residents and that going forward no temporary residents will be enrolled in their fund, the trustee has an obligation under the Corporations Act to advise all existing fund members of the change and to amend the fund Product Disclosure Statement to include the change.

It is estimated that the cost to industry of the significant event notification to the holders of the 33 million superannuation accounts, and the amendment of each fund's PDS could approach \$40 million. This is a cost that will be carried by all fund members, not just those directly impacted by the policy.

Funds will also incur costs in meeting the ATO processing requirements. The structure of the proposed administration arrangements with its assessments and transfers and freezing of accounts amongst other things would require substantial systems and other changes. In the first year implementation costs could exceed \$200 million. As well, in the first year there would be a need to process perhaps 500,000 payments from accounts, involving costs of up to \$40 million. There would also be costs in later years. The precise costs would depend on what specific administrative and other requirements were involved.

Generally, costs such as these (i.e. changes driven by new regulatory requirements) are met by the fund membership as a whole not by those at whom the policy is directed. Such costs would substantially detract from the retirement savings of working Australians.

In comparison a large part of the addition to the cash position of the Commonwealth in the Forward Estimates is a taking on of a liability by the Commonwealth for the payment of benefits to departed temporary residents. In terms of accrual accounting, the preferred approach, the net addition to revenues is far less than the quoted \$877 million over the period of the Forward Estimates.

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It will be the broad membership that will be impacted by the cost, not the temporary residents.

The annual transfer of account balances, irrespective of whether there are ongoing contributions, also will result in an increased cost of member benefit protection for funds with temporary residents. Unless these accounts are exempted from the member benefit protection rules, these costs will be borne by the general fund membership. However, it needs to be noted that exempting the accounts from the rules would create its own issues and lead to another set of processing, administration and system development costs to be met by the general fund membership.

Impact on retirement living standards

ASFA has always been supportive of measures that improve retirement outcomes. There is nothing in this Policy that will lead to any such improvements.

The majority of costs incurred by superannuation fund trustees in establishing the required new administration processes will be borne by the broader fund membership. The net result is that this increase in costs for funds will have a negative impact on retirement living standards.

Potential breach of the constitution

Subsection 51(xxxi) of the Australian Constitution grants parliament the power to acquire property on just terms from any person for any purpose in respect of which the Parliament has power to make laws.

The proposed structure of the arrangement is to impose a tax on fund trustees of the equivalent of 100% of a temporary resident's account balance in the fund. The expectation is that the trustee will recover the tax paid from the member's account and the member will retain a property interest in the monies held by the ATO and will be able to reclaim the money on departure from Australia.

(There is a presumption in this that fund trustees have the capacity, under the relevant trust deed, to recover the tax from the member. This may be a false presumption.)

Arguably the proposal to not pay any interest on moneys that are transferred to the ATO and the proposal to confiscate amounts that remain unclaimed five years after the temporary resident has left the country would appear to be a breach of subsection 51(xxxi).

Whilst a typical backpacker may not be interested in mounting a constitutional challenge, there may be others who, on financial advice, have utilised the existing tax treatment of superannuation and may be in such a position and concerned enough to mount a challenge.

Conclusion

In conclusion ASFA questions the need for such a broad policy as proposed. If the issue is truly one of lost members then the accounts targeted should be those of temporary residents who have departed Australia and are reported as lost. (The measure should not target those accounts reported as 'lost' because the account is 'inactive'.)

However, if the measure is primarily a revenue measure then ASFA suggests that a detailed analysis be conducted of the net revenue gain to the Commonwealth and that this be contrasted to the additional costs to industry.

Finally, should the measure proceed, ASFA suggests that it should only apply to new temporary residents and only after they have permanently departed Australia.

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COMMENTS ON THE PROPOSED ADMINISTRATION ARRANGEMENTS

Who is a temporary resident

Should the measure proceed, ASFA would propose that the measure only apply to temporary residents who:

- arrive in Australia from the date of proclamation of the measure; and
- who have permanently departed Australia.

By only targeting those temporary residents who arrive in Australia after the date of Royal Assent, temporary residents could be appropriately informed prior to their contributions being directed to a superannuation fund. This could be done in the first instance by the ATO when issuing the member with a TFN and then followed up by appropriate disclosure in fund product disclosure statements.

In this manner, any additional contributions made by temporary residents would be with full knowledge of the implications flowing from the action. This would be consistent with the Government policy of informed consumers of financial and other services.

ASFA supports the permanent exclusion from the measure of New Zealanders. These temporary residents do not currently have access to the DASP condition of release. For this reason it would be inappropriate to now apply such a harsh measure to them.

ASFA also supports an exemption for those temporary residents who have become permanent residents.

Payments from employers direct to the ATO

ASFA supports the continued application of the SG legislation to temporary residents. Were it to not to apply, employers would look more favourably at employing temporary residents than permanent residents.

In regard to the proposal that employers should have the option of paying temporary residents' SG contributions direct to the ATO, ASFA is concerned that such an option would lead to confusion among employers and payments for non-temporary residents being incorrectly paid to the ATO.

Should contributions be inappropriately paid to the ATO those employees affected would suffer adverse impacts on their retirement incomes and would not have access to life insurance cover through a superannuation fund.

Additionally, there would be associated breaches of the SG requirements by the employers concerned.

A further consequence would be considerable additional processing of contributions where errors had been made, leading to additional costs for employers and funds.

ASFA considers that simplicity of operation should be favoured over employer choice.

This approach is consistent with the Government's proposal for a superannuation contributions clearing house to ease the burden on small employers.

Payments of superannuation balances of temporary residents from funds to ATO

Identification of temporary residents

ASFA considers that the measure should only apply to future temporary residents and then only to benefits remaining unclaimed after departure.

As the ATO will be data matching with the Department of Immigration and Citizenship to identify temporary residents with accounts in superannuation funds (including Retirement Savings Accounts and Approved Deposit Funds) it could use the same process to identify when the temporary resident had left the country.

As an alternative to matching with Immigration and Citizenship records to identify inbound temporary residents, the ATO could identify temporary residents from their TFN application form. This is possible as the reason for seeking a TFN is considered during the application process.

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Amounts to be paid to the ATO

As noted earlier, payment of the entire withdrawal benefit to the ATO may result in the member account being closed and insurance cover ceasing. However, where the member is still employed and the fund is the employer default fund, then any subsequent employer contribution would require the account to be reopened. In processing terms, the member's account would be closed, an exit statement issued and then, on receipt of an employer contribution, a new account opened, a welcome letter and PDS sent to the member and the employer advised of the member account number. These transactions are costly for the fund and would prove confusing for the employer and the fund member!

ASFA suggests that as a cost reduction method, funds be given the capacity, in respect of temporary resident members for which they have received a contribution in the past six months, to retain an amount in the account such that the fund can:

- pay any insurance premiums when they fall due;
- deduct administration fees as they fall due; and
- avoid having to 'member benefit protect' the account.

Payment of balances to the ATO

It is noted that on receipt of a notice from the ATO identifying a person as a temporary resident, the fund will not be able to rollover or transfer any amounts from the temporary resident's account.

ASFA seeks clarification on the situation where the fund has received and is processing a transfer or rollover request at that time. ASFA would anticipate that such processes should be able to run their course.

ASFA considers that the member should still be able to access their benefits under the DASP provisions.

Legal structure of obligations on funds

ASFA notes the intention to structure the obligation on funds to pay amounts to the ATO as a special tax on superannuation funds in respect of their temporary resident members.

This raises the question as to whether specific fund trust deeds give trustees the power to recover the tax from the member's account.

Fund trustees will be under an obligation to review their trust deed and seek an amendment where necessary. This is another cost that will fall on all fund members.

A further legal issue arises with the taxation obligation itself. Under general principles any tax imposed must be certain. This will create an issue for the ATO as the policy requires payment of the withdrawal benefit but the account information held by the ATO will generally only be the member's balance at the previous 30 June.

Should the ATO adopt a self assessment process this raises issues as to how, in the suggested timeframe the trustee can confirm that the member is a temporary resident, provide the member with the opportunity to object to the trustee/ATO tax determination and pay any tax liability by the due date.

The situation will be further complicated if the member has not provided their TFN to the fund. The legislation will need to recognise the fund trustee's entitlement to withhold part of the benefit to meet their no-TFN tax liability as at the following 30 June.

Payments from ATO to temporary residents

Process for making claims

ASFA supports affected individuals being required to claim their benefit payment from the ATO.

ASFA would not support a process whereby the temporary residents were required to seek the payment of benefits transferred to the ATO through the superannuation fund that transferred the money.

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On permanent departure

The proposed claim processes are similar to the current DASP claim process which appear to be working effectively.

ASFA considers that the proposed forfeiture of amounts not claimed within five years would be appropriate only where the possibility of such an outcome was properly advised to the member. For this reason ASFA considers that the proposed measure should only operate prospectively.

It is noted that no interest will be payable on amounts held by the ATO and that existing DASP withholding provisions will apply. While this may be appropriate going forward in respect of people given due notice, this is not equitable in respect of persons who have made additional contributions under existing arrangements.

On meeting any other condition of release

ASFA notes the Government is considering the ongoing appropriateness of allowing temporary residents to claim their superannuation under general conditions of release while they remain a temporary resident, and the appropriateness of applying general concessional taxation treatment to such payment to temporary residents instead of applying the DASP withholding arrangements.

ASFA has not as yet formed a view on these matters.

However, such a change would, in respect of amounts currently within the system, represent the retrospective imposition of taxation.

ASFA does not support the retrospective imposition of taxation as it would undermine confidence in the superannuation system and negatively impact on the willingness of people to place additional, voluntary, contributions into superannuation.

Further, there necessarily would be practical difficulties and inequities in attempting to impose such higher rates of taxation benefits. For instance, temporary residents aged 60 and over would generally be able to take benefits tax free, prior to departure given that funds would not necessarily know that they were temporary residents. This could expose fund trustees to action under taxation laws.

Lump sum payments only

ASFA supports the proposal that the ATO only make lump sum payments or transfers to funds and only pay the whole entitlement in a single payment.

Payments from funds to temporary residents

ASFA supports the proposal to permit funds to make payments direct to temporary residents if they apply to the fund and meet the relevant eligibility criteria.

On permanent departure

ASFA supports the retention of the existing requirements applying to departing Australia superannuation payments and the retention of the existing taxation arrangements for departing Australia superannuation payments.

Other issues

Insurance

ASFA is concerned that temporary residents would frequently lose their insurance cover through the annual account balance transfer requirement. This would have severe consequences for temporary residents who become disabled, and for the dependants of temporary residents who die.

Affected members also would need to regularly monitor their insurance coverage, a situation not imposed on other fund members and, in ASFA's view, an unnecessary complication within the superannuation system.

For fund trustees, who are required to act in the best interests of members, the duty to monitor the impact of compulsory transfers to the ATO imposes an unwanted, and in ASFA's view an unnecessary, burden, the cost of which will be borne by the broader fund membership.

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Choice of fund

ASFA considers that for choice of fund purposes, temporary residents should be treated the same as other employees.

ASFA is of the view that it is simpler for an employer to apply a standard set of rules to all employees than to differentiate between various classes of employees.

Fees and charges

ASFA considers that where a superannuation fund incurs additional costs that can be directly attributable to a temporary resident member under this measure the fund should be able to recover those costs directly from the member.

Funded defined benefit funds

If the proposal is to proceed, ASFA supports the proposed arrangements for defined benefit funds. However, the legislation should make it clear as to whether the policy applies to defined benefit funds per se, or only defined benefit interests. Clarification is also required where a member has both an accumulation and defined benefit interest in the one fund and also where the defined benefit is all or in part based on the accumulation component.

Applying the measure to unfunded public sector defined benefit schemes is at best likely to be problematic.

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