SUBMISSION

Submission to Treasury — Miscellaneous amendments to Treasury portfolio laws 2020

17 November 2020

The Association of Superannuation Funds of Australia Limited
Level 11, 77 Castlereagh Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T +61 2 9264 9300
1800 812 798 (outside Sydney)
F 1300 926 484
W www.superannuation.asn.au

ABN 29 002 786 290 CAN 002 786 290

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Law Design Office

Treasury

Langton Crescent

Parkes ACT 2600

Via email: miscamendments@treasury.gov.au

17 November 2020

Dear Sir/Madam

Miscellaneous amendments to Treasury portfolio laws 2020

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the package of proposed miscellaneous amendments to Treasury portfolio laws released on 21 October 2020. The package comprises the exposure draft:

- inserts for Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Minor and Technical Amendments (the draft Bill)
- *Treasury Laws Amendment (Miscellaneous and Technical Amendments) Regulations 2020* (the draft Regulations)
- *Treasury Laws Amendment (Miscellaneous Amendments) Instrument 2020* (the draft Instrument).

ASFA's submission addresses aspects of the draft Bill and draft Regulations; we have no comments in relation to the draft Instrument.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.7 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16 million Australians with superannuation.

General comments in relation to the consultation package

As noted in the introductory material accompanying the release of the consultation package, the amendments seek to ensure the Treasury portfolio laws operate as intended by correcting technical or drafting defects, removing anomalies and addressing unintended outcomes.

Many of the proposed amendments address issues ASFA has highlighted in our previous advocacy, particularly in relation to the introduction of MySuper product rules, the Protecting Your Superannuation/Putting Members' Interests First reforms, and recommendations to remove impediments to mergers of superannuation funds.

ASFA supports the majority of the proposed amendments.

However, as outlined in our submission:

- we are concerned that two of the proposed amendments to the *Income Tax Assessment Act 1997* may have potentially significant adverse implications for superannuation funds and, therefore, their members
- we consider there is scope in some cases to broaden the amendments to provide greater clarification and/or relief.

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If you have any queries or comments in relation to the content of our submission, please contact Julia Stannard on (03) 9225 4027or by email jstannard@superannuation.asn.au.

Yours sincerely

Glen McCrea

Deputy Chief Executive Officer and Chief Policy Officer

1. Comments in relation to aspects of the draft Bill

1.1. Amendments to the *Superannuation Guarantee (Administration) Act 1992*

ASFA supports efforts to clarify and/or simplify the superannuation guarantee (SG) legislation where these do not involve any reduction in the benefits received by employees.

Items 62–64 propose to clearly exclude from the 'ordinary time earnings' (OTE) on which SG is calculated any 'salary or wages' excluded by sections 27 or 28 of the *Superannuation Guarantee (Administration) Act 1992*. While this is a positive development, we note that the amendment is narrow in its focus and suggest that consideration could be given to providing broader clarification about 'salary or wage' and fringe benefits amounts that are excluded from OTE.

Recommendation
Exclusions from ordinary time earnings ASFA recommends that consideration be given to reframing the proposed amendments to provide broader clarification about amounts that are excluded from ordinary time earnings.

1.2. Amendments to the *Superannuation Industry (Supervision) Act 1993*

1.2.1. MySuper charging rules

ASFA welcomes the amendments in items 65–69 to the MySuper charging rules in sub-section 29VA(9) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). The amendments will allow the trustee of a fund that offers a lifecycle MySuper product to charge more than four differentiated investments fees with respect to the members in different lifecycle stages.

In our submissions to the Treasury and the Parliamentary Joint Committee on Corporations and Financial Services[1] on the *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011*, ASFA advocated for the legislation to allow a trustee to be able to recover a different quantum of investment fees with respect to each lifecycle stage/portfolio, based on the actual investment expenses incurred with respect to that lifecycle stage.

ASFA advocated that it was important that members within the same cohort, invested in the same portfolio, should have the same investment fee. Lifecycle strategy investment costs can vary significantly from stage to stage and so, in order to give effect to the policy of minimising the extent to which cross subsidisation occurs, we submitted that the legislation should allow the trustee to charge a different investment fee in each lifecycle stage.

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[1] *ASFA, Submission to Treasury - Exposure Draft Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011*, 18 October 2011; ASFA, Submission to the Parliamentary Joint Committee on Corporations & Financial Services - Inquiry into *Superannuation Legislation (MySuper Core Provisions) Bill 2011*, 22 January 2012

Compelling trustees to categorise each lifecycle stage into one of up to four cohorts, which would then be charged the same investment fee, resulted in members in some stages cross-subsidising members in other stages. Given that one of the overarching principles of MySuper was that investment fees should be borne by members on a 'cost recovery' basis, this was an anomalous outcome, and we support the amendment to remove it.

Further to this, we submit that the draft Bill should also amend sub-sections 29VA(5) and (6) of the SIS Act to permit buy-sell spreads, as they relate to investment transaction activity in a lifecycle product, also to be charged on a fair and reasonable basis, as opposed to the current requirement that they be the same for each member. This would be in keeping with the policy intent of the proposed amendments and the requirement to stream gains and losses to MySuper members on a fair and reasonable basis.

Sub-section 29V(4) of the SIS Act defines a buy-sell spread as 'a fee to recover transaction costs *incurred by the trustee'* [emphasis added]. The ability to charge buy-sell spreads permits a trustee to pass on the costs of acquiring and disposing of assets to the members who have transacted, as opposed to being passed on to all members, and therefore is a more equitable and transparent mechanism.

Given the current drafting of sub-sections 29VA(5) and (6) it is not possible to achieve a fair and reasonable attribution of investment-related costs as there are different asset allocations in each subclass and so the investment-related costs will vary from subclass to subclass. In our view, to enable the policy intent of the proposed amendments to be fully achieved, the charging of buy-sell spreads should follow the proposed amendments to the charging of investment fees and allow buy sell spreads to be charged on a subclass by subclass basis.

Recommendation
MySuper charging rules
ASFA welcomes allowing different investment fees for each lifecycle stage and recommends that sub-sections 29VA(5) and (6) be amended to extend this to buy-sell spreads**.**

1.2.2. Impact of successor fund transfer on insurance elections

ASFA welcomes the amendments in items 70–73 that implement the successor fund transfer (SFT) measures outlined in the APRA guidance for Putting Members' Interests First (PMIF) implementation.

We understand that the amendments will not only ensure that member elections to maintain insurance will be respected in the event of a SFT they will also ensure that insurance maintained under the Protecting Your Super (PYS) and PMIF transitional arrangements will also be protected.

Specifically, this means that insurance will be maintained through a SFT:

- for any member who has made an election under PYS between 1 July 2019 and the proposed start date for these measures (the day after Royal Assent); or
- where insurance was maintained under the PMIF transitional arrangements (those under age 25 as of 1 April 2020 and those who have had an account balance higher than $6,000 at some point after 1 November 2019 but which may have subsequently fallen below $6,000).

1.3. Amendments to the *Superannuation (Unclaimed Money and Lost Members) Act 1999*

ASFA welcomes the amendment in item 75 which clarifies that an account in which the member has elected to maintain insurance, including where the member is under age 25, should be exempt from the 'inactive low balance account' definition.

1.4. Amendments to the *Income Tax Assessment Act 1997*

1.4.1. Extension of the non-arm's length income rules

ASFA is concerned that the amendments proposed by items 93–95, which will extend the operation of the non-arm's length income (NALI) rules, may have an adverse impact on SFTs.

Ordinary income and statutory income of a complying superannuation fund earned from segregated current pension assets is tax exempt under section 295-385, except where it is taxable at 47% as NALI under section 295-550.

Capital gains made by a complying superannuation fund from the disposal of those segregated current pension assets are disregarded under section 118-320 and are therefore tax exempt. However, as noted in the draft explanatory memorandum[2], due to an unintended legislative drafting oversight, there is currently no exception to this tax-free status for non-arm's length capital gains. Items 93-95 of the draft Bill proposed an amendment to section 118-320 to introduce that exception, so that non-arm's length capital gains will be taxable at 47% (in alignment with the treatment for ordinary income and statutory income).

ASFA is generally supportive of amendments to overcome unintended tax outcomes. However, in this instance we are concerned that — in its current form — the proposed amendment has the potential to create other unintended and adverse tax consequences.

Specifically, ASFA is concerned that the proposed amendment will have an adverse impact on some rollovers of assets undertaken, utilising Division 310, as part of superannuation fund mergers. This would apply to rollovers both future and past (to the extent that assets received by the continuing fund are still held), thereby in effect causing a retrospective tax liability.

These adverse tax outcomes may arise if the amendment is made in its current form because, under a Division 310 rollover, the successor fund inherits the cost base for the assets received from the closing (predecessor) fund. Often that inherited cost base will be lower than the market value of the assets acquired, and the member benefit liabilities assumed, from the closing fund. The result is that later (perhaps years later) when the successor fund sells those segregated current pension assets that have an inherited cost base, it will make larger capital gains and consequently a larger net capital gain (that is, statutory income) than if it had bought the same assets on-market at the time of the merger. The legislation currently does not prevent application of the capital gains tax (CGT) exemption in section 118-320 in that circumstance. There is, in ASFA's view, no mischief in funds applying the legislation in that manner. The proposed amendment will potentially deny that CGT exemption.

In the above circumstances where assets are rolled-over under a fund merger pursuant to Division 310, ASFA submits that section 295-550 should clearly not apply, as trustees acting in accordance with their fiduciary and statutory obligations (including members' best interests requirements) should never deal on a non-arm's length basis.

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[2] Paragraphs 1.98 and 1.99

However, the proposed amendments, along with the recent extension of section 295-550 to non-arm's length expenditure and subsequent pronouncements from the Australian Taxation Office (ATO), have created uncertainty for large APRA regulated superannuation funds. Even though the risk of section 295-550 applying might be low (if not remote), the consequences could be significant to the fund and its members.

The purpose of section 295-550 and the mischief it is directed toward is, broadly "…to prevent income from being unduly diverted into superannuation entities as a means of sheltering that income from the normal rates of tax applying to other entities…"[3]

Given the extensive prudential regulation imposed on trustees of large APRA-regulated funds, there is in ASFA's view little scope for the meaningful application of the NALI rules to such funds. In light of this, ASFA is of the view that large APRA-regulated superannuation funds should be entirely excluded from the operation of section 295-550. At the very least, in the context of the proposed amendments, section 295-550 could be amended to include clear wording to the effect that circumstances involving tax loss transfer and asset roll-over relief under Division 310 do not, of themselves, cause any increased amounts of ordinary or statutory income to be NALI.

The tax risks associated with the proposed amendment could impact all the segregated current pension assets included as part of a Division 310 rollover and are potentially significant, given the large scale of fund merger transactions.

The risk is particularly acute where the merger is between superannuation funds that have the same trustee. Due to having a single legal identity, this trustee is effectively dealing with itself in performing the merger. The risk would also be heightened where the trustees are related corporations within a wealth management company group.

In both cases, again, ASFA submits that there should not be any non-arm's length dealing between parties, however given the subjective nature of section 295-550 there remains a risk that the ATO might take a contrary view. Depending on the circumstances, this could have a significant adverse impact on the tax outcomes for the successor fund[4].

ASFA considers there is a risk that the CGT impacts and risks associated with the amendment in its current form may act as an impediment to fund mergers, potentially frustrating efforts to achieve or enhance scale efficiency and maximise Australians' retirement outcomes through fund rationalisation.

ASFA is accordingly of the view that the application of the pension tax exemption for capital gains should be explicitly preserved for assets acquired under Division 310 rollover.

Whilst the proposed amendment specifically affects only segregated superannuation funds, the issues discussed above in terms of the impact of section 295-550 in a successor fund context and more broadly are also relevant to unsegregated superannuation funds.

Accordingly, ASFA considers there is a need for certainty by way of an exclusion from section 295-550 for all large APRA-regulated superannuation funds in the context of SFTs, if not a complete exclusion.

[3] Explanatory Memorandum to the *Superannuation Legislation Amendment Bill (No.2) 1999*, paragraph 2.13

[4] For example, as outlined in Draft Law Companion Ruling LCR 2019/D3, paragraph 18 and Example 2 (albeit in different circumstances)

Recommendation

Non-arm's length income rules – potential impact on successor fund transfers

ASFA recommends that the amendments proposed by items 93–95 are revised to ensure there is no adverse impact on successor fund transfers involving large APRA-regulated funds.

1.4.2. Change to deductibility of temporary incapacity insurance benefits paid from a superannuation fund

ASFA notes that there is not currently a universal view or practice in relation to the taxation treatment, within a complying superannuation fund, of periodic temporary incapacity insurance receipts from policies owned by the fund that are on-paid to sick and injured members.

There are currently two approaches that may be adopted:

- the receipt is treated as not assessable and the on-payment is treated as non-deductible; or
- the receipt is treated as assessable and the on-payment is treated as deductible.

Both approaches effectively achieve tax neutrality for the fund and the tax outcome is largely the same.

Item 97 proposes an amendment to section 295-495 that will have the effect of denying a tax deduction for the on-payment of benefits, without providing certainty as to the tax status of the receipt by the fund.

ASFA does not support the proposed amendment in its current form. We submit that the proposed amendment should be revised to provide corresponding certainty that the insurance receipts are non-assessable to the fund.

Further, we note that the amendment is proposed to have retrospective operation, back to 1 July 2007.

Given the proposed amendment effectively amounts to the removal of what has, before now, been an acceptable method of treating temporary incapacity insurance receipts and on-payments, we are strongly of the view it should it should operate on a *prospective* basis only.

Recommendation

Deductibility of temporary incapacity insurance benefits paid from a superannuation fund

ASFA recommends that the amendment proposed by item 97 should:

- be revised to provide corresponding certainty that the insurance receipts received by a superannuation fund are non-assessable to the fund
- apply on a prospective basis only.

1.4.3. Recovery of No-TFN contributions tax paid by predecessor fund

ASFA welcomes the amendments by items 98–99 to allow a successor fund to claim the no-TFN contributions tax offset in respect of no-contributions tax paid by a predecessor fund, provided eligibility conditions are satisfied, and the equivalent amendments in relation to SFTs involving retirement savings accounts.

Given the level of rationalisation occurring within the industry currently, with the encouragement of the Government and the regulators, it is important to ensure that the legislative framework does not impede fund mergers or impose adverse impacts on the merged fund and/or its members.

The current inability of a successor fund to recoup the no-TFN contributions tax paid by a predecessor fund is a matter that ASFA has highlighted previously and we strongly support the proposed amendments.

2. Comments in relation to aspects of the draft Regulations

2.1. Amendments to the *Retirement Savings Accounts Regulations 1997* and the *Superannuation Industry (Supervision) Regulations 1994*

ASFA supports the amendments in items 64–66 and 70 that will retrospectively confirm the entitlement of New Zealand permanent residents to access their superannuation under the Coronavirus early release initiative. The amendments rectify an oversight in the drafting of the provisions introducing the early release initiative and provide welcome confirmation of the status of New Zealand permanent residents under that initiative.

We understand that the amendments reflect the original policy intent and, given they are consistent with the manner in which the ATO has administered the initiative since its commencement, we do not have any concerns regarding their retrospective application.