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Superannuation Tax Reform
Retirement Income Policy Division
The Treasury
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Dear Sir/Madam

Superannuation Reform Package: Tranche 2

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission on tranche 2 of the superannuation reforms, announced in the 2016-17 Budget, as reflected in the following exposure draft legislation released on 27 September 2016:

- *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* (the ED Bill);
- *Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016* (the ED Imposition Bill);
- *Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulation 2016* (the ED Regulations).

We would welcome the opportunity to discuss our submission with Treasury, and potentially with the Australian Taxation Office (ATO), to ensure we have a common understanding as to the roles and responsibilities of superannuation funds and the ATO with respect to the implementation and administration of these new measures.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14 million Australians with superannuation. ASFA has also established a specific sub-group - ASP services – whose function is to identify, develop and implement operational efficiency improvements for the administration of superannuation funds and their members.

1. General observations

1.1. Start date

The proposed implementation timetable is possible to achieve for many of the measures, as they represent amendments to existing rates or caps, where information technology infrastructure and processes have been built but now need to be modified.

There are two measures, however, that are not based on existing settings - the changes to Transition to Retirement Income Streams (TRIS) and the new transfer balance cap – which will pose a considerable challenge to be implemented in time for a 1 July 2017 commencement date.

The superannuation industry needs, as a minimum, a 12-month lead time from the time that legislative requirements have been finalised to settle the administrative design, determine the information technology specifications, and build and test system changes. A shorter period introduces significant risk and imposes additional, unnecessary cost.

There are a number of extensive and complex regulatory reforms scheduled for commencement over the coming 12 months, including changes to SuperStream and fee and cost disclosure. Accordingly, project resourcing capacity is extremely limited and there are finite windows for system releases.

Funds have indicated that there is little likelihood of their being able to meet the commencement date of 1 July 2017 with respect to the changes to TRIS and the transfer balance cap as currently drafted.

With respect to the changes to TRIS, a number of funds have indicated that it will take them up to 18 to 24 months to build the new tax engine that will be required to implement this measure. The alternative - to close their existing products - would take at least nine months to complete.

Implementation of the transfer balance cap is dependent on the development and delivery of ATO mechanisms/services. The ATO and the superannuation industry are developing and building a new service - the Member Information Exchange (MIX) service – that would be ideal to support the implementation of the transfer balance cap. The MiX is not scheduled to be completed until the end of 2017. If the 1 July 2017 commencement date is adhered to this will require the ATO and the superannuation industry to design and build interim solutions, which introduces additional risk and unnecessary cost to the ATO and industry.

1.1.1.Need for urgent industry roundtable re TRIS

Given that funds have indicated that there is little likelihood of their being able to meet the commencement date of 1 July 2017 with respect to the changes to TRIS we recommend that **an industry roundtable be convened as a matter of urgency** to workshop potential solutions. While we appreciate the difficulties associated with deferring revenue measures, this may need to include consideration of **the possibility of deferring the commencement of the TRIS measure until 1 July 2018.**

1.1.2.Possible alternatives approaches to TRIS

Given the considerable difficulties in implementing the proposed measures by 1 July 2017 as drafted, we recommend that consideration be given to **possible alternative approaches** to the TRIS and transfer balance cap measures.

TRIS measure

Two possible alternatives approaches to the TRIS that could be considered would be that

- the 15% tax offset for income paid to the member from a TRIS could be reduced for members under 60. **This change is significantly simpler for funds and would dramatically decrease implementation costs**.
- the measure could be applied prospectively, which would enable funds to close their existing TRSs to new members and either not offer a TRIS to members after 1 July 2017 or to offer a new, complying TRIS from a later date, once it has been built.

These are just two possible alternative options but others may be revealed at the industry roundtable.

1.1.3.Transfer Balance Cap measure

Funds are concerned that, if there are reporting delays by funds (especially in circumstances where a member has multiple pension accounts or where a fund has difficulty segregating the assets and calculating the earnings tax) a member will be unfairly penalised through an unintended breach of the new requirements. **Accordingly our recommendation is to provide a transitional period for members and funds by providing a 12 month amnesty on the proposed penalty provisions, including the excess balance transfer tax (on the notional earnings on the excess amount)**. This will allow members and the industry an adequate period during which to transition to the new regime and system development to be completed.

If a roundtable is held with respect to the TRIS measures this could include a discussion as to how the amnesty on penalties may work.

1.2. Role of the ATO and a 'whole of industry' roadmap

The role of the ATO will be critical in the successful implementation of these measures in an effective manner.

The superannuation industry and the ATO already have a large change agenda scheduled for the coming 12 months as part of the ongoing SuperStream program as well as the introduction of Single Touch Payroll (STP). Implementation of this measures will be affected by, and affect, the scheduled SuperStream and STP changes.

Previously the ATO has developed a roadmap with respect to SuperStream implementation, which has proven to be a valuable resource. It would be useful if the ATO were to develop a roadmap with respect to these measures as well. Given the degree of interaction between these measures and SuperStream it would be valuable to overlay the measures roadmap with the SuperStream one, to assist in identifying dependencies on the critical path.

1.3. Defined benefit funds

Defined benefit funds have a number of specific implementation issues that will need to be addressed. We would strongly support the establishment of a defined benefit working group as a matter of urgency to progress these issues and would welcome the opportunity to work with Treasury and the ATO to help resolve them.

2. Specific measures

2.1. Transfer Balance Cap

Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 – Schedule 1

As stated above, funds are questioning whether a 1 July 2017 start date is possible. In particular, the ATO would need to issue the supporting specifications for the data reporting standards, which would then need to be built and tested by superannuation funds.

2.1.1.Proposed commutation authorities

Funds have identified the following concerns with the proposed commutation authority:

- *30-day timeframe:* Given funds will be required to make contact with and consult the member to seek their instructions*,* the proposed 30 day timeframe for trustees to comply with a 'commutation authority' from the ATO may not be sufficient. Accordingly, a timeframe of 60 days would be a more appropriate time period to consult with the member and, if the member has proven to be uncontactable, for the fund to determine what would be in the best interests of the member.

- *Inability to commute:* There may be circumstances where a fund could be prevented from being able either to partially or fully commute the excess transfer balance at the time of receiving the authority. By way of example, during the global financial crisis there were underlying managed funds that imposed a freeze on redemption requests (but would still pay income). In addition, a fund may be invested in term deposits and other securities that, if redeemed before maturity, may incur significant additional costs. It would not be in the best interests of members if such an investment had to be partially redeemed in order to comply with a commutation authority in respect of a particular member. Accordingly, we recommend that the ED Bill should recognise circumstances where commutation may be impossible or not in the best interests of members, beyond the control of the member and/or the superannuation income stream provider.

- *Income & realised gains:* The ED Bill as currently drafted deems the income stream to not be in the retirement phase from the beginning of the financial year, irrespective of when it was that the commutation authority was not complied with. This is inconsistent with the tax treatment of the excess transfer balance, where notional earnings only begin accruing from the day the member has exceeded their transfer balance cap. A daily split or allocation is considered to produce the most equitable outcome as a member may not have been, or remain, in the same investment option for the whole income year. In many funds members own units in an investment option. Typically, the unit price will fluctuate reflecting both income and capital growth/loss. The split between realised and unrealised income and gains ordinarily is not determined or made available on a daily basis in relation to pension tax-exempt investment options. Accordingly, we recommend that under this proposed measure only income and realised gains should be subject to tax.

- *Excess commutation:* Currently under the ED Bill as drafted those who breach the cap by less than $100,000 will have 60 days to commute the excess to avoid a 15% tax on notional earnings on the excess. Funds are concerned that, if there are reporting delays by funds, a member will be unfairly penalised through an unintended breach of the new requirements. Accordingly, as per above, our recommendation is to provide a transitional period for members and funds by providing a 12 month amnesty on the proposed penalty provisions, to allow members and the industry an adequate period of time to transition to the new regime.

- *Minimum pension requirements*: Members have sought confirmation that partial commutations that are cashed out will be counted towards the minimum pension requirements of account-based pensions.

2.1.2.Defined benefit funds

2.1.2.1. Valuing all DB pensions at 16 times the annual payment amount

Valuing all pensions at 16 times the annual payment amount is simply inequitable for those in receipt of a pension at 30 June 2017 who are at an advanced age. By way of example, a member in receipt of a pension may be 80 years of age - life expectancy tables would value the pension at approximately 7 times – valuing the pension at 16 times the annual pension amount is grossly inequitable. This is inconsistent with how an account-based pension will be valued. By way of contrast, a member may have started an account-based pension of $1.6 million ten years ago. The value of the account would have diminished significantly during that period, with only this diminished value counting towards the cap as at 30 June 2017 (as opposed to the full value of the account based pension when it commenced 10 years previously). Valuing at 16 times the annual payment amount is manifestly inequitable between members of different ages - the value of a pension at, say, age 55 is significantly more than a pension at age 65 or 70.

In trying to achieve simplicity this has produced an inequitable outcome. One possibility may be to value the pension utilising the same method as is used in the tax component proportioning rules. Alternatively, a specific sliding scale of different valuation factors could be determined with respect to different ages.

2.1.2.2. How are DB pensions that commence before age 60 to be treated?

It is unclear how defined benefit pensions that commence before age 60 are to be treated. The provision in the ED Bill that are with respect to the alternative treatment of defined benefit pensions simply refer to sections in the tax act with respect pensions where the recipient (or primary beneficiary with reversionary pensions) is over the age of 60. A pension of the same value commencing before age 60 would be valued higher than one commencing at age 60 but it appears as though there is no effect on these pensions and they are able to remain in the retirement phase, with the benefit tax remaining the same as it is now (marginal rates less 15% tax offset).

2.1.2.3. Payment summaries and withholding tax

For defined benefit income streams there will be new requirements to

- issue payment summaries to all recipients who have reached the age of 60; and
- withhold tax on income stream benefits that are over $100,000 per annum.

These are significant changes. In particular, it will prove difficult to implement new withholding arrangements by 1 July 2017.

2.1.3.Other issues with the transfer balance cap

In ASFA's view indexation should be linked to AWOTE as opposed to CPI, in line with like all other superannuation thresholds.

Finally we note that, in circumstances such as the diminution in the value of members' remaining pension assets as a result of a significant market downturn (such as the global financial crisis) there may be a need to consider a temporary amendment of the legislation to allow 'top-up' contributions to be made.

2.2. CGT Cost base relief for TRIS & Transfer Balance Cap
Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 – Schedule 1, Part 3

ASFA supports the reset of the Capital Gains Tax (CGT) cost basis, as this will serve to ensure that there is no detrimental market effect on members who will need to have part of their account balance switched to cash prior to it being transferred back to accumulation.

Funds have indicated, however, that there will be difficulties with the relief expiring after a period of 10 years, as the majority of funds have not retained records of the historical cost base of the asserts supporting an income stream.

2.3. Concessional superannuation contributions
Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 – Schedule 2

As a matter of policy, we believe this is too low, especially with respect to those who are approaching retirement. These members should be able to contribute at a higher rate.

Our funds have not identified any issues with implementation, however, we note that it is likely to lead to an increase in the volume of cap breaches and, accordingly, excess concessional contributions release authorities. As this largely is a manual process this will serve to increase the administrative costs for superannuation funds.

2.4. Division 293 tax
Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 - Schedule 2

ASFA supports the proposed implementation mechanism.

2.5. Catch-up concessional contributions
Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 - Schedule 6

ASFA strongly supports the underlying policy intent of this measure.

There will be complexity in determining the value of defined benefit interests for the purposes of the $500,000 balance, which may cause the trustee of such funds to incur substantial additional costs.

2.6. Tax exemption extended to earnings of DLAs and group self-annuitisation products

Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 - Schedule 8

The opening paragraphs of Chapter 8 of the Explanatory Memorandum explains that the aim of this reform is to remove tax barriers to the development of innovative income stream products, by extending the earnings tax exemption to 'new lifetime products such as deferred annuities and group self annuities. ASFA is supportive of the removal of tax barriers to the development of innovative income stream products, in particular the extension of the earnings tax exemption to new lifetime products such as deferred products and group self-annuities.

Having said that, our funds believe that the amendments could go further to promote the development of income stream products, in that the proposed legislation may serve to unduly restrict the availability of income stream products.

Firstly, with respect to the definition of group self annuity products, paragraph 307-380 of the ED Bill does not appear to be sufficiently expansive to meet this stated aim.

In particular, this paragraph defines a superannuation income stream as being in the retirement phase if it is a deferred superannuation income stream. This appears effectively to render group self-annuities to be a sub-set of deferred superannuation income streams, which could prove to be limiting. We note that 'deferred superannuation income stream' is yet to be defined in the regulations.

Accordingly, there is a need to clarify the position and definition of group self annuities products.

Secondly, our funds have raised a concern with the definition of an annuity in the context of a disaggregated product. It appears as though the proposed amendments to section 320 - 246 in the ED Bill do not have the effect of providing an exemption - at the level of a life insurance company - in respect of disaggregated annuity products. These are products where the investment pooling component resides with a superannuation fund, while the longevity pooling components is with a life insurance company.

If this remains in place the investment earnings in respect of assets backing these products in the life company would not be tax exempt. This would cause the funding of such a product to become more expensive and therefore less attractive to members, thereby rendering the provision of such income stream products potentially unfeasible.

Finally, there is an issue with respect to the deferral period prior to the satisfaction of a condition of release.

We envisage that both annuity and deferred annuity products will be purchased prior to retirement age. It appears as though the proposed amendments as set out in the ED Bill would operate to treat a product as not being a complying superannuation liability at the life insurance company level until such time as one of the conditions of release with a nil cashing restrictions is met.

As per above, the inability of the life insurance company to treat deferred income stream products as a complying superannuation liability would make the funding of such products more expensive for the life insurance company, and therefore will act as a disincentive for members to start contributing towards deferred annuity products prior to their retirement age. This may hinder life insurers and superannuation funds in trying to develop effective income stream products and may render the provision of such products potentially unviable.

2.7. Removal of tax exemption on earnings of Transition to Retirement Income Streams

Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 - Schedule 8

Some funds have expressed considerable concern about their ability to implement the proposed measure by 1 July 2017 and the cost and risk involved.

This measure presents a fundamental shift in the way in which pension products have been built and currently operate. In particular, current registry systems, fund accounting and tax return processes have not been developed to manage an earnings tax on an individual's pension assets.

Accordingly, funds have indicated to us that they believe it will take them between 18 and 24 months to build a tax engine to be able to administer this. Alternatively, it will take funds nine months to close existing accounts.

From an administrative perspective, this one will be complex and time consuming to implement. Funds will have to segregate their TRIS members from other members receiving income streams and this will necessitate significant system changes. Funds will need to restructure their TRIS arrangements with respect to their underlying assets and rebuild their tax engine.

Superannuation funds and other entities will need to

- make considerable investment in changes to IT systems; processes and procedures, disclosure material and training to reflect the proposed changes;
- update web based calculators, and if used, retirement income projections on statements; and
- provide more financial advice and information to members.

Funds would be required to build systems to track earnings in the fund against each member and to tax each investment option at 15%:

- TRIS members frequently have more than one investment option so funds would need to aggregate total earnings across investment options;
- given the number of affected products and investment options this is a complex, complicated operational build for funds;

For many funds tax is attributed into the unit price and there is segregation of accumulation and pension members. In order to apply the earnings tax to TRIS members, funds will be required to create a new subset of TRIS members and new, standalone, TRIS investment options. Along with the considerable project and operational expenses required, the categorisation of new products and members presents a number of operational risks that will need to be managed. Given the complexity of this change, we expect this process could take up to 18 months to undertake.

This will also lead to increased custodial costs as a whole new suite of investment options will need to be created due to the differing tax treatment.

Further, the implementation of the CGT cost base relief will necessitate the determination and retention of market values of affected assets.

There will also need to be changes made to ATO reporting. Currently TRIS member are reported as pension members but, as their account balance will not count towards the transfer balance cap, this will need to be changed in future reporting.

Excessive costs

One large fund has estimated that this measure alone will account for approximately two-thirds of their total compliance costs for the entire package.

Another large fund has indicated that its high level costing are that this measure, as currently drafted, will cost between three and five million dollars to implement.

Another large fund has indicated that, should the draft TRIS changes be legislated, a conservative estimate of their implementation costs is a minimum of $2 million. From an overall fund perspective, the cost of implementing the TRIS reforms is disproportionate to the number of members who have a TRIS in place.

Alternative approaches

As outlined above, we recommend that consideration be given to adopting an alternative approach to the TRIS measure.

Conditions of release

The TRIS reforms, especially if they result in the closure of TRIS products, may be likely to cause members to access funds from other sources or increase debt, such as through extending their mortgages. Consideration should be given to create e new condition of release to allow members who have reached their preservation age to withdraw an amount from their accumulation account.

2.8. Anti-detriment provisions
Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 - Schedule 2

ASFA supports the proposed implementation mechanism.

A number of defined benefits have the anti-detriment provisions coded into their benefit design within their information technology systems. As a result, for these funds the effort to remove the effect of the anti-detriment provisions will be substantial and will take time and incur considerable implementation costs.

One issue may be the retention of equitable treatment between members of public sector and private sector funds. One possibility to redress this may be to increase the taxation on death benefits paid out of public sector funds.

2.9. Administration
Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 – Part 1 of Schedule 10

We support the plans to streamline and automate the release authority processes and would welcome the opportunity to participate in any consultation with respect to this measure.

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Should you have any queries with respect to this submission, please do not hesitate to contact me on (03) 9225 – 4021, 0431 490 240 or via fgalbraith@superannuation.asn.au.

Yours faithfully

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