

SUBMISSION

Submission to Treasury — Minor superannuation tax reform technical amendments

27 March 2019

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Retirement Income Policy Division
The Treasury
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Lodged via email: superannuation@treasury.gov.au

27 March 2019

Dear Sir/Madam

Minor superannuation tax reform technical amendments

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to Treasury's consultation package on minor superannuation tax reform technical amendments, released on 27 February 2019.

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 over 90 per cent of the 15.6 million Australians with superannuation.

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

Yours sincerely

Glen McCrea
Deputy CEO and Chief Policy Officer

1. General comments

ASFA welcomes the proposed amendments, which address a number of issues identified in relation to the taxation treatment of superannuation death benefits, market-linked pensions, defined benefit pensions and innovative income stream products.

In this submission, we wish to focus on one specific aspect of the consultation package, relating to the rollover of superannuation death benefits.

We note that the situation addressed by the proposed amendment — involving the rollover of a superannuation death benefit in order to commence an income stream from a new fund — is likely to arise relatively infrequently. ASFA agrees that it is appropriate to address the potential tax advantage that arises currently in these situations. However, we consider it important that funds are able to adopt an administrative approach that balances the cost and increased administrative complexity of the amendment against the likely low volume of death benefit rollovers anticipated to be received.

In addition, we wish to highlight a need for additional guidance to industry to:

- ensure correct and consistent processing of death benefit rollovers
- address the implications for funds' reporting of rollovers
- clarify the treatment of death benefit rollovers completed between 1 July 2017 and the date the proposed amendment becomes law.

2. Specific comments in relation to death benefit rollovers

2.1 The issue to be addressed

Section 307-290 of the *Income Tax Assessment Act 1997* (ITAA1997) applies to create an element untaxed in the fund (abbreviated in this submission to 'untaxed element') in a superannuation lump sum death benefit in circumstances where the paying fund has claimed tax deductions for insurance and self-insurance in relation to the death benefit.

As noted in the draft Explanatory Memorandum (draft EM), under the current law:

- Where the lump sum death benefit is paid *from the fund of which the deceased was a member* (the original fund) directly to a 'death benefits dependant' (abbreviated in this submission to 'dependant'), the benefit will be tax free in the dependant's hands by virtue of section 302-60 of the ITAA1997. This is so even though section 307-290 may have applied to create an untaxed element. Similarly, if the deceased's benefits are used to instead pay a superannuation income stream directly from the original fund to a dependant, section 307-290 does not apply.
- In contrast, if the lump sum death benefit is instead *rolled over to another fund* (the receiving fund) by the dependent, the untaxed element created by the application of section 307-290 will be included in the receiving fund's assessable income under item 2 of the table in subsection 295-190(1) of the ITAA1997. (Section 295-190 brings into a fund's assessable income specified contribution and rollover amounts.) The amount available to commence an income stream from the rollover will consequently be reduced by the amount of tax paid on the untaxed element by the receiving fund, thereby reducing the capital of the income stream on which future earnings may accrue.

This inconsistency in treatment — depending on whether the income stream is paid directly from the original fund or as a result of a rollover to the receiving fund — is unintended and inequitable. As noted in the draft EM, this penalises dependants who may prefer to have the income stream paid by a fund other than the original fund. In addition, ASFA notes that an income stream may simply not be available to the dependant from the original fund, thus necessitating a rollover and exposing the dependant to inequitable tax treatment. ASFA supports the proposed amendment to remove this inequity.

Regulation 6.21 of the *Superannuation Industry (Supervision) Regulations 1994* requires a regulated superannuation fund to cash out a death benefit as soon as practicable after the death of a member. Upon receiving a death benefit rollover, the receiving fund is required to either pay out the death benefit as an income stream to an eligible dependant or as a lump sum death benefit.

A dependant would not typically roll a superannuation death benefit to a receiving fund simply to then withdraw it as a lump sum. Accordingly, in the overwhelming majority of cases where a rollover of a death benefit is requested by a dependant, it will be with a view to commencing an income stream from the receiving fund. That aside, ASFA considers that the incidence of rolled over death benefits — let alone death benefits with an untaxed element — will be low and many funds may never receive a single rollover of this type. This means it is important to consider the administrative implications of the proposed amendment.

2.2 Administrative impacts of the proposed amendment

Item 3 of Schedule 1 of the exposure draft *Treasury Laws Amendment (Miscellaneous Amendments) Bill 2019* amends the ITAA1997 to exclude an amount that the untaxed element from the assessable income of the receiving fund. This is achieved by amending table item 2 in paragraph 295-190(1) to exclude from the specified contribution and rollover amounts that must be included in a receiving fund's assessable income an amount that is an untaxed element under subsection 307-290(4).

ASFA considers that the proposed amendment is effective to achieve the intended tax outcome. However, we have two concerns in relation to its administrative operation.

2.2.1 Administrative complexity

Where a rollover with an untaxed element is received by a fund, the untaxed element is currently included in its assessable income and, when paid out by the fund, has effectively been converted into a taxed element.

As the proposed amendment excludes the untaxed element of a death benefit rollover from the receiving fund's assessable income, this conversion process will not occur. As a result, the receiving fund will need to be able to account for the amount, on an ongoing basis, as an untaxed element. When paying out an income stream containing the untaxed element, the fund may need to withhold tax at a different rate to any taxed element, as the untaxed element attracts a maximum tax offset of only 10 per cent (rather than 15 per cent for a taxed element) and the availability of the offset depends on the age of the deceased member and/or the dependent beneficiary. ASFA understands that few taxed superannuation funds would currently have the systems or process capability to achieve this outcome.

Accordingly, to the extent the amendment requires funds to administer untaxed elements and withhold tax from income stream payments containing them at the appropriate rate on an ongoing basis, this will introduce new administrative complexity for trustees and administrators of taxed superannuation funds.

Some trustees may resolve that, given they are likely to receive relatively few death benefit rollovers containing an untaxed element, they cannot justify incurring significant cost to implement the system and process changes necessary to administer them. These funds may instead simply resolve to not accept such rollovers. This decision may be made somewhat more difficult by the need to ensure such rollovers can be readily identified – see 2.3 below in relation to reporting issues associated with these rollovers.

Other trustees may decide that they will utilise manual processes to administer income streams generated from a death benefit rollover that includes an untaxed element.

ASFA observation

It is important that funds are able to adopt an administrative approach that balances the cost and increased administrative complexity associated with implementing the proposed amendment against the likely low volume of death benefit rollovers anticipated to be received.

2.2.2 Need for additional guidance

Secondly, we are concerned that — without further guidance — some uncertainty could arise for receiving superannuation funds and/or their administrators in processing the tax components of a rollover containing an untaxed element in accordance with the amendment.

While the untaxed element is excluded from the receiving fund's assessable income, the amount nonetheless remains part of the *taxable component* of the superannuation interest. ASFA perceives a risk, however, that the untaxed element will be mistakenly added to the *tax free component* of the interest, on the basis that component typically comprises amounts that are not assessable.

ASFA accepts that this is not the intended outcome. Pursuant to section 307-210 of the ITAA1997, the tax free component of a superannuation interest comprises the crystallised segment (not relevant for present purposes) and a contributions segment. The definition of the 'contributions segment' includes contributions to the extent these "have not been and will not be included in the assessable income" of the receiving fund, but effectively excludes "the taxable component of a roll-over superannuation benefit paid into the interest" (paragraphs 307-220(1) and (2)(a)(i)).

However, given the technical complexity of this amendment and the implications if benefits are incorrectly processed, we recommend that additional clarity is provided in the EM accompanying the amendments as they are finalised and incorporated into a Bill for introduction into Parliament. We further recommend that the ATO updates its guidance material to inform superannuation funds about the impact of the amendment and assist with its correct implementation.

Recommendation

ASFA recommends that clarity on the characterisation of the untaxed element of death benefit rollovers is provided in the Explanatory Memorandum to the amending Bill and in updated ATO guidance material.

2.3 Reporting implications

The proposed amendment applies only in relation to untaxed elements arising in relation to the rollover of a death benefit where the original fund had claimed tax deductions for insurance and self-insurance (that is, an untaxed element arising under section 307-290). It has no impact on the rollover of benefits that may contain an untaxed element arising for other reasons (for example, those paid by an untaxed fund).

In order for the receiving fund to treat the rollover in accordance with the proposed amendment, it must first be on notice that the amendment applies. Under the current framework for reporting rollovers between funds, there is no scope to distinguish between different categories of untaxed element. As a result, a mechanism will need to be put in place to enable the original fund to communicate to the receiving fund the fact that a superannuation death benefit rollover contains a *relevant* untaxed element.

We note that the current framework for electronic reporting of rollovers between funds, SuperStream Message Implementation Guide (MIG) version 2, does not currently incorporate all necessary information in relation to the rollover of death benefits. Instead, the Australian Taxation Office (ATO) has implemented a manual, paper-based reporting process as an interim measure — the death benefit rollover statement. MIG version 3, which is due to go live in November, will incorporate a field identifying death benefit rollovers. Of itself, this will not be sufficient to address reporting needs arising from the proposed amendment because it will not identify where an untaxed element is relevant to that amendment. It may, however, suffice — at least as an interim measure — to alert the receiving fund that they need to seek additional information from the original fund.

In this respect, we note that changes to the SuperStream architecture are time consuming and costly for the ATO and funds to implement and must be managed carefully, especially where it is unlikely that a high volume of benefits will be impacted by a particular change. We recommend that the ATO commences discussion with the industry as soon as possible on potential short and longer term reporting solutions to ensure that receiving funds are provided with all relevant details about a death benefit rollover to ensure correct processing in accordance with the proposed amendment.

Recommendation

ASFA recommends that the ATO commences discussion with the industry as soon as possible regarding the reporting of information between funds, to ensure correct processing of death benefit rollovers in accordance with the proposed amendment.

2.4 Retrospective application of amendment

The proposed amendment in relation to death benefit rollovers is intended to apply retrospectively from 1 July 2017. ASFA agrees that this is appropriate, given the amendment addresses an unintended consequence arising from earlier amendments that commenced on that date. However, the consultation package is silent in relation to the treatment of death benefit rollovers that have occurred since 1 July 2017, or that may yet occur prior to the date the amendment becomes law on receipt of Royal Assent.

Recommendation

ASFA recommends that clarification is provided regarding the treatment of superannuation death benefit rollovers made between 1 July 2017 and the date the amendment becomes law.