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25 March 2011

The Manager
Contributions and Accumulation Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: over50supercap@treasury.gov.au

RE: Consultation Paper – Concessional superannuation contributions caps for individuals aged 50 and over

Dear Manager,

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission with respect to the above consultation paper.

The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-political national organisation whose mission is to advance effective retirement outcomes for members of superannuation funds through research and advocacy. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds as well service providers some of whom deal with self managed superannuation funds (SMSFs), has over 90% of the approximately 12 million Australians with superannuation as members. ASFA members manage or advise on the bulk of the $1.3 trillion in superannuation assets. ASFA is the only organisation that represents all types of superannuation funds and associated service providers.

Comments on the policy

ASFA strongly supports the Government's decision to provide a mechanism for enabling those age 50 or more and with limited superannuation savings to access a higher concessional contributions cap. ASFA has previously expressed its concern that the expiration of the transitional concessional contributions cap would disadvantage those who were nearing retirement and have had limited capacity to contribute to superannuation during their working life but who were now able to do so.

While ASFA appreciates the need to target the measure by placing restrictions on who is able to access the increased contribution cap, we would like to point out that the proposed arrangement entrenches the current inequity that exists between couples and singles and between single and dual income families with regard to the existing concessional contribution caps. We note that the social security system, unlike the superannuation system, takes account of lifestyle status (e.g. single, couple living together, couple living apart) when determining the level of government support to be provided to persons of aged pension age.

Comments on the proposed arrangements

Background

A key policy parameter is that neither the additional $25,000 contribution cap, nor the superannuation balance cap of $500,000 is to be indexed. ASFA has concerns that individuals may consider the $500,000 cap to be a government proxy for what is considered to be sufficient to provide for an adequate level of income in retirement. This may have impacts on savings behaviours and, as the purchasing power of that sum is eroded over time, may result in increasing numbers of people not achieving their desired standard of living in retirement. The Westpac - ASFA Retirement Standard estimates that a couple enjoying a comfortable lifestyle will spend $53,729 per annum in today's dollars.

Another key policy parameter is that access to the higher concessional contributions limit is restricted to those with superannuation balances of less than $500,000. Whilst it is considered necessary to limit access to the higher contribution limit, the setting of a fixed limit immediately raises a number of issues including:

- Setting an appropriate definition of 'superannuation balance'
- Determining a workable 'test date' for eligibility
- Maintaining the integrity of the measure
- Ensuring equity across individuals with varying circumstances

Key to successful implementation of the measure is designing a legislative and administrative framework that will enable individuals to contribute with confidence and certainty.

ASFA notes that many fund members are encountering significant difficulties in complying with the current contribution limits. The difficulties appear to arise from a combination of a desire to maximise contributions, the impact of third party contributions, difficulty in planning contributions over a 12 month period and a lack of understanding/appreciation of the operation of the law by both individuals and their advisers.

ASFA also notes that while recent legislative changes have provided an opportunity for fund members to seek relief from the ATO prior to being issued with an excess contributions tax assessment, the change does not address the underlying problem of the limited discretion available to the Commissioner of Taxation to grant relief.

The level of difficulty individuals have in complying with the law is reflected in the ATO's response to Question on Notice Number 367 (Senate Hansard, 3 March 2011 at page 102) which indicates that the number of excess contribution cap assessments has more than doubled from 22,561 in 2007-08 to 48,721 in 2009-10.

The administrative complexity of the current process is also revealed in the ATO's response to the same Question on Notice with ATO administration costs for the contribution caps being identified as $5,180,857 in 2007-08, $7,641,137 in 2008-09, $12,975,218 in 2009-10 and estimated at $34,640,110 for 2010-11. The ATO's costs are mirrored in the increased costs incurred by funds, advisors and individuals with relation to the contribution caps.

ASFA considers that, whilst the introduction of the superannuation balance cap will reduce the number of people able to access the higher contributions caps by some 90% to around 275,000[1], it will at the same time introduce a level of complexity that may see a rise in the number of contribution cap breaches.

Of particular concern is the potential that implementation of the announced change will result in increased ATO-reporting costs for superannuation funds. These costs will be borne by all fund members, not just the approximately two and a half percent of members that the government has estimated will have access to the extended cap and will also be financially able to contribute above the ordinary cap amount. ASFA would be very concerned to not repeat the Contributions Surcharge experience where the implementation costs for industry and the ATO were estimated to have exceeded the first year revenue gain of $500 million.

ASFA notes that the implementation of the Better Super regime shifted the regulation and assessment of superannuation to contributions only basis. Implementing this measure will move the system back to the pre-2007 situation of regulating both contributions and benefits, making regulation both more complex and more costly.

It seems somewhat incongruous that whilst implementing Stronger Super reforms aimed at reducing fund administration cost by improving back office efficiency, a measure is to be implemented that will increase the complexity, and the overall cost of administering, the superannuation system.

Against this background, ASFA would like to provide the following comments with respect to the various options proposed in the discussion paper.

[1] In the 2010-11 Budget Papers it is indicated that continuing with a higher cap for those both aged over 50 and with an account balance of less than $500,000 will benefit some 275,000 people. This is over 10% of those aged over 50 with superannuation contributions and over half of those aged over 50 who were making salary sacrifice contributions in 2007 (before the tighter caps applied).

Proposed eligibility arrangements – treatment of withdrawals

Option 3.1 Extend eligibility to those who have commenced withdrawals and add those withdrawals to the account balance

Of the three broad options this is the preferred option from an equity and system integrity perspective.

However, from an administration perspective it is the most costly and the least efficient. Many in the industry liken the reporting requirements required to support this proposal to the pre-2007 reporting requirements required to support the reasonable benefit limits system. That system created significant issues for individuals.

The proposal to index annually to AWOTE all withdrawal amounts appears to be aimed at providing a rough approximation of fund earnings. This appears reasonable on equity grounds. The expectation of industry is that the accumulated withdrawal information would be maintained by the ATO who would also undertake the annual indexation.

ASFA notes the use of the term 'hardship grounds' and seeks clarification as to whether the exclusion covers withdrawals on both compassionate and financial hardship grounds. Consideration also needs to be given to the situation where a member makes a withdrawal under a TPD or Terminal Medical Condition claim and also the treatment of TPD and ill health pensions. Determining an appropriate treatment for death benefit pensions, particularly those paid to children may also be problematic. ASFA also sees the need to give special consideration to the treatment of amounts paid in respect of excess contributions tax.

As a secondary issue, ASFA would question the likelihood of persons who have accessed their benefits on financial hardship ground having the financial capacity to subsequently be able to make additional contributions.

Clarification will also be required on the treatment of a transfer of contributions to a member's spouse's account and family law benefit splits. Are they to be regarded as a 'benefit withdrawal' or ignored? On equity grounds, ASFA suggests the first should be included and the latter excluded.

To deliver the required information to the ATO will require some not-insignificant changes to ATO superannuation reporting requirements including:

- Modification to the ATO's Member Contributions Statement (MCS) reporting requirement
- A one-off report of withdrawals made during relevant previous reporting periods (i.e. from periods covered by the proposal but prior to the period covered by any new ATO MCS reporting arrangements commencing)

- A one-off report of defined benefit entitlements as at the relevant date and
- A one off report of the account balance of those accounts for which no contributions were received in the year for which account balance is to be captured (i.e. reporting for those accounts that were excluded from MCS reporting).

ASFA anticipates that the extent of the required changes to be made by industry and the ATO will not be possible within the timeframe needed to advise individuals prior to 1 July 2012 of their entitlement to access the new caps.

ASFA also sees great difficulties in the ATO developing its administration systems within the prescribed time frame and would prefer to see ATO resources applied to more important activities such as a facility to validate that a TFN belongs to the person who is quoting it. As the change under consideration interacts with many of the proposed SuperStream proposals which are under separate consultation, there is significant concern about the need to implement changes in an ad hoc manner rather than as a consolidated and well thought through package designed to provide clarity, minimise implementation errors and reduce implementation costs.

ASFA also has concerns that the proposal to exclude hardship payments and other payments from the reporting requirements may prove difficult and costly to achieve where a fund does not electronically track the reason for benefit payments.

Several dates are proposed for the commencement of the counting of draw downs and withdrawals. Any date that is retrospective will create significant issues for fund administrators as it requires creation of a one off process to examine past transactions. A retrospective process will also fail to capture withdrawals from funds which have been wound up after the reporting start date. Where a new administrator has been appointed since the reporting start date there will be significant difficulties in obtaining information about pre-transition transactions. On the other hand, any commencement date that is prospective should be sufficiently in advance to provide funds with a suitable period of time in which to amend administration systems so as to correctly capture data and develop the necessary ATO reports.

Because of the issues set out above, ASFA considers that should option 3.1 be adopted then the requirement should be to report payments and withdrawals made from 1 July 2012.

Despite the above, ASFA considers that this option should be preferred over the proposals as set out under options 3.2 and 3.3. Note however, that ASFA requests that consideration be given to examining the merits of a modification to option 3.3 which, if considered practical and feasible, would be our preferred option.

ASFA notes that the ATO is in the process of reviewing its superannuation reporting with a view to consolidating reports and moving the reporting process into the SBR framework. From a systems development perspective, there would be significant advantages in including this new reporting requirement as part of the conversion to the SBR process. Going down this path may require one or a combination of:

- A postponement of the commencement of the measure for one or two years, or
- A modified administration process for the first few years, or
- An extension of the current transitional caps for one or two years.

Option 3.2 Extend eligibility to those who have commenced withdrawals but do not add withdrawals to the account balance

Whilst reducing complexity, particularly in the 'set up' phase, ASFA has serious concerns about the opportunity for manipulation of the rules to advantage those the proposal is not designed to assist.

ASFA is concerned that where a person aged over 60 can establish a 'nil' condition of release such that all current benefits are deemed unpreserved, that person could 'manage' their account balance so as to maintain their entitlement to the higher cap. This could be combined with a strategy of subsequently returning the withdrawn amounts as a non-concessional contribution. The outcome would be to deliver a benefit to a person that the policy was not designed to assist. That is, the integrity of the measure would be undermined.

ASFA can also envisage strategies using multiple transition to retirement pensions that could deliver a similar outcome.

ASFA does not support this option on equity and system integrity grounds.

ASFA considers that the maintenance of the integrity of the system would require, as a minimum, withdrawals made in the three years preceding the test date to be included in the eligibility test.

Option 3.3 Exclude those who have commenced withdrawals from eligibility

As a refinement to option 3.2, this option has the advantage of simplifying the administration arrangements whilst eliminating the opportunity to manipulate account balances. For this reason alone it has great appeal.

However ASFA has serious concerns with this proposal on equity grounds. Specifically, ASFA is concerned with the exclusion of people who would otherwise qualify simply because they have commenced a transition to retirement income stream.

The social policy behind transition to retirement income streams is to extend the working life of certain individuals. This has benefits for both the individual and the nation with the individual contributing to Australia's GDP whilst maintaining their current standard of living and improving their retirement standard of living.

However, the equity issue could be overcome if this option provided a mechanism whereby a person who would otherwise be excluded could seek access to the higher caps on the basis that their current account balance and the sum of all relevant withdrawals was less than the $500,000 threshold.

ASFA sees the option operating as follows:

- The law would specify that, subject to a Commissioner of Taxation discretion, access to the higher contribution caps was restricted to those members who, since the commencement date, had not commenced an income stream or made a benefit withdrawal.
- The Commissioner's discretion would apply where the Commissioner was satisfied that had the member not commenced an income stream or made a benefit withdrawal the total of all of the member's superannuation account balances would not have exceed the $500,000 cap on the relevant date.
- Supporting regulations could set out the details of what amounts were to be counted or excluded, whether amounts would be indexed and if so the method for doing so.
- For superannuation funds, in addition to reporting accumulation balances and defined benefit entitlement values, as part of the annual MCS process they would advise the ATO whether or not a member had taken a withdrawal benefit. Funds would also report to the ATO details of those members in receipt of a pension. The ATO would capture this information and use it to monitor the eligibility of individuals.
- Members, being aware as to whether they were in receipt of a pension or had withdrawn a relevant lump sum since the test date, would approach their superannuation fund(s) seeking details of the amounts and dates of withdrawals and the payment details of pension benefits for the purpose of approaching the ATO where they wished to access the higher contribution cap.
- This information would be provided to the ATO together with a request for exemption from the basic rule that the withdrawal or commencement of pension prevented access to the additional contribution cap.
- The ATO would use the supplied information to assess eligibility, by reconstructing the member's total superannuation balance as if the withdrawals and pension payments had not taken place and in accordance with the regulations.
- Where the reconstructed account balance was under $500,000 the ATO would permit the member to access the additional contribution cap in a specified

financial year.

ASFA considers that adoption of this modified version of option 3.3 would provide the following benefits:

- It would simplify the reporting requirements for funds, and thus the cost of reporting.
- It would enable funds to impose an activity fee for provision of the information. Thus, as occurs with Family Law requests, the administration cost is, at least in part, met by those individual's seeking the information.
- It would simplify ATO administration of the caps as they could monitor eligibility to access the cap without the need to collect and index information about all withdrawals from the superannuation system.

Where the member sought the relevant withdrawal information from the fund, a fee could be charged as currently occurs with Family Law requests. Thus the cost would be carried by the small number of benefiting members, not the fund membership generally.

ASFA recommends that Treasury establish a small joint Treasury, ATO and industry working group to consider the practicalities of adopting the above proposed amendment to Option 3.3. ASFA would be pleased to nominate suitably knowledgeable industry representatives to participate. The working group could consider this option in the light of being either a permanent solution, or an interim solution pending development of the improved ATO reporting system currently being developed within the SBR framework.

Proposed eligibility assessment arrangements

Option 4.1 Full self-assessment model

The operation of a full self assessment model has the advantage of placing the onus on assessing eligibility with the person who is proposing to make the additional contribution. However, self assessment works best where the rules are simple, there is symmetry of information and the penalties for 'getting it wrong' are not excessive.

The current contribution cap rules generally operate under a 'self assessment' regime insofar as the responsibility lies with the individual to understand the rules and to determine what amounts have been contributed by others to their accounts and then to determine their remaining entitlement to contribute. Experience with the current contribution cap self assessment regime, as reflected in the number of excess contributions tax assessments, leads to the conclusion that the rules are not simple and there is a lack of symmetry of information between individuals, employers and advisers.

Under the current contribution caps the individual need only concern themselves with what is being contributed to a fund both by and for them. Should option 3.1 or 3.2 be adopted, with its requirement for awareness of what is in the fund, what has been taken out of the fund and what the indexed amounts are, the expectation is that the increased complexity introduced will result in additional breaches and more excess contributions tax assessments being issued.

The current full assessment regime already imposes additional administration costs on funds and advisers as the necessary information is provided to members/clients and issues with excess contribution tax assessments are addressed and resolved. These costs will necessarily increase as a result of the increased complexity.

Option 4.2 ATO to provide account balance information

Whilst this option will remove the uncertainty of whether an individual can avail themselves of the cap, it does not address the fundamental issue of the current difficulty many people encounter with the contribution caps.

As noted in 3.1 above, this will involve significant implementation and ongoing administration costs for both funds and the ATO.

It would be essential that an individual could rely on the ATO advice, subject to the application of general anti-avoidance rules and rules addressed the issue of the deliberate provision of false information to the ATO.

ASFA considers this to be a viable solution once appropriate reporting mechanisms can be put in place and administration systems developed by the ATO.

In the interest of administrative simplicity, ASFA requests reconsideration of the proposal to capture and index to AWOTE all withdrawals made by an individual post the commencement date (1 July 2010 is the date proposed by ASFA).

An alternative approach may be to count withdrawals made in, say, the two years prior to and during the year leading up to the account balance test date and to not index those amounts. For example, if option 5.1.2 below was adopted, for eligibility to contribute in 2012/13, with an account balance test date of 30 June 2011, you would count withdrawals made from 1 July 2010 through to 30 June 2011. For eligibility to contribute in 2017/18, with an account balance test date of 30 June 2016, you would count withdrawals made from 1 July 2013 through to 30 June 2016.

Under such a method, if option 3.1 was adopted funds would only need to report withdrawals made by persons who were 46 or older during the year.

If the modified option 3.3 was adopted, funds would only have to retrieve, at the member’s request, information for the three years preceding the year in which the request was made.

Such an approach would provide significant savings in administration cost whilst still maintaining the basic integrity of the system.

Calculation of an individual's total superannuation account balance

5.1 Date of assessment of account balance

Option 5.1.1 30 June in the financial year preceding the year in which contributions are to be made

ASFA understands that under this option an individual's account balance as at 30 June 2012 would be the determinant for their eligibility to make contributions in the 2012/2013 financial year.

ASFA considers this to be impracticable given the processing time frames associated with providing MCS data to the ATO (including the lodgment period for SMSF returns). This is particularly the case where option 4.2 is adopted and the ATO is required to provide the relevant advice to eligible individuals.

Option 5.1.2 30 June two years prior to the end of the financial year in which contributions are to be made

ASFA understands that under this option an individual's account balance as at 30 June 2011 would be used to determine their eligibility to make contributions in the 2012/2013 year.

While recognising that this approach may enable access to the higher contribution cap for someone who would be ineligible at the commencement of the relevant financial year, we note that the advantage gained is a one-off additional contribution of $25,000, or a maximum tax saving of $7,875 in that financial year ($25,000 x ($0.465 – $0.15)) to those in that position.

ASFA considers that this is a reasonable compromise between a workable solution and highly technical solution that based eligibility on the most current information.

Calculation of account balances

ASFA accepts that on equity grounds it is appropriate to determine a person's total superannuation entitlements and to also consider amounts the individual may have withdrawn from the superannuation system. However, as noted above, the interests of system design simplicity may be best served by only counting withdraws made recently.

ASFA considers it appropriate that, for SMSFs, fund reserves are required to be attributed to members. Guidance will need to be provided as to how this is to be done so as to provide certainty of operation of the requirement to SMSF trustees and their service providers.

Methodology for valuing an account balance

Option 5.3.1 Withdrawal benefit

Amongst ASFA members the clear preference for reporting accumulation account balances is for the use of withdrawal benefit, an amount currently reported to the ATO on the MCS in respect of accumulation account members.

ASFA has concerns with the use of withdrawal benefit for measuring the value of a defined benefit. As acknowledged in the discussion paper, for a defined benefit the withdrawal benefit is generally lower than a retirement benefit and the closer a person is to normal retirement age the smaller is the gap. However, in some scheme designs there is a large jump in withdrawal benefit once a person reaches the schemes early retirement age of 55. This has the potential to provide a significant advantage to scheme members aged 50 to 55.

As the purpose of the policy is to determine a person's potential retirement benefit, and to overcome the above scheme design issue, ASFA considers that a more appropriate measure for defined benefits is Accrued Retirement benefit. The Accrued Retirement benefit measure is consistent with providing retirement benefits, is closer to the member's retirement benefit and, for many funds, is reported annually to actuaries for valuation purposes. As it represents what the member would get if retiring, it is more consistent with the policy than the withdrawal benefit; a member's entitlement to a cash benefit following resignation. As ASFA has received conflicting advice on the availability of this information on an individual member basis, ASFA suggests that advice be sought from the Institute of Actuaries of Australia and CPA Australia as to whether this information is routinely available/required for accounting and or actuarial purposes and therefore whether this is a practical solution. If not ASFA would support the use of withdrawal benefit on the grounds of simplicity.

An issue that needs to be addressed is the reporting requirement of funds with a non-30 June balance date. This also has implications for the reporting by these funds of member withdrawals.

A further issue to be addressed is defined benefit funds in which the member has no entitlement to a lump sum benefit. ASFA suggests that, rather than adopting the valuation methods set out in the Income Tax Assessment Acts, a simple methodology be adopted such as multiplying the annual income stream for the test income year by, say, a factor of 10. ASFA considers that a simple method needs to be adopted as the administration systems for these benefit types do not have an in-built lump sum valuation methodology.

Option 5.3.2 Family law methodology

Although the Family Law methodology is an established methodology for valuing a member's interest, for reasons of cost it has not been widely incorporated into fund administration systems. ASFA considers that to implement it solely for this purpose would impose an unacceptable cost burden on funds.

Given that Accrued Retirement benefit provides a reasonable approximation of a person's retirement benefit, ASFA does not support the general adoption of the Family Law methodology for valuing an interest. However, ASFA would be amenable to a fund being permitted to the Family Law methodology where they choose to do so.

No-TFN accounts

ASFA supports, as an integrity measure, preventing a person from rolling over to an account where no TFN has been quoted.

However, if not properly designed, this measure could introduce some significant administration issues associated with determining whether the destination fund is currently holding the TFN.

ASFA proposes that to overcome this issue, regulations to the SIS Act be introduced such that the rollover of a benefit to another superannuation entity is prohibited where (on the rollover request form) the member does not:

- Authorise the passing of the TFN to the destination fund, and
- Authorise the recipient trustee to record and use the TFN.

ASFA also suggests, as a further integrity measure, that relevant legislation be amended to remove the ability of a member to direct a trustee to cease using a quoted TFN.

Consideration should also be given to whether there is a need to address the issue of existing accounts for which no TFN is held. Is an anti avoidance measure required so as to prevent members accessing those benefits without providing a TFN or otherwise validating their identity?

Rules for self managed superannuation funds

Valuation of SMSF accounts

ASFA supports the proposal that an SMSF be required to allocate its unallocated fund reserves to its members for the purpose of determining eligibility.

As part of the design, careful consideration will need to be given to the definition of 'unallocated reserves' and specifying a methodology to be applied by the SMSF in allocating the reserves. An appropriate apportionment methodology could be to apportion unallocated reserves by reference to the value of the member's interest compared to total of all members' interests in the fund.

ASFA also supports the proposal that for a member of an SMSF to access the higher contribution cap the SMSF will be required to report assets on a net market value. Current legislation requires assets held in SMSFs to be valued at market value for purposes such as determining the market value ratio of the fund's in-house assets at the end of each income year and when acquiring an asset from a related party. Even though SMSFs are non-reporting entities for the purpose of Australian Accounting Standard AAS25 – *Financial Reporting by Superannuation Plans*, the ATO has previously stated its view in Superannuation Circular 2003/1 that SMSFs should use market values for all valuation purposes.

ASFA is aware that the issue of SMSFs valuing their assets at net market value is part of the Stronger Super reforms for SMSFs and is currently being consulted upon through the Treasury working groups. With increasing interest being shown by various regulators (e.g. the ATO, APRA and ASIC) in the accounts of SMSFs, ASFA considers that now is also an appropriate time to review the status of SMSFs as non-reporting entities for accounting purposes. Accordingly, ASFA recommends that the issues of the account valuation methodology in regards to the extended contributions cap, the overall reform of introducing net market value for SMSF asset valuations, and the appropriateness of SMSFs continuing to be considered non-reporting entities be linked and considered in the overall context of the Stronger Super reform process.

ASFA notes that should the first eligibility test date be earlier than 30 June 2011, this may require some SMSFs to have fresh accounts prepared using net market value for their assets. ASFA does not consider this to be an unreasonable burden should an SMSF member seek access to the higher contribution caps. A process would also be required where the ATO can retrospectively capture the asset valuation methodology used by certain SMSFs.

Other Issues

Fund reporting

As stated earlier, ASFA is concerned at the potential impact on fund administration costs in implementing and administering the proposed reporting requirements at a time when the industry and government focus is on improving the efficiency of administration.

While recognising the need for the ATO to receive appropriate data to support its administration of the measure, ASFA requests that in designing the implementation process and the timing of the new reporting requirements due consideration be given to current proposals to move ATO superannuation reporting requirements into the SBR framework.

Assessment process

Whilst agreeing that it is appropriate to apply the existing contribution cap assessment process to this new contribution cap, ASFA would like noted the current issues fund members are having complying with the existing contribution caps.

Commencement date

Whilst noting the commencement date of 1 July 2012, ASFA urges that should option 3.1 be adopted consideration be given to either extending the existing transitional contribution caps for a further period whilst the new ATO SBR-compatible reporting arrangements are put in place or adopting the modified option 3.3 as an interim arrangement.

Should you have any questions please contact our Principal Policy Adviser, Robert Hodge, on 02 8079 0806.

Yours sincerely

D. Graus

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