6 June 2013

Manager
Contributions and Accumulation Unit
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The Treasury
Langton Crescent
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Email: superannuation2013bill@treasury.gov.au

Dear Sir/Madam

Exposure draft: Regulations to Support Sustaining the Superannuation Contribution Concession

The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of over 4,000 members, including more than 2,000 actuaries. Our members have had significant involvement in the development of insurance regulation, financial reporting, risk management and related practices in Australia and Asia.

We refer to the Exposure drafts of the above Regulations and Explanatory Memorandum (EM) and thank you for the opportunity to provide comments.

Method of determining defined benefit (DB) contributions

Our submission of 8 May 2013 on the related Bill (copy attached) included our views on the method of determining DB 'contributions' for the purpose of the additional 15% contributions tax for high income earners. Given the strong reasoning behind our recommendation that notional taxed contributions (NTCs) also be used for this purpose, we are very disappointed that the draft regulations propose to use essentially the 'surchargeable contributions' methodology for this purpose.

The proposed methodology would impose very substantial additional costs and complexity on the industry compared with the NTC method. We expect that the costs would largely be passed on to employer sponsors of DB funds.

We are also concerned that for many funds strict application of the proposed regulations would require rates to be calculated by an actuary for each member individually each year.

This is because many funds have 'greater of' defined benefits, most commonly because of minimum benefit underpins designed to meet Superannuation Guarantee (SG) requirements but also, for example, where accumulation-style resignation benefits apply as a minimum on retirement. In many cases the impact of the minimums varies from member to member and from year to year, so there is limited ability to apply grouped rates, even with variation by age and service or membership duration. Furthermore, with the 2008 changes to the SG earnings base, the minimum benefits may have a different salary definition (i.e. Ordinary Time Earnings) than the standard defined benefits.

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These issues were much less significant when the surcharge was introduced, due to the level of the SG at that time and grouped factors were often used for surcharge purposes. Nevertheless, the surcharge factors were often very complex, varying by age and duration so that there were hundreds of factors for each benefit category, as compared to one NTC rate.

With the prospect that individual surcharge rates are now likely to be required for many funds (with yearly reassessment), we are now even more concerned with the level of cost and complexity involved with the method proposed in the draft regulations.

Indication of Implementation Costs and Timeframe

In discussions with Treasury officers we were asked to provide some indication of the estimated implementation costs and timeframe associated with the proposed methodology.

If we assume initial average actuarial costs of $20,000 for around 500 private sector DB funds and sub-funds, this would involve actuarial implementation costs of around $10m. The associated administration and communication costs could exceed this. Ongoing actuarial costs would be expected to be lower but would still be substantial – say averaging $10,000 per year. In our view it is unreasonable to impose this level of compliance cost given that only a small number of DB members in each fund (none in some funds) are likely to be subject to the higher tax.

Based on the details for the sample of funds set out below, this indicates an average cost per affected DB member of around $4,000 in the first year and $2,000 pa ongoing, plus administration and communication costs.

Given the short time available for submissions, we have not been able to obtain industry input on the likely implementation timeframe that would be required. However even if all questions on how the calculations are to be done can be quickly resolved, we expect that it would take at least until the end of 2013 for all of the actuarial calculations for 2012/13 reporting to be completed. Further time would be required for administrative implementation so that ATO reporting for 2012/13 would likely be towards the end of Q1 2014 at best.

However past experience with the time it has taken to identify and address regulatory and calculation methodology issues with surcharge and NTC, as well as the myriad of other issues which are already placing actuarial and administration resources under severe pressure, suggests that this timeframe would be highly optimistic and that Q2 or Q3 2014 is likely to be more realistic.

Indication of Additional Costs vs Revenue

We have collected information for about 200 funds (or sub-funds) that have defined benefit sections, with the number of defined benefit members totalling a little over 200,000. From this group we counted 1,124 defined benefit members with a superannuation salary of $280,000 or higher, or an average number per fund (or sub-

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fund) of around 5.6. This is less than 1% of the total number of high income earners (128,000 – extracted from the Minister's Media Release on 8 May 2012) that Treasury expects will be affected by the high income superannuation contributions tax (HISCT). Whilst our sample does not cover all taxed DB funds and sub-funds (of which there may be closer to 500 based on an ASIC media release), we expect that it is biased to large funds and hence we would not be surprised if the overall number of taxed fund DB members affected was less than 2,000.

You can see from these numbers why we are reluctant to produce the complex and expensive surcharge factors for each and every one of the 500 or so taxed DB funds, when so few defined benefit members are expected to be affected and the NTC factors are already available.

Based just on our sample of 200 funds, if we assume that the average notional superannuation contribution for these members is (say) 10% x $400,000 = $40,000, the additional tax collected each year from each defined benefit member will be approximately 15% x $40,000 = $6,000, or a total of 1,124 X $6,000 = $6.7 million. If instead we used a table of surcharge factors that produced a notional contribution rate that was 1% or even 2% or 3% of salary higher (on average), then the additional annual revenue raised from these 1,124 defined benefit members would be approximately $0.7 million to $2.1 million. Clearly, the higher implementation costs are not justified by the additional revenue at risk.

Other comments

While we have detailed comments on the draft regulations, we have not yet documented or forwarded these. Instead, we encourage you to proceed with the NTC method rather than the highly costly and complex surcharge method.

Conclusion

Therefore, our strong recommendation remains that NTCs be used for this purpose. We would be happy to discuss how the small number of public sector funds without NTCs might be handled.

If required, we would be happy to discuss our views on this matter. Please do not hesitate to contact Melinda Howes, Chief Executive Officer of the Actuaries Institute (phone 02 9239 6106 or email melinda.howes@actuaries.asn.au) to arrange this, or for any further information.

Yours sincerely

pp

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8 May 2013

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Dear Sir/Madam

Exposure draft: Tax Laws Amendment (Sustaining the Superannuation Contribution Concession) Bill 2013

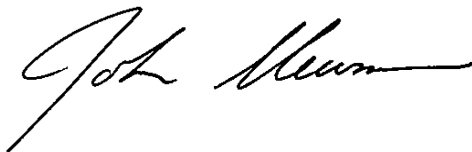
The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of over 4,000 members, including more than 2,000 actuaries. Our members have had significant involvement in the development of insurance regulation, financial reporting, risk management and related practices in Australia and Asia.

We refer to the Exposure drafts of the Bill and Explanatory Memorandum (EM) and thank you for the opportunity to provide comments. Our comments are set out in the attachment and relate to the following aspects of the draft material:

- The determination of defined benefit (DB) contributions;
- The time at which the DB debt account becomes payable; and
- The determination of the 'end benefit cap' of the DB debt account.

If required, we would be happy to discuss our views on this matter. Please do not hesitate to contact Melinda Howes, Chief Executive Officer of the Actuaries Institute (phone 02 9239 6106 or email melinda.howes@actuaries.asn.au) to arrange this, or for any further information.

Yours sincerely



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Attachment - Comments on Exposure Draft of the Tax Laws Amendment (Sustaining the Superannuation Contribution Concession) Bill 2013

There are two matters relating to the Exposure drafts of the Bill and Explanatory Memorandum (EM) on which we wish to comment. These are dealt with in turn below.

Determination of defined benefit (DB) contributions

The EM indicates that the method of determining DB 'contributions' for the new high income superannuation contributions tax (HISCT) is to be specified in regulations which are not yet available.

We note that most funds are already required to determine and report notional taxed contributions (NTCs) for DB members. NTCs are used as the measure of DB 'contributions' for the purpose of the concessional contribution limits. A member's NTCs are capped at the member's concessional contribution limit if the member is eligible under grandfathering rules established for this purpose.

The Institute strongly recommends that NTCs also be used for determining DB 'contributions' for the purpose of the additional 15% contributions tax for high income earners (although we understand that it is not intended that the grandfathered cap would apply for the purpose of this new measure).

Our reasons for this recommendation include:

- Avoiding substantial additional implementation costs for the majority of funds, since they are already required to determine and report NTCs for DB members. From our discussions with the Australian Government Actuary's (AGA's) office and Treasury, we are concerned that the implementation costs for taxed DB funds in the private sector may be significantly higher than the revenue raised by the new HISCT if any other approach is taken.
- Avoiding the substantial additional lead time that would be involved in implementing the measure for the majority of funds if a different set of DB contribution rates had to be actuarially determined for each fund and then fund administration systems updated to calculate and report DB contributions amounts on the additional basis.
- Ease of understanding for members – the NTC system of calculating DB contributions is already in place for most funds and is reasonably simple, with one NTC rate per benefit category.
- Many DB funds have small numbers of members, none of whom are on high incomes – it is highly desirable to avoid imposing additional costs on these funds which are likely to have no members subject to the new HISCT.

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We understand that another method which has come up for consideration is the method which was used for determining surchargeable contributions for the purpose of the superannuation surcharge tax which applied from 1996 to 2005. We would not support this approach, given that the NTC system is already in place for most funds. We note that:

- The surchargeable contributions factors were much more complex for the actuary to determine and for the fund to apply; in many cases there were hundreds of factors per category (depending on the member's age and service) as compared with one NTC factor per category; furthermore, some benefit designs or features such as 'greater of' benefits, which are very common due to superannuation guarantee (SG) underpins, were very problematic to deal with.
- The number of factors involved added substantially to the cost of administration and the complexity of member communications.
- If surchargeable contributions were to apply for the new HISCT, funds would need to communicate the factors to all DB members even though very few members are likely to be affected.
- Separate sets of factors may be required for each year from 2012 to 2019 due to the increase in the SG rate over this period.
- If surchargeable contributions were to apply for both concessional contribution limits and the new HISCT, the grandfathering eligibility rules based around no increase in the NTC (new entrant) rate would require a total overhaul (as surchargeable contributions factors usually increase with age/service without any benefit improvement being required); it would be even more confusing if NTCs were retained for concessional contribution limits and surchargeable contributions were used for the new tax.

It is also relevant to note that, as the vast majority of DB funds are closed to new members (and have been for many years), the number of defined benefit members affected (and associated revenue) is likely to decrease significantly in coming years. Large implementation costs become even harder to justify when this is taken into account.

We understand from discussions with the AGA's office and Treasury that a higher number of DB members might be affected in some of the much larger public sector funds (which do not currently have NTCs) and that it may be more straightforward to produce and implement surcharge factors for those funds. However, in our view, an unnecessarily costly burden should not be placed on the private sector funds for this reason alone.

Hence we would strongly prefer to use the much simpler NTC rates already in use for taxed funds for the new HISCT as well as for the contribution caps.

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End Benefit Cap

Under the draft Bill, the Australian Taxation Office (ATO) will maintain a 'debt account' relating to deferred tax on DB contributions.

The DB debt account will have to be paid when the first benefit becomes payable from the superannuation interest (should this be DB interest?) to which the debt account relates. Draft s134-70 refers to the debt being due and payable 21 days after the 'end benefit is paid'. It is unclear what is meant by 'is paid', but the commentary in the draft EM suggests this is when the benefit is paid out of the fund (unless to a successor fund). We note that in the private sector it is common for DBs to be crystallised well prior to being paid out of the fund (e.g. on termination of service with an employer or on conversion to accumulation).

We suggest it would be preferable to target the time when the DB is crystallised (i.e. ceases to be a DB interest) in the case of a lump sum benefit. However care would be needed to allow sufficient time for payment as the member's benefit may not be determined for some time after the effective date of crystallisation (particularly in the case of conversion to accumulation).

Draft s134-65 specifies that the DB debt account will be subject to an 'end benefit cap', being "15 per cent of the employer financed component of the value of the superannuation interest that accrued after 1 July 2012".

We note that determination of "the employer financed component of the value of the superannuation interest that accrued after 1 July 2012" will not necessarily be straightforward, particularly where 'greater of' benefits apply, which is very common due to SG underpins. Complexity can also occur when pension or deferred benefits become payable as it is necessary to place a value on them.

This may require the fund's administrator to keep additional records, such as the member's accrued multiple at 1 July 2012 and/or separate account balances relating to pre- and post-1 July 2012, purely for the purpose of this end benefit cap – again, for all DB members even though very few are likely to be affected by the new HISCT and even fewer by the end benefit cap.

Given the complexity involved, and that it will be required so infrequently, funds are likely to strongly consider manual rather than mechanised calculations. Actuarial input is likely to be required for the calculation in some circumstances. Hence we consider that the requirement for the fund to provide the end benefit cap within 7 days of a request by the ATO (as per draft s134-65(3)) is unreasonable. We suggest that 30 days would be a more reasonable period.

Finally, we suggest that 'end benefit cap' should be defined by reference to the DB interest rather than the superannuation interest (i.e. "15 per cent of the employer financed component of the value of the defined benefit interest that accrued after 1 July 2012".

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