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8 April 2014

SUBJECT: **Sustaining the Superannuation Contribution Concession – Division 293 Tax - Calculating notional contributions for defined benefit interests**

Dear Sir/Madam

Thank you for the opportunity to comment on the draft regulations. Mercer is ideally placed to comment on these regulations as we provide advice in relation to over 100 defined benefit arrangements covering both the private and public sectors.

Executive Summary

We fully support the draft regulations in relation to the use of the notional taxed contribution methodology. This approach is far more straightforward, less costly to implement and easier to explain to members than the approach proposed in the initial draft regulations issued in mid 2013.

However we have a number of concerns relating to Division 293 tax for defined benefits. Some of these are outside the scope of the draft regulations, nevertheless, they need to be raised:

1. **Reporting of defined benefit contributions for 2013/14**

   Due to time delays, defined benefit funds will incur unreasonable costs developing one off reporting of defined benefit contributions for 2013/14. *The transitional approach adopted for 2012/13 should also be adopted for 2013/14.*

2. **Existing concerns with the calculation of notional taxed contributions**

   Many existing concerns in relation to notional taxed contributions (NTCs) have not yet been resolved. *These concerns need to be resolved urgently to avoid ongoing confusion for NTCs as well as these spreading to Division 293 tax.*

3. **Public sector funds**

   The intention and application of draft regulation 293-115.15(2) is unclear. *It should be rewritten and clarified after further discussions with the Actuaries Institute.*

4. **Public sector funds funded by last minute contributions**

   The draft regulations do not solve the long standing problem for public sector funds where the employer financed benefit is provided by a last minute contribution to the fund and benefits are paid as untaxed benefits. *As part of the current amendments, the regulations should be amended to remove the need for such funds to report notional taxed contributions.*

5. **The definition of "end benefit"**

   The definition of "end benefit" in the Taxation Administration Act appears to inappropriately include payments from a member's non-defined benefit interest. *The legislation should be amended to reflect the interpretation set out on the ATO website.*

6. **The definition of "end benefit cap"**

   The "end benefit cap" is currently based on the member's superannuation interest. *The definition of end benefit cap should be based on the member's defined benefit interest not the superannuation interest.*

7. **Payment of debt account discharge liability**

   The provisions which only enable the debt account discharge liability to be paid from the relevant defined benefit fund are inappropriate. *It should be possible for a release authority in respect of the debt account discharge liability to be used with any fund.*

Comments in more detail

1. Reporting of defined benefit contributions

The ATO has already advised the industry the Member Contribution Statements for the 2013/14 year will not include reporting of the defined benefit contributions due to the lack of time available to change reporting systems. Rather, defined benefit funds will be required to lodge amendments to Member Contribution Statements for 2013/14 at a later date. This will add considerable cost as well as leading to even greater confusion for members who may receive more than one assessment/amended assessments due to the piecemeal reporting of contributions for 2013/14.

This is a costly and unreasonable impost on funds which has resulted from delays in the Government issuing the necessary regulations.

Recommendation

The approach adopted for 2012/13 should also be adopted for 2013/14 to minimise the red tape costs on superannuation funds and minimise confusion for members.

2. Existing difficulties with the calculation of notional taxed contributions

There are a significant number of outstanding issues associated with the determination of notional taxed contributions and the operation of the grandfathering rules. Many of these have been set out in the Actuaries Institute's submission dated 6 May 2010. As these issues will now relate to Division 293 tax as well as excess contributions, it has become even more urgent that these issues be resolved.

Recommendation

The issues referred to above should be resolved without further delay.

3. Public Sector funds

The intention and application of draft regulation 293-115.15(2) is unclear. For example, what happens if a trustee does not make the certification in part (i)? It would appear the fund would then be treated as an unfunded fund, irrespective of whether the benefits are fully met from contributions and earnings or not and irrespective of whether the fund has elected to exclude contributions from assessable income.

Further, the reference to "contributions made by you, or on your behalf" in part (ii) is inappropriate terminology for defined benefit arrangements as generally no employer contributions are made on behalf of a particular member – rather they are made in respect of the fund as a whole.

Thirdly, there is a possibility the defined benefit contributions will be determined on a different basis from the notional taxed contributions for some funds. This should be avoided.

Recommendation

Draft regulation 293-115.15(2) needs to be rewritten after further discussions with the Actuaries Institute to reflect the above comments.

4. Public sector funds funded by last minute contributions

The draft regulations do not solve the long standing problem for public sector funds where the employer financed benefit is provided by a last minute contribution to the fund and paid as an untaxed benefit. Such funds are required to report notional taxed contributions with members unfairly being subject to both the excess concessional contribution provisions as well as benefits in excess of the untaxed benefit cap being taxed at higher rates. Not only will some benefits be subject to tax at the member's marginal tax rate, these benefits will potentially have been partially or fully funded by contributions which have been effectively taxed at up to the top marginal tax rate.

> ***Recommendation***
>
> ***As part of the current amendments, the regulations should be amended to remove the need for such funds to report notional taxed contributions for benefits which will be paid as untaxed benefits.***

5. Definition of end benefit

The end benefit is defined in Section 133-130(1) (TAA) as:

> "A *superannuation benefit is the end benefit for a *superannuation interest if it is the first superannuation benefit to become payable from the interest, disregarding a benefit that is any of the following……"

Almost all private sector DB funds (and some public sector funds) provide members with **a single superannuation interest** which includes:

- A defined benefit interest PLUS
- An accumulation benefit account. The accumulation benefit account includes amounts such as amounts rolled over from previous superannuation funds with other employers as well as employer, member and salary sacrifice contributions which are not part of the defined benefit interest

Based on this definition, the following appear to be end benefits **if made from the member's accumulation account**:

- A rollover of the member's accumulation account to another fund
- A cash benefit from the member's accumulation account
- Payments made under a release authority to pay:
    - an excess contributions tax liability
    - a Division 293 tax liability (either for an accumulation or DB interest)
    - a superannuation surcharge liability (other than an amount resulting from the commutation of a pension which is wholly used to pay the surcharge liability)

In each of these cases, the defined benefit interest would be untouched and has not become payable. Treating the above payments as an end benefit is likely to cause significant criticism and defeats the purpose of the deferred tax provisions. Defined benefit funds would effectively be required to adjust defined benefits so the deferred tax liability can be paid from the fund. This will create problems for almost all defined benefit funds with potential funding issues arising for some public sector arrangements which provide defined benefits on an unfunded basis.

We note the ATO website provides information which appears to be inconsistent with the legislation (albeit far more logical than the legislation). For example, the following link (last updated on 18 March 2014) http://www.ato.gov.au/Super/APRA-regulated-funds/In-detail/Super-reform---a-guide-for-funds/Super-reform---a-guide-for-APRA-funds/?page=12 includes the following comments:

> "An end benefit occurs when the member is paid their first super benefit – subject to certain benefit exclusions – from the defined benefit account."
>
> "If you receive one of these release authorities, it is because you have advised us that your member has requested a benefit from their defined benefit interest in your fund. If you have not paid the benefit when you receive the release authority, you can release the money from your member's defined benefit interest."
>
> "You need to keep this information and, based on knowing about the debt account, advise us if your member requests an end benefit from the defined benefit interest to which the debt account is attributed."

Whilst we believe these statements reflect what the legislation should say, they appear inconsistent with the actual law.

Recommendation

Ideally Section 133-130 should be amended to refer to the defined benefit interest rather than the superannuation interest.

Alternatively, Section 133-130 could be amended or a legislative instrument could be issued (under Section 133-130(2)) to exempt the following from being treated as an end benefit:

> ***"Any payment from the superannuation interest which is not a payment from the defined benefit interest"***

If appropriate legislative action is not taken, then special consideration should be given to take account of the apparently incorrect and misleading information provided by the ATO, with any payments from a member's accumulation interest before say 1 July 2014 not treated as an end benefit.

6. End benefit cap

A similar issue relates to the definition of the end benefit cap. Based on Section 133-120, this too appears to be based on the member's total superannuation interest (including the member's accumulation interest). This appears illogical as the cap would be partly based on accumulation benefits which have resulted from accumulation contributions on which Division 293 tax would already have been paid.

Recommendation

Section 133-120 of the Taxation Administration Act should be amended so the end benefit cap is based on the defined benefit interest rather than the superannuation interest.

7. Payment of debt account discharge liability

The legislation enables a release authority to be issued to the relevant defined benefit fund in order to meet the debt account discharge liability. However this release authority is not valid for any other fund. This will lead to situations where members are unable to pay their tax. For example, the defined benefit may have become payable at, say age 45 when no condition of release has been satisfied. If the member has already rolled their benefit over to another fund, it will not be possible for the person to use their superannuation to pay the tax. The tax will need to be met from the person's other assets – potentially causing significant financial hardship. We consider the restriction on which fund can utilise the release authority is unnecessary and will result in inappropriate outcomes.

This restriction will also create difficulties for funds who will need to establish new procedures to try and avoid members inadvertently rolling over benefits. This is made more difficult by the portability requirements imposing a three day turnaround for rollover requests.

Recommendation

It should be possible for a release authority in respect of the debt account discharge liability to be used with any fund.

Please contact John Ward (03 9623 5552, john.ward@mercer.com) or myself if you have any queries on this submission.

Yours sincerely,

Dr David Knox
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