Manager
Retirement Benefits Unit
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email to: superannuation@treasury.gov.au

Dear Manager

Re: Submission in response to Superannuation Reform Package- Minor and Technical Amendments consultation

Thank you for the opportunity to comment on the Superannuation Reform Package Minor and Technical Amendments exposure draft legislation and explanatory memorandum.

The Financial Services Council (FSC) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Our submission and recommendations are provided in attachment A.

Please do not hesitate to contact me should you wish to discuss further.

Yours sincerely

S. Premetis

SPYRIDON PREMETIS
Senior Policy Manager
Tax and Economics

Attachment A – Substantive Comments

Application date for the transfer of assets by life insurance companies

We support this measure and thank the Government for appropriately amending the legislation to facilitate the appropriate outcome.

CGT relief to assets supporting continuing TRIS accounts that were not held by the fund continuously during the pre-commencement period (9 November 2016 to 30 June 2017)

The proposed legislative amendments do not resolve current issues that prevent superannuation funds from applying transitional CGT relief to assets supporting continuing TRIS accounts that were not held by the fund continuously during the pre-commencement period (9 November 2016 to 30 June 2017).

Some superannuation funds have no member level records for historical cost bases for existing TRIS accounts as there was no requirement to record this detail prior to 1 July 2017 given no tax applied to TRIS earnings. These superannuation funds will be unable to determine from 1 July 2017, at a member level, the amount of tax to be applied to earnings for assets purchased after the 9th of November 2016 that are supporting a TRIS as at 30 June 2017.

Allowing the transitional CGT relief to be applied to **all** assets supporting a TRIS as at 30 June 2017 will allow these superannuation funds to reset the cost bases of these assets thereby allowing the fund to determine, at a member level, the amount of tax to be applied to earnings for all TRIS accounts from 1 July 2017.

Section 294-110 of the *Income Tax (Transitional Provisions) Act 1997* as amended by *Treasury Laws Amendment (2017 Measures No. 2) Bill 2017* will allow the transitional CGT relief to be applied to TRIS assets that are held throughout the pre-commencement period and that cease to be a segregated current pension asset of the fund at a time during the pre-commencement period or at the start of 1 July 2017.

Recommendation 1: We request further legislative amendment to provide an exemption for assets supporting a TRIS from the requirement that to be eligible for transitional CGT relief an asset must have been a segregated current pension asset of the fund on 9th November 2016 (s294-110(1)(a) of the *Income Tax (Transitional Provisions) Act 1997*) and must have been held by the fund throughout the pre-commencement period (s294-110(1)(c) of the *Income Tax (Transitional Provisions) Act 1997*).

CGT Relief for complying superannuation entities that will be relying on PCG 2017/3 (PCG)

For complying superannuation entities that will be relying on PCG 2017/3 (PCG) in order to implement the changes to the taxation of TRIS, we would like to seek an extension of time for the CGT relief to apply up until the date that the Trustee or the Life Company is able to segregate and transfer the assets supporting TRISs back into the accumulation phase. It should be noted that the administrative relief under the PCG is limited to APRA regulated superannuation funds, pooled superannuation trusts (PSTs), life insurance companies and not available to SMSFs.

These entities relying on the PCG will not be properly segregated on 1 July 2017. However the current proposed amendments to CGT relief for assets supporting TRIS only intends to deem the 'cessation time' in respect of assets supporting TRISs to the start of 1 July 2017.

Recommendation 2: We would submit that the 'cessation time' in paragraph 294-110(1)(b) of the Income Tax (Transitional Provisions) Act 1997 ought to also be consistent and kept aligned with the start date of the 'remainder period' mentioned in paragraph 13 of the PCG. Arguably the intent of the CGT relief was to assist funds with transferring assets and effectively becoming fully segregated. Accordingly the alignment of dates between the CGT relief and the PCG is required so as to not disadvantage those funds that can't fully comply with the TRIS measures on 1 July 2017.

This could be achieved perhaps by amending subparagraph (ii) of that paragraph to effectively state that the 'cessation time' will be at the start of 1 July 2017 or a later date as allowed by the Commissioner.

For Superannuation Entities that are required to sell their pension units and then purchase an accumulation unit, we further submit that CGT relief be granted to ensure that this disposal is exempt from capital gains tax. .
NOTE: This may require the ATO to issue another PCG to stipulate that the later cessation date allowed by the Commissioner in subparagraph 294-110(1)(b)(ii) of the Income Tax (Transitional Provisions) Act 1997 will be the start date of the 'remainder period' in PCG 2017/3.

TRIS & nil cashing restriction conditions of release
The FSC acknowledges that the proposed legislation addresses an industry concern for individuals with TRIS accounts that meet a condition of release with a nil cashing restriction and availability of tax concessions by moving the account into the retirement phase.

Our concern is that there are some potential unintended consequences in the legislation as drafted:

- An obligation is created to treat these TRIS as in retirement phase
- Does this create an obligation to report to the ATO for purpose of a credit to the individual's transfer balance account?
- Where an individual permanently retires but does not tell their product provider for some time, what is the effective date for when the TRIS is now in retirement phase - when the product provider is notified or when condition of release was met - which could be in the past.
- Where the balance in the TRIS is higher than the transfer balance cap of $1.6M does only the portion below the cap get classified as in retirement phase?
- Are product providers expected to automatically apply an earnings tax exemption and/or automatically transfer a member's benefit in a TRIS product to an account-based income stream (or other retirement phase income stream) when the member attains age 65?

Implementation

There are a range of implementation issues, not dissimilar to the issues that arose from introducing tax on earnings to TRIS.

Member level tax treatment, or investment options that support the tax treatment are generally configured at the product category level, splitting the tax treatment of TRIS assets to the member level based on condition of release means that the same TRIS account may be considered to be in both a tax exempt and no—tax exempt state during the same financial year. This would pose significant challenge for many product providers.

To meet this requirement as drafted product providers may wish to treat the TRIS as if it was an unrestricted pension, eg the TRIS would become an account based pension or other such retirement income stream product.

Based on the EM and the interpretation that a TRIS cannot convert to an unrestricted pension, the TRIS would need to be commuted and a new income stream commenced in a product category that has the correct zero tax treatment – which is something that operationally some product providers have wanted to avoid.

As the TRIS is generally a sub category of an unrestricted pension product, we suggest that the TRIS rules could be modified so that when the individual reaches age 65 or dies, or advises their provider that they have met another nil cashing restriction condition of release (retirement, terminal medical condition or permanent incapacity) the TRIS ceases to be a TRIS, and the income stream can continue as a retirement phase income stream (of the base pension product) without the requirement to commute.

This alternative would meet the policy setting of ensuring assets of a TRIS are no longer eligible for an earnings tax exemption and align to existing operational processes that lift the TRIS flags that restrict the maximum annual payment and non-commutable elements on reaching a nil cashing restriction condition of release.

Recommendation 3: The TRIS rules could be modified so that when the individual reaches age 65 or dies, or advises their provider that they have met another nil cashing restriction condition of release (retirement, terminal medical condition or permanent incapacity) the TRIS ceases to be a TRIS, and the income stream can continue as an retirement phase income stream (of the base pension product) without the requirement to commute.

In regard to the issue of the product provider being dependent on being advised by the pensioner that they have satisfied a condition of release (particularly when they retire prior to 65), for clarity and to assist funds and the ATO in implementing these requirements, we propose that the Explanatory material include comments along the following lines:

> *It is recognised that in many cases funds will only become aware a TRIS pensioner has satisfied a retirement or other relevant condition of release when they are provided with a suitable statement to this effect by the pensioner, even though the pensioner may have satisfied the condition of release some time earlier. In addition, for many funds it will not be administratively feasible to backdate the movement of the TRIS to retirement phase. It is accepted that funds may set their own rules, with appropriate disclosure to members, as to the effective date of the movement of the TRIS to retirement phase in these circumstances, provided that this date is no earlier than the actual date at which the pensioner satisfied the condition of release.*

Reversionary TRIS

It is common for a TRIS to have a reversionary beneficiary death benefit nomination. A pension with an automatic reversion is a continuation of the original pension.

In light of the recent view that a TRIS is always a TRIS (despite a condition of release with a nil cashing restriction being met), a reverted TRIS would be a death benefit income stream and also a TRIS.

As death is a condition of release with a nil cashing restriction, the 10% limit on pension payments and the limitations on commutation would be removed. As a result, from a superannuation law perspective, it would be a TRIS by title however would have the features of a standard death benefit pension paid from an accumulation account or existing income stream.

Seeking confirmation of the above.

A death benefit can only be paid to a dependant in the form of an income stream if the income stream is in the retirement phase (6.21(2)(b)(i) and (ii) of the *Superannuation Industry (Supervision) Regulations 1994*).If a TRIS can revert on death and is considered a death benefit TRIS, the proposed amendments to subsection 307-80(3) won't result in the income stream being in the retirement phase. As a result this income stream won't receive the tax exemption on earnings as death benefit income streams ordinarily do (as they are considered in in the retirement phase). This would be an unintended outcome resulting in a more limited range of death benefit nominations being available to TRIS members. In addition, existing nominations that allow a TRIS to continue to be paid to a nominated beneficiary would become invalid. This would create administrative burden for industry and existing TRIS members and remove certainty and flexibility in relation to death benefit nominations for existing and new members of TRIS products.

Recommendation 4: Consideration could be given to amending proposed subsection 307-80(3)(b) to something along the lines of:

(b) the person to whom a *superannuation income stream benefit is payable from the superannuation income stream:

(i) has not satisfied a condition of release specified in paragraph (2)(c); or
(ii) did not receive the superannuation income stream as a result of the condition of release specified in item 102 (death) of the table in Schedule 1 to the Superannuation Industry (Supervision) Regulations 1994.

TRIS and Transfer Balance Cap interaction due to proposed amendments

Some existing TRIS members who have satisfied a condition of release listed at 307-80(2)(c) of the Income Tax Assessment Act 1997 and previously did not have more than $1.6m invested in the retirement phase because TRIS was excluded may now exceed their transfer balance cap on 1 July 2017 as a result of their TRIS now being included in the retirement phase. These members will have very little time to seek additional financial advice and make arrangements to remove excess amounts from the retirement phase before 1 July 2017 to avoid paying additional tax.

Recommendation 5: Transitional relief (from transfer balance tax) should be provided to individuals impacted by these amendments to provide them with sufficient time to seek financial advice and make arrangements to remove excess amounts from retirement phase.

Death benefit roll-overs

The proposed Bill will bring forward the amendment to the definition of roll-over to include death benefits to the date the Bill is introduced to parliament. We request that the proposal is removed from the Bill for the following reasons.

- The specifications for the new roll-over benefit statement are yet to be released. Superannuation funds are currently dealing with a lot of system changes and will be pressed to implement the roll-over benefit statement changes by 1 July let alone an earlier date,
- Where the system changes are unable to facilitate the roll-over of death benefits, a breach of the portability requirements will occur,
- Until the new laws come into force, a spouse who is in receipt of a death benefit income stream can commute their income stream back to the accumulation phase provided they are outside of the death benefit period (ie the latter of 6 months of death and 3 months of the granting of probate). Therefore the current laws allow these members to take preventative action to avoid exceeding the transfer balance cap at 1 July 2017. Those within the death benefit period can still commute their pensions, however the commuted amount will need to be paid out of the superannuation fund. This payment will be considered a death benefit and be tax-free as it is being paid to a spouse. Extensive pieces of advice dealing with these issues have been developed and amending this advice will be costly to the member.
- In the case of child pensions, under current law, where the commutation occurs prior to age 25, the lump sum will be tax free. Therefore a child who wishes to commute their pension to comply with the transfer balance cap pre 1 July 2017 will receive the death benefit tax free. The proposed change won't benefit children in this situation.

Superannuation funds will also be in the difficult position of not being able to act on a roll-over request received after the Bill has been tabled in Parliament but is yet to become law. There are possible portability issues where the request is received and not actioned until the change is legislated. The risk is greater where the Bill takes time to pass through Parliament and receive Royal Assent.

Recommendation 6: The proposed bring forward of the amendment to the definition of roll-over to include death benefits to the date the Bill is introduced to parliament does not proceed and is removed from the final legislation.

Structured settlement contributions and the transfer balance cap
There is currently an inconsistency in treatment of retirement income streams that were commenced with or include a structured settlement contribution before or after 1 July 2017. For structured settlement contributions made from 1 July 2017 both the structured settlement contribution and future investment growth are not counted against the individuals transfer balance cap. However for structured settlement contributions made prior to 1 July 2017, only the contribution is excluded from the individual's transfer balance cap and investment growth is included. This may result in some clients with large structured settlement contributions exceeding the transfer balance cap.

We understand it was the Government's intention to exempt these individuals from the transfer balance cap so that they can continue to access their funds to meet their healthcare and living needs without facing a faster depletion of their lump sum.

Under ITAA 1997 294.25 the individual receives a transfer balance cap credit based on the value of the pension at 1 July 2017.

Under ordinary circumstances an excess transfer balance will arise where the credit exceeds the transfer balance cap of $1.6m as per section 294.30.

Clients who make a structured settlement or personal injury contribution receive a debit based on the amount of the contribution under 294.80.

For those contributions made from 1 July 2017, the above credit and debit will generally net each other out. For example, the client makes a structured settlement contribution of $10m on 1 December 2017 and immediately starts a pension. This creates a credit and debit of $10m and a transfer balance cap of $0. Future investment earnings on that pension will not be counted as part of this client's transfer balance account and this client is therefore exempt from the transfer balance cap
For a similar client, who made a structured settlement contribution, but this time prior to 1 July 2017, they will not be exempt from the transfer balance cap. For example, a client received a personal injury payment of $10m in 2012 and contributed these funds to super. At 1 July 2017 the balance of their pension has increased with investment earnings and is now $13m. In this case the credit is for the full $13m and the debit is based on the original contribution of $10m meaning this client has a $3m transfer balance account and needs to remove $1.4m from the pension as it is in excess of the transfer balance cap. This is a different outcome to the first client example above and is inconsistent with the Treasurer's intention for these individuals.

Recommendation 7:
Include an amendment along the following lines:

Section 294-80(1) (table item 2)
Repeal the item, substitute:

2	a * structured settlement contribution is made in respect of you	the amount of the contribution or, if the contribution was made before 1 July 2017, the * value, just before 1 July 2017, of the * superannuation interest that is attributable to the contribution that supports the superannuation income stream	at the later of: (a) the time the contribution is made; and (b) the start of the day you first start to have a * transfer balance account

Unused concessional cap carry forward
Section 291-20(3) is clear that in a financial year the concessional contribution cap is sought to be increased (by utilising any (within 5) previous years unused concessional contributions cap) where the person's Total Superannuation Balance (TSB) is under $500,000 on the immediately prior 30 June.

It is not clear whether in those previous years one could have ("or generate") unused concessional contributions cap if their TSB was $500,000 or more.

For example (based on $25,000 concessional contribution cap throughout):

- TSB on 30 June 2018 is $500,001 and person only makes $5,000 concessional contributions for 2018-2019.
- TSB on 30 June 2019 is $515,000 and person only makes $10,000 concessional contributions for 2019-2020
- TSB on 30 June 2020 is $525,000 and person only makes $10,000 concessional contributions for 2020 -2021
- TSB on 30 June 2021 $499,999 (due to negative investment earnings)

Clarification is required to determine whether the person in 2021 -2022 can make concessional contributions of $25,000 plus$20,000 unused (2018-2019).

Industry believes this is the case because the definition of unused concessional contributions cap (UCC cap) makes no reference to the $500,000 TSB.

Recommendation 8: We seek clarification that this interpretation is correct, or make an amendment to clarify. Potentially the ATO could provide guidance with an LCG. We would also like some clarification as to whether a person can have (or generate) UCC cap for a financial year if they are a non-tax resident in that financial year.

Pooled Superannuation Trusts

In order to facilitate compliance by individuals with new provisions related to the transfer balance cap and revised taxation treatment of Transition to Retirement Income Streams (TRIS), the FSC submits that an amendment to Subdivision 294 -B of the Income Tax (Transitional Provisions) Act 1997 is required. The amendment will enable complying superannuation providers that invest members' money through a Pooled Superannuation Trust (PST) (or life company policy) to ensure equivalent transitional CGT relief is afforded to those individuals under the terms of the Subdivision and in accordance with the policy intent.

Policy Objective

As outlined within section 294-100 of the Income Tax (Transitional Provisions) Act 1997, the objective of the Subdivision is to provide temporary relief from certain capital gains that might arise as a result of individuals complying with the transfer balance cap (a limit of $1.6 million in pension phase) or the Transition to Retirement Income Stream (TRIS) changes.

As per the Explanatory Memorandum, the temporary CGT relief appropriately ensures that tax does not apply to unrealised capital gains that have accrued on assets that were either supporting TRIS or retirement phase assets in excess of the transfer balance cap prior to these policy changes coming into effect.

Submission

Since 1 July 1988, what we now know as complying superannuation funds have been subject to income tax at 15% of their taxable income. Also with effect from 1 July 1988 PSTs were introduced into the Australian superannuation environment, principally as a wholesale investment vehicle exclusively for complying superannuation funds, complying approved deposit funds and the complying superannuation business of life offices (referenced as complying super funds).
A PST is best understood as a wholesale investment vehicle for a complying superannuation fund. The PST provides the fund with a tax paid investment. Given their role as an investment vehicle for complying superannuation funds a PST is subject to tax on the same basis, and at the same rate, as a complying superannuation fund. In particular a PST is able to treat income attributable to underlying pensioners in the investing superannuation fund(s) as exempt from tax on the same basis afforded to complying superannuation funds.

There are various regulatory requirements imposed upon a PST (or more particularly the trustee of the PST) including via the Superannuation Industry Supervision Act (which also governs complying super funds).

Subdivision 294-B of the Income Tax (Transitional Provisions) Act 1997 provides temporary relief for complying superannuation funds ,by way of a CGT cost base step up, to deal with the introduction of the transfer balance cap and the removal of the tax exemption for TRIS.

Were these measures not introduced, members would, in effect, be retrospectively taxed on gains which accrued before the effective date of introduction of these new measures.

The FSC has identified the inadvertent omission of the PST and a life company in respect of these new measures which would, if not corrected, mean some individuals are adversely (and retrospectively) affected simply due to the nature of their fund's investment structure. That is, unless the relevant provisions are appropriately amended, members where assets are held via a PST (or life company), will be retrospectively taxed on gains accrued before the effective date of the new measures; such an outcome does not appear to have been the intent and we do not believe this outcome as contemplated by the legislature.

The FSC consider a fairly simple amendment would rectify this unintended error and would be happy to provide assistance in this regard.

Recommendation 9: Extend to PSTs temporary relief from certain capital gains that might arise as a result of individuals complying with the transfer balance cap (a limit of $1.6 million in pension phase) or the Transition to Retirement Income Stream (TRIS) changes.

Partial Commutation of a superannuation income stream

New subsection 307-65(2) of the 97 Tax Act provides that a lump sum arising from the partial commutation of a superannuation income stream is to be treated as a superannuation lump sum for the purposes of the 97 Tax Act (except for Subdivision 295-F—which deals with exempt pension income). This is particularly relevant for the purposes of Transfer Balance Account debit purposes and also in order to effect a rollover for the purposes of s.306-10 of the 97 Tax Act.

The issue here is there is no generally accepted view of what constitutes a partial commutation of an account based income stream.

Recommendation 10: s.307-65 be modified such that the amount is identified in an approved form and the ATO release further information concerning what in their view constitutes a partial commutation in this context.

Valuation of a superannuation interest which is a defined benefit interest in the accrual phase

Valuation of a superannuation interest which is a defined benefit interest in the accrual phase

Where a defined benefit interest is in the pension phase, for these purposes, a product provider will use the value determined for Transfer Balance Account purposes, however, if the benefit is in the accrual phase they will need to determine a lump sum value for that interest.

S.307-205 of the ITAA 1997 provides that an accumulation phase interest (in contrast to a retirement phase interest) is to be valued in accordance with the Income Tax Regulations (1997) if they specify a value (which in this context they do not), alternatively, the value of the interest is determined having regard to the total amount 'of the superannuation benefits that would become payable if you voluntarily cause the interest to cease at that time. ' This default method works acceptably in an accumulation benefit context and for most defined benefits but it does not work for all defined benefits – e.g. what value is to be placed on a DB interest which only pays a pension in the future?

We understand that this issue is recognised by Government and that it is also recognised that it is not feasible to impose a new valuation method on defined benefits for 30 June 2016 reporting of accumulation phase values. We therefore seek confirmation that:

- for 30 June 2016 reporting of accumulation phase values of defined benefits , the value will be the lump sum benefit available on immediate withdrawal where this exists, otherwise nil; and
- Government will consult on the ongoing method for determining accumulation phase values of defined benefits in the coming months.

In regard to the second point, we recommend that the lump sum benefit available on immediate withdrawal continue to be used where this exists. This is a pragmatic and simple approach that will provide reasonable values for the vast majority of super funds without imposing substantial additional costs on those funds.

A new methodology will then only need to be specified in regulations where there is no immediate lump sum withdrawal benefit (e.g. the leaving service benefit is an immediate pension with no lump sum option or a non-commutable deferred pension entitlement). We would be happy to discuss appropriate valuation approaches for these types of benefits.

Successor Fund Transfer and Transfer Balance Account

Division 294 of the 97 Tax Act (which deals with the transfer balance cap) contains no explicit recognition of the impact of a successor fund transfer upon the transfer balance cap. That is, on one view the successor fund transfer of a superannuation fund with members in the retirement phase could amount to the cessation of those income streams and the provision of new income streams by the transferee fund.

We see no reason why a successor fund transfer should not be overlooked for these purposes, albeit the transferee fund being recorded as the provider of these income streams.

Recommendation 11: A debit/credit to the transfer balance account is not required where an income stream moves provider as a result of a SFT – and that the ATO reporting rules supporting the administration of the transfer balance accounts be updated to reflect SFTs and change in provider.