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Dear Rebecca

Work test exemption for recent retirees – Draft legislation and regulations

Thank you for the opportunity to make a submission in response to the above draft material.

Mercer supports the policy measure to allow recent retirees to boost their superannuation balances by providing a one-year exemption from the work test for superannuation contributions.

However we have a number of concerns with the exposure draft material, the main ones being:

- We recommend removal of the proposed condition that non-concessional contributions (NCCs) made using the work test exemption (WTE) would NOT be able to be used to trigger the bring-forward rule. This condition would add a significant additional level of complexity and administrative burden for what we expect would be marginal revenue savings.
- We believe changes are also required to SIS Regulation 7.05 to accommodate the application of the WTE to defined benefit funds.
- For simplicity it would be preferable if the total superannuation balance threshold for eligibility for the work test exemption was aligned with the \$500,000 cut-off level that applies for carry-forward of unused concessional contributions caps, rather than introducing another cut-off level of \$300,000.

We have set out further comments in Attachment A.

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We also recommend the opportunity be taken for a more general review of the regulatory arrangements relating to the work test for superannuation contributions. We have set out in attachment B a proposal for a set of alternative arrangements that we believe would provide improved integrity and facilitate more effective and efficient administration, leading to reduced costs and lower fees for superannuation members.

Who is Mercer?

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Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have over \$150 billion in funds under administration locally and provide services to over 2.4 million superannuation members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, 239,000 members and more than \$22 billion in assets under management.

We would welcome the opportunity to discuss our submission and the proposal set out in Attachment B. Please contact me on [REDACTED] or by email if you would like to arrange a discussion.

Yours sincerely,



Dr David Knox
Senior Partner

Attachment A – Comments on Exposure Draft material

A1. Proposed condition re non-concessional contributions bring-forward rule

The draft material includes a proposed condition that non-concessional contributions (NCCs) made using the work test exemption (WTE) would NOT be able to be used to trigger the bring-forward rule (the Bring Forward Condition).

Additional complexity

Inclusion of the Bring Forward Condition would inhibit member understanding and add significant additional complexity to the communication material required to inform members about the WTE and to explanatory material relating to the bring-forward rules.

The bring-forward rules are poorly understood already by many super fund members and the Bring Forward Condition would significantly increase the complexity of these rules for members around the WTE time period.

We note the members able to take advantage of the WTE will have relatively modest superannuation balances and are therefore unlikely to have had much knowledge or understanding of the contribution limits and bring-forward rules in the past. They are also less likely to have utilised – or be confident about utilising - financial advice.

We note that inclusion of the Bring Forward Condition would add significant complexity even for the majority of members who might use the WTE without using the bring forward rules, as they will need to have sufficient understanding of the WTE rules to apply them to their personal circumstances and work out that the Bring Forward Condition would not affect them.

For the few who might seek to use the WTE in conjunction with the bring forward rules, the Bring Forward Condition would create very complex scenarios and would be likely to lead to member (and adviser) errors. Consider the following scenario:

- A member is age 64 on 1 July of the relevant year. They stopped work late in the prior financial year but may go back to work again if a suitable opportunity arises. Their 65th birthday is on 1st October, and, as events transpire, they subsequently return to work and first meet the work test on 1 March. They want to contribute \$150k to super to increase their current \$200k balance.
- As WTE contributions do not count towards the bring-forward, they will ONLY have access to the bring-forward if they contribute at least \$100,001 collectively in the periods 1 July to 30 September and 1 March to 30 June.

- If they contribute more than \$50,000 of their available \$150,000 during 1 October – 28 February, they will not have sufficient contributions eligible to trigger the bring-forward, and so will face at least \$50,000 of their total contributed amount being excessive. However it appears they could resolve this excess contribution by borrowing funds (say from a bank) to contribute enough to super after 1 March such that their total contributions in the periods 1 July to 30 September and 1 March to 30 June exceed \$100,000, qualifying them for the bring-forward so they no longer have an excess contribution problem.

The Bring Forward Condition means that the person intending to make contributions during the year of their 65th birthday may or may not be able to depending on the amount, timing and sequence of those contributions during the financial year. This level of complexity is likely to be impossible to navigate for many super fund members without financial advice.

As the propensity to use and pay for financial advice decreases with fund balance, having a contribution provision targeting low balance members that is dangerous to use without financial advice seems counter-productive.

Additional administrative burden

Inclusion of the Bring Forward Condition would mean that in some circumstances the ATO (in order to assess whether there had been a breach of the NCC limit) would need to know whether NCCs made by someone aged over 65, in the year they turn 65, were made using the WTE.

The explanatory material does not indicate how the ATO will determine this. There appear to be two main options:

- (a) funds will be required to somehow report to the ATO that the fund had accepted NCCs for a member under the WTE ; or
- (b) the members will be required to provide this information directly to the ATO, through their personal tax return or some other process.

Option (a) would impose significant additional costs on funds, which will generally be passed on to all fund members:

- 1) The least costly option would be for funds to notify the ATO a member is using the WTE via a report loaded through the Data Transfer Facility (DTF) or the new ATO MAAS/MATS Portal.
- 2) It would be much more costly to add a new attribute to the Member Account Attribute Service (MAAS) and use this to notify the WTE status to the ATO where required. In our view the numbers involved would not justify the investment required.

- 3) It would be even more costly to update and utilise the Member Account Transaction Service (MATS) somehow – for example this would mean funds would be re-reporting non-concessional contributions every time someone meets the WTE criteria. Again, in our view the numbers involved would not justify the investment required.

Option (b) would seem to be more efficient, given the ATO already has to extract other superannuation information from members' personal tax returns.

Also refer to Attachment B for an alternative process for administration of the work test and work test exemption that we believe would reduce system compliance costs and improve integrity.

Limited revenue savings

Inclusion of the Bring Forward Condition seems unlikely to result in significant tax savings to the Government (which we presume is the underlying reason for including this proposed condition). In order to have an impact on revenue we would need the following scenario:

- 1) the member turned age 65 during the year
- 2) the member did not satisfy the work test in the year
- 3) the member did satisfy the work test in the prior year
- 4) the member had a total super balance of less than \$300k at the end of the prior year
- 5) the member made NCCs for the year in excess of the NCC limit
- 6) the member did not make NCCs in excess of the NCC limit before they turned age 65
- 7) the member has not previously utilised the WTE

So essentially the member has to be in a position where:

- they can arrange their affairs to make NCCs in excess of \$100k for the year (more than one-third of their total super balance under the proposed threshold) but
- they can't arrange their affairs to make NCCs in excess of \$100k for the year before they turn 65 and
- they can't arrange their affairs to meet the work test in that year and
- if that money remained outside super the earnings would be taxed at a significantly higher effective rate.

Has Treasury conducted a cost benefit analysis of the Bring Forward Condition?

Recommendations

- 1) We recommend removal of the proposed condition that non-concessional contributions (NCCs) made using the work test exemption (WTE) would NOT be able to be used to trigger the bring-forward rule.
- 2) If Recommendation 1 is not accepted we recommend that the ATO be responsible for determining whether NCCs made by someone aged over 65, in the year they turn 65, were made using the WTE via information sourced directly from the member (rather than from fund to ATO reporting).
- 3) If Recommendations 1 and 2 are not accepted and hence funds are to be required to report to the ATO whether NCCs made by someone aged over 65, in the year they turned 65, were made using the WTE, given the low numbers expected to be involved we recommend that funds be able to notify the ATO of this via a report loaded through the Data Transfer Facility (DTF) or the new ATO MAAS/MATS Portal.

A2. Application of the WTE to defined benefit funds

The draft material includes amendments to SIS regulation 7.04 which sets out the conditions for a regulated superannuation fund to accept contributions made in respect of a member.

We note that SIS regulation 7.05 sets out the conditions for a defined benefit superannuation fund to grant a benefit accrual in respect of a member and currently mirrors the circumstances permitted under the contribution standard in regulation 7.04.

Recommendation

We recommend that amendments corresponding to those proposed for regulation 7.04 also be made to regulation 7.05 to ensure that members of defined benefit superannuation funds are able to take advantage of the work test exemption.

A3. Cut-off balance for WTE eligibility

For simplicity it would be preferable if the total superannuation balance threshold for eligibility for the WTE was aligned with the \$500,000 cut-off level that applies for carry-forward of unused concessional contributions caps, rather than introducing another cut-off level of \$300,000.

Alternatively the \$300,000 threshold should be indexed so it maintains its real value over time.

Recommendation

We recommend that the total superannuation balance threshold for eligibility for the WTE be set at the same level as applies for the carry-forward of unused concessional contributions caps (i.e. \$500,000).

If this recommendation is not accepted we recommend that the \$300,000 threshold be indexed by linking it to (12 times) the indexed base concessional contribution limit.

A4. Clarity that funds can rely on member attestations

P.6 of the Draft Explanatory Statement (ES) starts “Regulated superannuation funds would need to request information from members that would allow the fund to assess whether a member has a total superannuation balance below \$300,000 on the 30 June of the previous financial year. This is because a particular superannuation fund will not be in a position to independently calculate an individual’s total superannuation balance as the fund will not have oversight of an individual’s superannuation interests held in other funds.”

We request that the ES be amended to avoid any implication that funds need to do anything more than to obtain a statement from the member that they had a total superannuation balance below \$300,000 on the 30 June of the previous financial year. Obtaining such a statement from a member would be in line with existing practices around eligibility to make contributions after turning 65 and eligibility to make a Downsizer contribution.

Similarly in relation to the condition that the WTE can only be utilised in one financial year, the ES should make it clear that it is permissible for funds to rely on a statement from the member that they have not previously utilised the WTE. We note this statement is not strictly necessary if the WTE is being utilised to make NCCs made by someone aged over 65, in the year they turned 65 (as this is the earliest year they could have been eligible for the WTE).

Recommendation

We recommend that appropriate amendments be made to the draft ES.

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A5. Exemption only available in relation to one financial year – clarification of Explanatory Statement

We understand that draft r7.04(1a)(c) of the ED Regulations relates to the condition that the WTE is only available in relation to one financial year. On our reading, draft regulation r7.04(1a)(c) would exclude a member from being eligible to utilise the WTE in a year if they have utilised the WTE to make a contribution (or to enable contributions for them to be accepted) in a prior year.

However the ED Explanatory Statement (page 5) reads that a member would be ineligible if they have previously **qualified** for the exemption, without adding the further condition that the member must have made a contribution by utilising the WTE in a prior year in which they qualified to use it.

We support the condition as set out in draft regulation r7.04(1a)(c) and request that the wording of the Explanatory Statement be modified to make clear that an individual would be ineligible if they have utilised the WTE to enable contributions for them to be accepted in a prior year, but simply qualifying for the exemption in a prior year (without contributions being accepted under the exemption) would not render a person ineligible.

Recommendation

We recommend that appropriate amendments be made to the draft ES.

Attachment B: A proposal for streamlining and improving the integrity of the work test administration arrangements

We also recommend the opportunity be taken for a more general review of the regulatory arrangements relating to the work test (WT) for superannuation contributions. This attachment sets out some of the problems associated with the current arrangements and puts forward a proposal for a set of alternative arrangements that we believe would provide improved integrity and facilitate more effective and efficient administration.

Current process is costly, cumbersome and inefficient

The current administration of the work test is very cumbersome and costly for funds to administer, leading to higher fees for superannuation members.

Funds receive almost all contributions electronically and it is not practical to prevent acceptance of contributions for or by those over age 65 until the fund receives a statement from the member or their employer regarding the WT. Hence in practice funds accept the contributions and then write to the member (or their employer in some instances) seeking confirmation the member is eligible to contribute. Then:

- if the member/employer provides the required statement that they meet the WT, the member's record is noted accordingly and subsequent contributions are accepted without special action for the remainder of the financial year
- if the member/employer advises the fund the member did not meet the work test, the fund refunds the contribution (to the member or employer as applicable)
- if the member fails to respond (this rarely occurs with an employer) within a time period determined by the fund and advised to the member, the fund returns the contribution to the member
- in many cases where the member fails to respond and the fund refunds the contribution, the member then provides the necessary statement and remakes the contribution.

For large funds there may be many thousands of contributions each month where the WT confirmation process is triggered, resulting in a large amount of administrative work which is difficult or impossible to fully automate. In the bulk of these cases the member or employer advises the WT has been satisfied.

Hence a very large amount of work is currently required to identify and refund a relatively small number and amount of ineligible contributions.

Integrity issues and inappropriate outcomes of non-compliance

Given that funds rely on a statement from the member that they meet the work test, the current processes effectively already rely on self-assessment by the member.

We are unaware whether the ATO does any auditing or reasonableness checks for those who have made NCCs after age 65 e.g. by looking at their level of personal exertion earnings as an indicator of whether or not they are likely to meet the WT. However we suspect it would currently not be straightforward to apply any sanction to an individual who willfully advised a fund they met the work test when they didn't, as the obligation currently lies with the fund not to accept such contributions, rather than on the member not to make them. This is at odds with the responsibilities for complying with the contribution limits and the transfer balance cap - which lie with the member - with specified legal consequences for the member, determined by the Parliament, if they exceed the caps.

Alternative approach

Given the problems discussed above, we recommend a broad review of the regulatory arrangements relating to the work test for superannuation contributions be undertaken, and that this include consideration of the following set of alternative arrangements that we believe would provide improved integrity and facilitate more effective and efficient administration:

- Members would be responsible for self-assessing whether they meet the WT or WTE before they make a contribution
- Funds would be permitted to accept the contributions on the assumption that the member is eligible
- The non-concessional contributions (NCC) rules would be modified so that an NCC limit of zero applies for a person aged over 65 who does not meet the WT or WTE in the financial year
- Questions to establish WT/WTE eligibility for a person aged 65-74 who had made NCCs in the year would be added to the personal tax return and be subject to audit by the ATO
- If NCCs were made by a person aged 65-74 who was not eligible under the WT or WTE, these would be excess NCCs and the normal excess NCC processes would apply
- This would also deal with the issue of ineligible Downsizer contributions where the person was aged 65-74 and did not satisfy the WT or WTE or was over age 74, providing a suitable taxing outcome to deal with this situation which it appears may not be identified by the ATO for up to 12 months or more.

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The same approach would apply for salary sacrifice or voluntary employer contributions for members aged over 65.

We think this alternative approach we have recommended would be fully automated with some modification to ATO systems – noting that some modifications may be necessary anyway to accommodate the WTE.

In addition, this approach would improve the integrity of the system by facilitating ATO oversight of compliance with the WT and utilising existing NCC processes including the tax consequences for individuals over age 65 who make NCC contributions but do not meet the WT or WTE requirements.

We note that, given the timeframe for this submission, we have not yet had the opportunity to test this idea with others in the industry. Doubtless some issues would arise (such as how to deal with those who would otherwise not be required to lodge a tax return) but given the advantages outlined above we believe it merits serious consideration.

We would welcome the opportunity to discuss this proposal.