Submission to Treasury, June 2021 Via email 04/06/2021

RE: Reducing red tape for Superannuation Funds

Providing choice for Trustees calculating Exempt Current Pension Income (ECPI)

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Andy O'Meagher is a software developer who introduced direct software processing of SMSF Actuarial Certificates in 2007 while working for Bendzulla Actuarial who went on to become the largest SMSF Actuarial Certificate provider by 2009, with roughly 80% of the national market.

Act2 Solutions was started by Andy after he was 'let go' by his previous employer in January 2010 and is now Australia's second largest provider of SMSF Actuarial Certificates.

Throughout this submission the term ***pension only*** refers to those periods during an income year where the only non-zero account balances are Account-Based Retirement Phase Income Streams.

Although I have a vested interest in the outcome of the proposed changes to the legislation, I am also invested in how the outcomes impact Trustees, Accountants and Advisors, software vendors and the ATO.

Concerns about proposal regarding ECPI election for trustees.

1. The proposed changes will increase complexity and costs around determining ECPI.
2. There can only be a loss of ECPI revenue to ATO resulting from the proposed changes.
3. An increase in cost and complexity for software vendors and actuarial certificate providers.
4. The suggestion that there will only be a single certificate required, is already the status quo.
5. There is confusion around the wording as it appears that ***pension only*** periods may be treated differently from each other, as well as potentially be broken into smaller periods for ECPI treatment.

Explanation on those concerns.

1. The aspiration for the proposed changes is that they will "provide superannuation trustees with greater choice in how they calculate exempt current pension income and minimise the complexity and cost in a fund's reporting." Unfortunately, those experienced within the SMSF industry can clearly see (and have expressed as much) that the unintended consequences of these changes will be an increase in complexity and greater confusion.

   If the intention is to allow Trustees to elect whether to use the current approach (all ***pension only*** periods must be treated as 100% exempt), or Trustees can treat the entire income year is as Unsegregated, this needs to be made clear as the current wording is ambiguous and is open to interpretation significantly beyond these two approaches.

2. The only possible outcome to Treasury/ATO is a reduction in the amount of ECPI paid by SMSFs. Whilst this sounds beneficial to Trustees, they can only realistically benefit after greater time and effort being applied to examining the options available to them to optimise the outcome which will put greater pressure on Accountants and Advisors.

3. These changes will require further expense on the part of software vendors as well as the actuarial providers, who have recently made significant changes to software for the introduction of Deemed Segregated Periods. The proposed changes could significantly increase the level of complexity of data required for actuarial calculations and certification.

4. The ATO Law Companion Ruling **2016/8 1.14** states that "…trustees could choose to apply the proportionate method for the whole of the income year based on a single actuary's certificate." The current approach with Deemed Segregated Periods (DSPs) where the Segregated Method must be used to claim ECPI for that period, only a single actuarial certificate is ever required. The certificate documents the different periods and indicates which approach for claiming ECPI must be applied to income received in each period.

   For example:

Start Date	**End Date**	**ECPI Method**	**Taxation treatment of relevant earnings**
01/07/2019	01/07/2019	Deemed Segregated	Earnings in this period are fully exempt.
02/07/2019	30/06/2020	Unsegregated	99.245% of earnings are exempt.

   Most actuaries endeavour to make things as clear as possible to Trustees, Accountants and Advisors as to how the ECPI is to be determined. Whilst there are some clients struggling to fully comprehend DSPs, there will always be a broad spectrum of understanding in the SMSF industry. However, these proposed changes do not eliminate the confusion, but rather, create further complication and confusion around how ECPI can and should be calculated.

5. After a long discussion with other major actuarial certificate providers, it was clear that, even these revered and highly educated professionals are confused around the intention or practical application of these proposed changes.

   The actuaries were concerned that:

   - *Each **pension only** period can be treated differently* (i.e. the first might be treated as a DSP being fully exempt and using the Segregated Method, where the second period might be treated as Unsegregated using the tax exempt percentage).

   - The wording around this change might mean something other than entire ***pension only*** periods. There was consternation around the possibility that some days in a ***pension only*** period could be treated as Segregated, whereas other days in the same period may be treated as Unsegregated.

   - Further software development would be required by each actuarial certificate provider, as well as each of the SMSF Administration software vendors, to cope with these proposed changes. Moreso that the time and effort that will go into these changes will return no benefit to the actuaries, software providers or the Trustees.

Proposals

1. Preferred option - maintain the status quo with Deemed Segregated Periods.

2. Return to treating the whole income year as Unsegregated. ***This is, from my industry experience, the fairest approach to income tax exemption - and the simplest!***

3. Go ahead with the proposed ECPI election, with the clarification that all ***pension only*** periods can be treated as DSPs or the entire income year is to be treated as Unsegregated. No middle ground.

Reasoning behind the proposals

1. After several years, most Accountants and Advisors understand how Deemed Segregated Periods work and have strategies around DSPs to benefit Trustees.

   Benefits of maintaining the status quo:

   - No additional complexity or confusion;
   - Systems are already in place to work with current legislation;
   - The majority of SMSFs are administered on software that handles the current legislation correctly and appropriately;
   - No expensive (and unnecessary) changes to software or procedures;

   Drawbacks of maintaining the status quo:

   - Some professionals still require a better understanding of the current legislation;
   - Earnings and Capital Gains realised during a DSP are 100% exempt (a more negative impact on the tax inflows than the Unsegregated approach).

2. Returning to treating the entire income year as Unsegregated is something that all actuarial providers and most Accountants and Advisors will be familiar with. It is something that is easily explained to Trustees and to newcomers in the industry.

   There is a simplicity and fairness in this approach in that ***the circumstances of the Fund whilst earning the income*** determines the level of income tax exemption, not ***the circumstances of the Fund at the time of receipt of the income***.

   If a 2-member Superannuation Fund is entirely in Accumulation (non-Retirement) Phase for most of the income year, then on 1st May one member commences a pension, and on 1st June the other member commences a pension.

   - Using the current DSP method, if the Fund receives 80% of its income in June (due to the timing of receipt of distributions), that ***80% of the income will be fully exempt*** from income tax because the Fund was fully in Retirement Phase in that period.
   - Using the Unsegregated method, if the members had similar balances during the year, the tax-exempt percentage will be around 12.5%. This is ***a fair and reasonable outcome*** given that all earnings received, at any time in the year, are 12.5% exempt and 87.5% taxable. This is because, for 87.5% of the year, the assets were in non-Pension accounts, earning taxable income. Even if 80% of the income arrives in June, still 87.5% of the entire annual income is taxable, since 87.5% was earned by non-Pension Assets (and non-Pension assets earn taxable income).

Benefits of returning to the Unsegregated Method:

- A likely reduction in the amount of ECPI being claimed from ATO;
- It is the simplest approach and is well understood by the industry;
- It should be simple for actuarial providers to revert their software.
- It is the fairest approach to claiming ECPI. Tax is paid according to how the income was earned, not according to when the income was received.

Drawbacks of returning to the Unsegregated Method:

- A likely reduction in the amount of ECPI being claimed by the Trustees;
- Changes required to software, strategies and procedures;
- Those who have become accustomed to utilising DSPs for improved income tax and CGT exemption will be resentful of the change;

3. ECPI Election legislated so that there are only two options for Trustees to choose from:

   - The Unsegregated Approach for the entire income year, or
   - The current DSP approach where all ***pension only*** periods must be treated as 100% exempt using the Segregated Method.

   The result is less confusion and the slight increase in complexity is offset by the opportunity for Trustees to gain a tax advantage by choosing the method that gives them the best outcome.

Thank you for the opportunity to provide a submission to this proposal. I hope these comments add some insight and understanding into to the complex nature of claiming ECPI within SMSFs. My firm fields many queries daily around Deemed Segregated Periods and Disregarded Small Fund Assets, so we have a good grasp of industry understanding around claiming ECPI. We desire a simple and fair approach for all Trustees; however, we also desire a stable and predictable system such that clients and Trustees can work with certainty when preparing for their retirement.

Yours sincerely,

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