18 June 2021

Retirement Income Policy Division
Treasury
1 Langton Cres
Parkes ACT 2600

Email: superannuation@treasury.gov.au

Dear Sir/Madam,

SMSF ASSOCIATION SUBMISSION: REDUCING RED TAPE FOR SUPERANNUATION FUNDS – ECPI MEASURES

The SMSF Association welcomes the opportunity to provide a submission on Treasury's two exposure drafts in relation to the requirement for actuarial certificates for certain superannuation funds and providing choice for trustees when calculating exempt current pension income.

1. Requirement for actuarial certificate for certain superannuation funds

The SMSF Association welcomes and supports this proposed legislative change. It adopts a practical, common-sense approach and removes unnecessary red tape and cost. The proposed application for the 2021-22 year of income onwards is appropriate and supported.

We think there is also an opportunity to simplify the way the disregarded small fund asset rule works by aligning the current $1.6m threshold with the general transfer balance cap.

In accordance with section 295-387(2)(c)(i) of the *Income Tax Assessment Act 1997* (ITAA97), the assets of an SMSF are disregarded small fund assets if, just before the start of the income year, a member of the SMSF has a total superannuation balance that exceeds $1.6 million, and that member is a retirement phase recipient.

When this measure was first introduced, this threshold was set so that the dollar value aligned with the general transfer balance cap. However, it is not directly connected to or indexed to the general transfer balance cap. As a result, it sits as a standalone threshold for application within this section of the legislation.

With the general transfer balance cap set to be indexed from 1 July 2021, we will see added complexity creeping in the system with another, separate threshold to apply, that ceases to align with other measures.

Given the multiple uses of the current $1.6 million threshold across a range of measures, that are also indexed to the general transfer balance cap, the lack of indexation here will likely cause confusion as it diverges from other measures.

To reduce this complexity, we think section 295-387(c)(i) of the ITAA97 should be amended by replacing the reference to "$1.6 million" with a reference to the general transfer balance cap.

This would not only reduce the number of balance thresholds that are used for different purposes, but would also ensure the threshold, which is used to determine whether an SMSF has disregarded small fund assets, is indexed over time.

Conceptually we think the disregarded small fund asset threshold and the general transfer balance cap should be linked. If the intent of the disregarded small fund asset rule is to prevent individuals with large superannuation balances being able to segregate the assets of their fund which are supporting the payment of a pension, it would seem reasonable to define a "large superannuation balance" consistently as the general transfer balance cap.

2. Providing choice for trustees calculating exempt current pension income

We acknowledge and welcome the positive policy intent behind this measure which is designed to reduce red tape, complexity, and cost. However, we are concerned this measure may now in fact have the opposite effect and may lead to additional complexity and cost for SMSF trustees.

We believe the time for this measure was when the *Fair and Sustainable Superannuation* legislation was first introduced. These reforms were significant, requiring substantial changes to SMSF accounting and administration software programs. This includes the calculation of and accounting for exempt current pension income.

As we are now several years into the active use of the *Fair and Sustainable Superannuation* legislative reforms, industry too has moved forward. As such, accounting, administration and actuarial systems and processes are now well established to comply with the legislation.

Allowing trustees now to choose their preferred calculation method will require further changes to software and accounting and administration processes. It will create further complexity and cost as software systems and administration processes will need to be able to support both calculation methods, including tax optimisation tools to enable trustees and practitioners to identity the most tax efficient calculation method given the specific circumstances of the fund.

We have identified several issues with the measures as proposed:

1. No specific time is stated on when an election must be made by Trustees.
2. Trustees meeting their 'best financial interests' duties, and the additional costs of doing so.
3. Measures are set at the asset level. This is too generous and may be open to manipulation and cherry picking.
4. Measures allow for an asset to be segregated at any time during the year, suggesting multiple periods can be created throughout the financial year.

The draft legislation does not specify the time at which an election must be made. The legislation needs to be precise in this regard and we would recommend that a statement to the effect of "the trustees can elect the method they wish to apply up to the time the SMSF Annual Return (SAR) is lodged with the Commissioner." This will provide Trustees with clarity and certainty on when the choice of ECPI methods must be made.

The timing of the election is also relevant and important when we consider a Trustee's 'best financial interest' duty. In meeting this obligation, Trustees need the opportunity to review and reflect upon the option best suited to the fund and its members.

If elections are required to be made prospectively at the start of the financial year, the trustees of the fund would not have the benefit of having access to key information in making that decision. The fund's activities and transactions for the income year would not yet be known and as such, trustees would not be able to discharge their duties and obligations adequately and appropriately.

Further, concerns are held as to what extent an SMSF trustee would be expected to explore different options and outcomes in discharging their duties. This will create additional administrative and cost burdens on SMSF trustees.

We note revenue forecasts in the 2019 Federal Budget project no revenue leakage from this measure over the forward estimates regardless of which ECPI calculation method is applied. This suggests allowing SMSF trustees to choose their ECPI calculation method respectively (i.e. after the end of the income year) rather than prospectively (i.e. just before the income year commences), is unlikely to lead to any material revenue leakage.

However, the law as proposed is very generous, applying at the asset level and allowing for an asset to be segregated at any time. Our concern is that whilst well intended, the proposed legislation would result in aggressive tax planning that seeks to deliver more favourable tax outcomes for the fund.

In our view, a simpler approach would be to adopt replacement legislation that would allow trustees to apply the proportionate method to all assets of the fund, for the entire year of income. The trustees would be required to obtain an actuarial certificate to determine the taxable/tax free percentage to be applied to the fund income for that financial year.

Under this method, funds that are in the retirement phase for the entire year of income would be classed as segregated funds. In this circumstance, an actuarial certificate would not be required and the whole of the fund's income would be classed as exempt current pension income.

To alleviate any red tape, additional cost and complexity, the proportionate method would be applied as the sole method. As such, replacing the current segregated current pension assets provisions and the proposed amendments in this Bill.

The proportionate method is one that aligns with the SMSF industry's interpretation and application of the ECPI method that was broadly applied prior to 1 July 2017. It would also avoid the complexities associated with making elections on which method to apply, including decisions that would be required at the asset level over multiple periods under the proposed legislation.

In our view, by adopting the proportionate method, the measure would align with the 2019 Federal Budget forward estimates and meet the policy objective of removing red tape along with unnecessary administration and cost from the system.

In the event our recommendation was to be adopted, it may be prudent to consider delaying the commencement date of the new legislation. The draft Bill as presented is set to apply from the 2021-22 year of income onwards. To allow time for the passage of the Bill and then for industry and software companies to amend their systems and processes, a revised commencement year of 2022-23 may be more appropriate.

If you have any questions about our submission, please do not hesitate to contact us, and we thank you again for the opportunity to provide this submission.

Yours sincerely,

Peter Burgess
Deputy CEO/Director of Policy and Education
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing SMSF sector which is comprised of over 1.1 million SMSF members who have more than $700 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.