AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

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AIST 2022-2023 Pre-Budget Submission to the Minister for Housing and Assistant Treasurer

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AIST

The Australian Institute of Superannuation Trustees (AIST) is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $1.6 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds in delivering the best financial outcomes for their members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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Executive summary

The AIST thanks the Minister for Housing and Assistant Treasurer for the opportunity to make this Pre-Budget Submission for 2022-23.

The submission reiterates policy recommendations made in recent years that remain unaddressed, and makes proposals directly related to the recent implementation of the Your Future, Your Super measures plus the ongoing impact of the COVID-19 Early Release of super scheme.

AIST's central propositions are that:

1. While our retirement savings system is already among the best in the world,[1] improvements can be made to better safeguard Australians' financial stability in retirement and enhance the equity of the system, in particular for vulnerable Australians and women.
2. There are opportunities to improve the fairness, equity, adequacy and transparency of our retirement savings system which will benefit all Australians

As the country continues to manage the economic impacts of the pandemic, retirement income policy needs to continue to strive for these improvements so we can strengthen our retirement income system to ensure the long-term financial stability and comfort of Australians.

An important step in achieving this transparency and fairness is ensuring that the performance test included in the YourSuper, Your Future legislation be extended to all APRA regulated superannuation products and include their details in the ATO YourSuper tool. This will allow all Australians with super, outside of self-managed super funds (SMSFs), to see how their fund is performing, compare it to others and make informed decisions about where they want their super to be managed.

In addition, the issue of the adequacy of Australia's system must be addressed to ensure we do not fall further in world rankings and on delivering outcomes for working Australians.

Accordingly, there should be no change to the legislated timetable to increase the Superannuation Guarantee (SG) rate to 12% by 2025.

In line with this, recommendations to enhance the ability of the system to generate strong retirement outcomes for Australians include expanding the right to SG contributions for all workers, passing the legislation to scrap the minimum monthly salary threshold of $450, and ensuring that super contributions are payable on paid parental leave. A range of measures targeting improvements to the overall equity of the system are also presented.

[1] Mercer CFA Institute Global Pension Index 2021

AIST repeats our call for the objective of the retirement income system, including the role of superannuation, to be codified in legislation.

AIST makes the following recommendations, which are outlined in greater detail in the pages that follow.

Fairness & Equity

1. Extend the YourSuper, Your Future performance test to all APRA regulated superannuation products and include their details in the ATO YourSuper tool.
2. SG to be paid on paid parental leave.
3. Amendments to superannuation and taxation law be considered to ensure that children adopted under traditional Aboriginal and Torres Strait Islander structures are treated as any other child of the member.
4. Progress the promised abolition of the $450 per month income threshold for the SG, to improve fairness and reduce incentives to casualization of the workforce, including commitment to universality of SG requirements for all PAYG employees, independent contractors, and the self-employed.
5. Further improve the equity of tax concessions and support to achieve financial security in retirement for all Australians.

Adequacy

1. Ensure the timetable for the legislated increase to the SG rate to 12% is not altered.
2. In addition to examining levels of paid parental leave, SG to be paid on paid parental leave.
3. Progress the promised abolition of the $450 per month income threshold for the SG, to improve fairness and reduce incentives to casualization of the workforce including commitment to universality of SG requirements for all PAYG employees, independent contractors, and the self-employed.

Transparency

1. Improve transparency and controls around the early release of superannuation, including assessing the impact on those experiencing family violence.
2. Measure and publish the impact that any future changes to super would have on women.
3. Legislate the objective of the retirement income system, including the roles of superannuation and aged care, to ensure superannuation is not viewed as a resource able to be used for anything other than retirement savings (except in the most exceptional of circumstances).

Other recommendations are:

- Adopt a single asset-based means test for the Age Pension and aged care.
- Reduce the taper rate to $2 per $1,000 in assets.
- Removal of the rule limiting the payment of superannuation to workers under the age of 18 who work at least 30 hours a week.
- At least double the rate of Age Pension rental assistance for those who do not own their home.
- Funding for government agencies to develop a data sharing framework for the retirement income covenant, design distribution obligations (DDO) and calculators and then assist agencies with implementation.
- Ensure design of the new remote jobs programme promotes real jobs that include full entitlements including award wage rates, superannuation and other award entitlements.
- Strengthen action against SG non-compliance to address unpaid and underpaid super.
- Prohibit super fund borrowing to purchase property and shares.
- Reform of Non-Arm’s Length Income and Expense Rules (NALI/E).

Recommendations

FAIRNESS & EQUITY

Extend the YourSuper, Your Future performance test to all APRA regulated superannuation products and include their details in the ATO YourSuper tool.

AIST submits that the Government extend the YourSuper comparison tool to cover *all* APRA-regulated superannuation products and fund the ATO and APRA to develop and implement the extended tool during the 2022-2023 financial year. This will enable members of products not currently included in scope for the YourSuper comparison tool to compare the performance of their fund in a simple, accessible, comprehensive, and consistent manner. A version of the tool should also be developed for look-up by employers.

Including all products in the YourSuper comparison tool is in line with the Productivity Commission's view that all products should have simple and comparable dashboards and meet performance requirements.

The expanded tool should encompass all APRA-regulated superannuation products in both the accumulation and retirement phases, regardless of size, eligibility and whether or not the product is open to new members. This should include pre-mixed options, single-class options and options delivered through a member-directed investment 'platform'. The tool could be split into different comparison options so accumulation would not be compared with a retirement phase product.

The inclusion of all accumulation products is particularly important in light of the recent findings of the APRA Choice heatmap, which showed that on average those Choice products assessed were higher cost and had a greater variance in performance than MySuper products. While the Choice heatmap is a good start, it only covers 40% of Funds Under Management of all accumulation superannuation options in the Choice sector leaving many Australians in the dark about the relative performance of their super fund.

In addition to the development of the YourSuper tool completed by ATO and APRA, other initiatives being implemented by these same regulators are removing impediments to the inclusion of all superannuation products and near real-time information about a member's super accounts. Collectively, these initiatives can and should be marshalled to support a comprehensive tool covering all APRA-regulated superannuation products.

These projects include:

- The ATO's Member Account Transaction Service (MATS) is a reporting solution that allows for more frequent, event-based reporting of member data to the ATO. MATS, together with the Member Account Attribute Service (MAAS), have provided comprehensive reporting of member superannuation information since 2018.
- APRA's multi-year Superannuation Data Transformation project is enhancing the comparability and consistency of reported data on APRA-regulated superannuation funds. This reporting covers all the products offered by APRA-regulated super funds.
- ATO offer a range of services allowing digital service providers the option of building functionality into their software products to allow employers to offer online commencement forms for new employees. The ATO also provides online access to these forms through myGov; with these forms being partially completed with the relevant default fund of the individual's employer and details of the individual's current super accounts.

The scope of the YourSuper comparison tool is only about "some of your super": the AIST proposal is for an AllYourSuper comparison tool that would provide a demonstrable benefit for almost all Australians.

AIST Recommendation
1. Extend the performance test and YourSuper comparison tool to cover all APRA regulated superannuation products (for those in both the MySuper and choice segments).

Pay SG on paid parental leave

AIST supports a Government-funded parental leave scheme that includes a superannuation component, linked to the payment of SG contributions required on average weekly earnings. Paid parental leave is the only paid leave that does not have superannuation paid. This particularly disadvantages women who are the overwhelming majority on parental leave, and further exacerbates the gender super gap.[2]

Latest statistics show that women still account for 93.5% of all the primary carer paid parental leave taken. The implementation of a paid parental leave scheme with a superannuation component would allow parents to continue building their superannuation whilst on parental leave.

The lack of such a superannuation component – coupled with the very low level of paid parental leave – adversely contributes to the gap between women's and men's retirement savings.

[2] Workplace Gender Equality Agency (WGEA), Parental leave statistics. Available from: https://www.wgea.gov.au/parental-leave

Paid parental leave schemes (coupled with superannuation) assist with improved workforce participation rates (particularly for women of child-bearing age). Chart 1 below[3] highlights where Australia sits internationally in terms of paid parental leave:

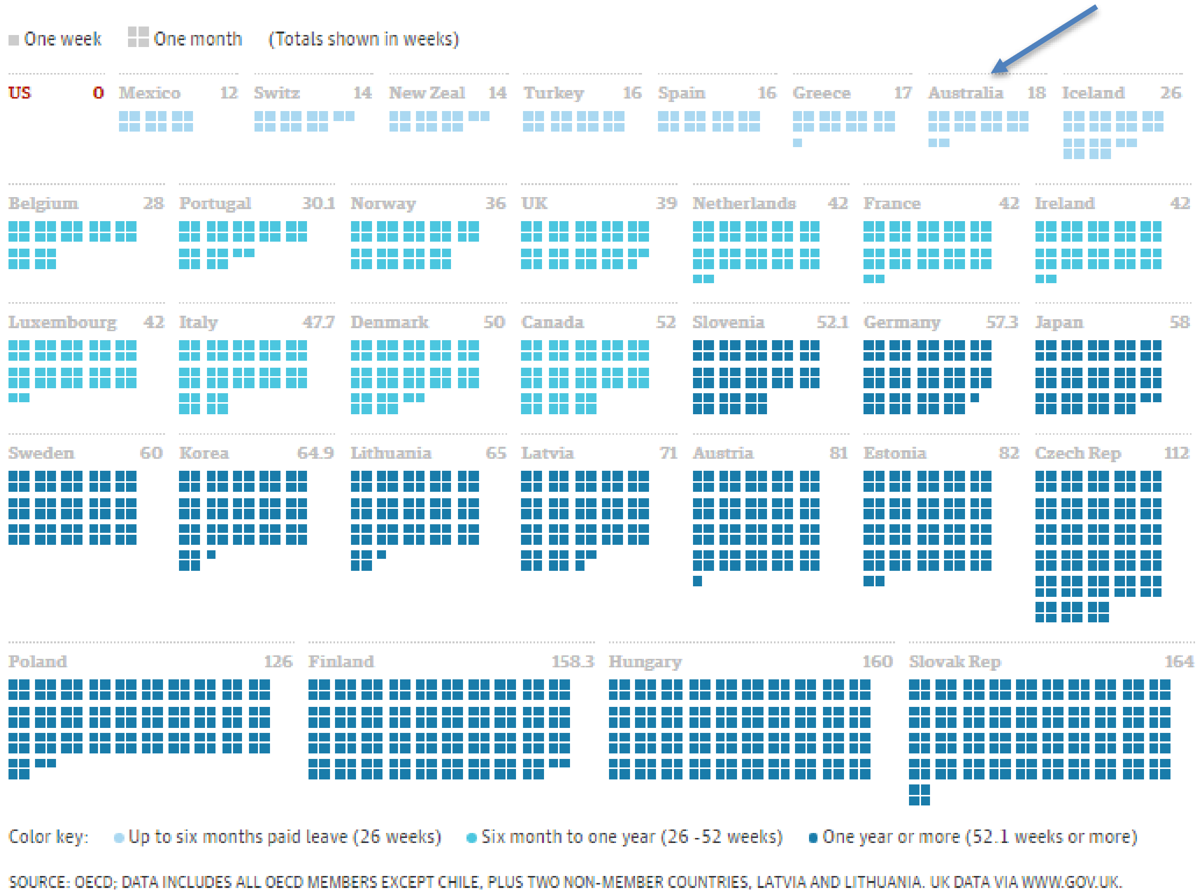


Chart 1

AIST recommends that (in addition to examining levels of paid parental leave) SG be paid on parental leave. The benefits of making this change were evidenced by the Retirement Income Review, as presented in the following Chart 2, reproduced from its final report.[4]

[3] Popovic, N. (2014). The US is still the only developed country that doesn't guarantee paid maternity leave. *The Guardian*. [online] Available from: http://tinyurl.com/mtabaum.
[4] Retirement Income Review final report, p.270.

Projected impact on women's retirement incomes of receiving superannuation for one term of employer paid parental leave

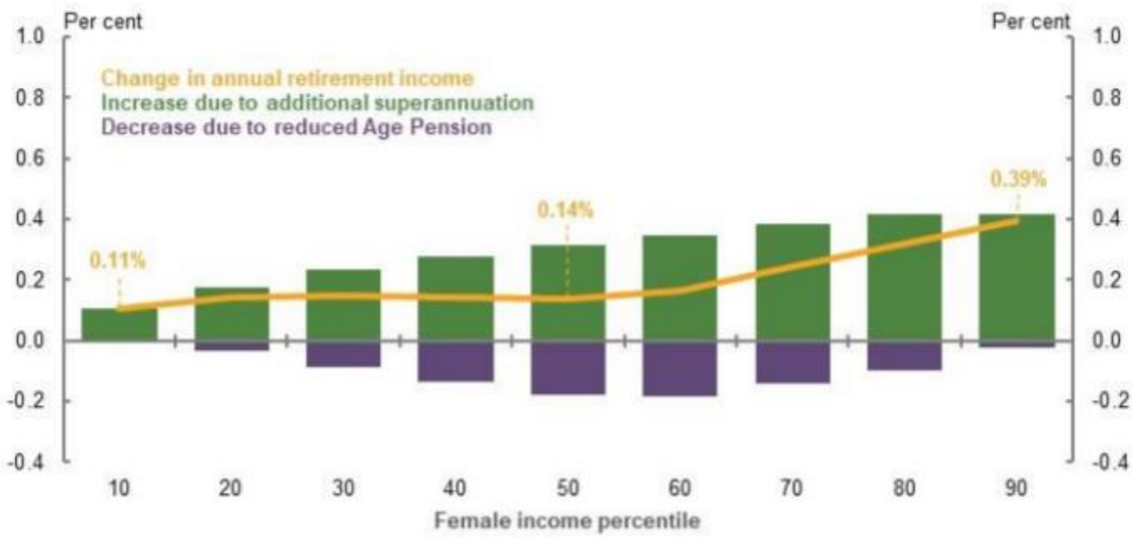


Chart 2

Further analysis has recently been carried out by Industry Super Australia who found that "A woman on median wage who has two children and receives both the Commonwealth Parental Leave Pay and employer funded parental leave would be $26,500 better off at retirement.[5]"

AIST Recommendation
2. SG to be paid on parental leave 3. Examine the levels of paid parental leave to ensure it provides an appropriate level and length of support to parents

[5] Industry Super Australia, Paying super on parental leave, September 2021. Available from: https://tinyurl.com/wn5mm34y

Government to further consider kinship issues with respect to Aboriginal and Torres Strait Islander adoption practices, and their interaction with superannuation binding death benefit nomination settings

The Financial Services Royal Commission suggested that the Government explore, in consultation with relevant Aboriginal and Torres Strait Islander peoples, difficulties they face making binding death benefit nominations.

In response, in March 2019 Treasury released the discussion paper "Superannuation binding death benefit nominations and kinship structures," inviting feedback on possible law changes to address how kinship structures of Aboriginal and Torres Strait Islander people are treated by laws applying to superannuation death benefits. We are unaware of any advancement on these issues since then or of any public statement from the Government outlining a policy position or a response to the paper, including any additional consultation with Aboriginal and Torres Strait Islander stakeholders.

In relation to the distribution of death benefits, current superannuation laws recognise people in an interdependency relationship but does not recognise all 'dependants' – e.g., where a person is a child under traditional law but is not in an interdependency relationship with the traditional parent at the time of death. AIST notes that although the introduction of the interdependency definition has provided some flexibility, this definition remains too narrow to explicitly accommodate Aboriginal and Torres Strait Islander kinship structures.

AIST recognises that this policy change will also require consideration of a mechanism to legally recognise beneficiaries who under traditional law are considered children, and urges the Government to continue discussions with stakeholders, including Aboriginal and Torres Strait Islander people, to progress these issues.

AIST Recommendation
4. Amendments to superannuation and taxation law be considered to ensure that children under traditional cultures are recognised as dependants.

Removal of the $450 per month SG threshold, and scrapping the rule withholding superannuation entitlements from employees under 18 years of age who work less than 30 hours a week and a commitment to universality of SG cover for all PAYG employees, independent contractors, the self-employed, and replacement of CDP with real jobs

AIST supports the removal of the $450 per month income threshold on the SG as a measure to improve fairness. While this measure has bipartisan support, legislation to formalise it was disappointingly stalled in the final parliamentary sitting weeks of 2021. We urge that it be prioritised in early 2022 to allow certainty and to provide time for any changes to be made to allow implementation by proposed 1 July 2022 start date.

Workers under the age of 18 should be entitled to receive superannuation contributions

Consideration should be given to removing the rule that employees under the age of 18 only receive superannuation contributions if they work at least 30 hours per week. The long-term benefit of receiving superannuation during these first years of employment would be significant yet cost employers relatively little.

Working 12 hours a week for 40 weeks each year between the ages of 15 and 18, an employee earning $12 an hour would cost their employer $1,728 in superannuation contributions over the three-year period. Based on ASIC's MoneySmart compound interest calculator, this could equate, after 50 years, to $20,000 in additional superannuation for the worker.

In addition, the exclusion currently skews employment practices, with employers in some sectors employing more people to work shorter shifts so they do not meet the SG threshold. Removing the working hours threshold would treat all workers equally.

While previously an argument might have been made that the impact of fees may have cancelled out the benefits of receiving relatively low amounts of superannuation, the rules pertaining to low-balance accounts, including the capping of fees and protections against inactivity, have allayed such concerns.

There is a strong argument too that providing access to superannuation earlier in life may enhance levels of member engagement, particularly now that stapling measures limit multiple-account proliferation from the outset of a young worker's career. This establishes a long-term relationship with their first fund, allowing funds greater opportunity to enhance financial literacy via targeted member education.

AIST recommends Government further consider and model this proposal.

AIST Recommendations
5. The legislation to abolish $450 per month income threshold for the superannuation guarantee be prioritised when Parliament returns in February 2022 6. Remove the rule limiting the payment of superannuation to workers under the age of 18 who work at least 30 hours a week.

According to the OECD, pension systems should be designed to mitigate disparities between standard and non-standard workers in terms of coverage, contributions and entitlements to protect against old-age poverty, smooth the living standards upon retirement, ensure fair treatment, pool risks as broadly as possible and facilitate labour mobility across job types.

This however is not currently the case as independent contractors, the self-employed and workers on the Community Development Program (CDP) are not covered by the superannuation guarantee.

Self-employed

According to the AI group approximately 1.4 million people in Australia are self-employed. Concerningly, 20% of those self-employed have no super whatsoever and if they do have super, will tend to have significantly lower balances. The average superannuation account balance for self-employed men in the 60 to 64 age cohort is around $143,000, compared with around $283,000 for male wage and salary earners. For women, the average balance for self-employed women aged 60 to 64 is around $83,000, compared with around $175,000 for female wage and salary earners.[6] Additionally, only 27% of the self-employed made contributions in 2016-17.[7]

This evidence suggests that the self-employed may forgo superannuation to invest more into their businesses. Although this is admirable, investment experts have long promoted the benefits of diversification. The self-employed could similarly benefit from avoiding putting all eggs in one basket.

As a result, if they are unable to sell or gain a return on their business when they retire, the self-employed will be more likely to solely rely on the age pension, giving them a lower income and consequently lower quality of retirement.

Independent contractors

According to ABS labour statistics, of the 12.9 million people who were employed in August 2021, approximately 8% were classified as Independent Contractors. However, it is important to note

[6] Craston, Andrew (2018). *Superannuation balances of the self-employed*. Association of Superannuation Funds of Australia. Available from: https://tinyurl.com/qlhnvjd.
[7] OECD (2019). Pensions at a Glance 2019: How does Australia compare? Available from: https://tinyurl.com/wfwtqwg

that a contractor is only considered an employee for superannuation purposes – and therefore entitled to super guarantee contributions – if they are paid ‘wholly or principally for labour’.

The difference in benefits between employees and independent contractors has led to an increase in what is known as sham contracting, where an employer may deliberately disguise an employment relationship as an independent contracting arrangement, instead of hiring the worker as an employee of the business or company to avoid superannuation obligations. For example, Cbus estimated that in 2013 alone $261 million was lost in contributions due to sham contracting.[8]

Community Development Program participants

The Community Development Program (CDP) commenced operation on 1 July 2015. The stated purpose of the program is to provide work and support to job seekers located in remote Australia.

As at 1 January 2016, approximately 35,000 people were participating in the programme of which 80% identify as Aboriginal or Torres Strait Islander. CDP participants with activity requirements are expected to complete up to 20 hours per week of work-like activities and in regions that have high unemployment rates – up to 51% when averaged across states and can be higher at a local level.[9]

Although the Government introduced changes to Mutual Obligation Requirements which took effect from May 2021, allowing some voluntary participation in work-like activities, AIST notes that the compulsory nature of the majority of the requirements, including “accepting suitable paid work when it is offered”, do not address the major shortcomings stemming from the CDP.

Namely, AIST is concerned that under the program, and notwithstanding the recent changes, workers continue to have no right to access workers’ compensation arrangements or holiday pay, and they are not paid superannuation.

AIST acknowledges the Government’s announcement that the CDP will be replaced by a new remote jobs program in 2023 and supports the co-design approach with Aboriginal and Torres Strait Islander peoples outlined as part of the announcement.

We believe this is an opportunity to design a program that includes the paying of award rates and associated workplace entitlements. This includes superannuation, paid leave, and workers’ compensation.

These are universal workplace entitlements and should be paid to all workers, particularly when as many as 35,000 CDP participants of Aboriginal and Torres Strait Islander background are not receiving these entitlements but are nevertheless required to undertake work-like activities (up until May 2021). CDP workers are no different to any other Australian worker and should be

[8] Cbus (2015). *Superannuation Guarantee non-compliance.* Available from: https://tinyurl.com/hgtpoog

[9] The Australia Institute (2018). The Community Development Program, remote Australia’s Work for the Dole scheme. Available from: https://tinyurl.com/vqv8pl8

afforded the same rights and protections as other Australians in the workforce, and the new remote jobs program should build on these principles.

AIST Recommendations
7. A commitment to universality of SG cover for all PAYG employees, independent contractors, and the self-employed. 8. Introduce full entitlements including award wage rates, superannuation, and leave as part of the new remote jobs program replacing the CDP.

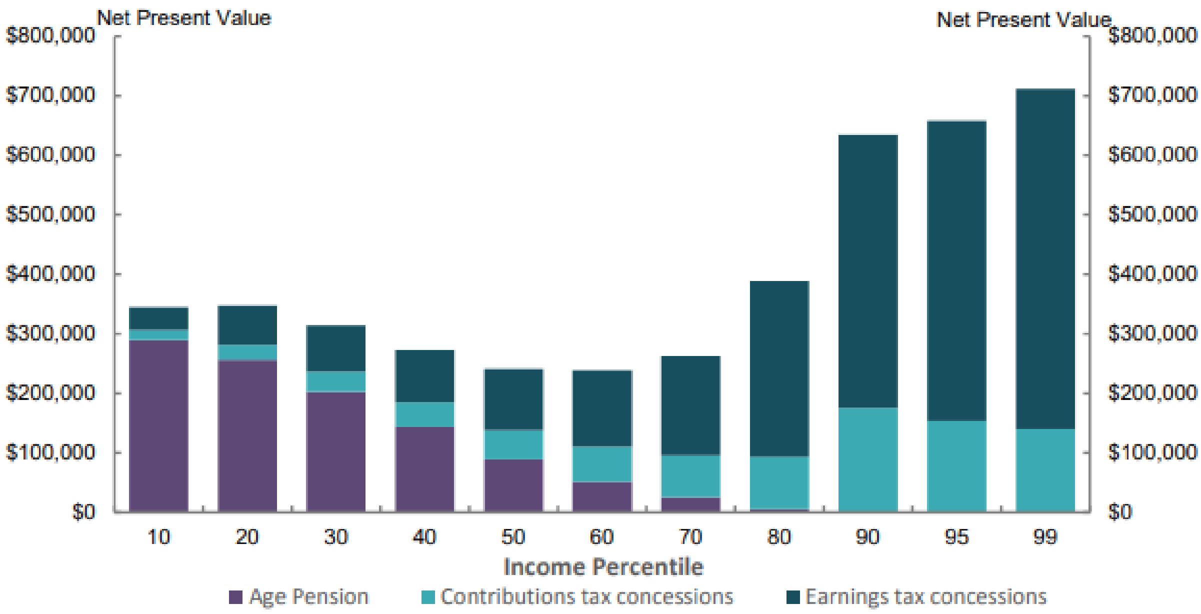
Further improve the equity of tax concessions and support to achieve a comfortable retirement

Introduce a $5 million limit on total superannuation balances

Superannuation tax concessions are a form of government support that must be assessed for fairness and sustainability.

Unfortunately, as shown in the below graph titled Figure 4, the current level of lifetime government support provided through the retirement income system is heavily weighted towards those in higher income brackets. Given that this cohort has a greater capacity to support themselves in retirement it is not only an inequitable situation but also unsustainable as the population of Australia ages. This observation was also made in the Retirement Income Review, which noted that there are over 11,000 Australians with more than $5 million in superannuation.

Figure 4: Lifetime government support provided through the retirement income system[9]



Source: Treasury calculations using a hypothetical cameo model

Lifetime government support provided through the retirement income system[10]

AIST has previously called for reform to existing superannuation tax concessions, highlighting the unequal level of government support provided to high-balance members as compared to those on lower incomes with lower balances. Limiting the amount permitted to be held tax-free in the retirement phase to $1.6 million (now $1.7 million following 1 July 2021 indexation) was a step supported by AIST. The Government should now address the tax treatment of accounts with balances of more than $5 million across both the accumulation and pension stages.

The earnings on the investments in these accounts receive the same percentage concessional tax benefits as much lower account balances. An argument made by opponents of increasing the SG rate to 12%, is that increasing it would perpetuate existing inequities.[4]

While this view may have some merit, AIST suggest that the appropriate response is to *both* increase the SG rate and reform the concessional design of the taxation system.

AIST submits that to further improve the equity of tax concessions, total superannuation balances of more than $5 million (regardless of whether they are in the accumulation or pension phase) should not be permitted within the superannuation system, and that people with more than this amount should be required to withdraw the amounts over $5 million.

AIST believes this proposal would have widespread support across the superannuation industry and would be an important step towards addressing issues identified by the Retirement Income review.

Analysis previously undertaken for AIST by Mercer found that the value of earnings tax concessions enjoyed by a single $10 million SMSF in a year would allow for 3.1 full Age Pensions to be paid. Based on Australian Taxation Office (ATO) statistics of the amount of assets held by all SMSFs with balances over $10 million, Mercer estimated that the earnings tax concessions arising from those high-balance members would allow for over 240,000 full Age Pensions to be paid at the end of a single tax year.

The current limits on concessional and non-concessional contributions mean that total super balances of more than $5 million are unlikely to be accumulated in the future and there are likely to be relatively few existing balances approaching $5 million beyond the short term.

In order to allow the orderly transition of amounts in excess of $5 million out of superannuation, AIST proposes an implementation date of 1 July 2024.

[10] Treasury, Retirement Income Review Consultation Paper (2019). Available from https://tinyurl.com/t57sbbr

ADEQUACY

Commit to increases to the Superannuation Guarantee rate

The changes to the schedule of increases to the Superannuation Guarantee (SG) which would see it eventually increase to 12% was formally delayed in 2014, through the repeal of the Mineral Resources Rents Tax.

Under the current timetable, the SG rate is set to increase to 12% from the earliest date of 1 July 2025. The original schedule would have seen Australians benefiting from a 12% SG rate from 1 July 2021. This delay represents a major setback to ensuring all working Australians enjoy an adequate retirement income. Any further delays to the SG timetable will also create more fiscal pressure on future governments in relation to Age Pension funding.

Lifting the SG rate to 12% is fundamental to ensuring that everyone – regardless of their gender or income level – can maintain their living standards in retirement. This is particularly important for people on low incomes, those working part-time or those who have taken time out of paid work as carers.

Many of those advocating a change in the legislated timetable for increasing the SG to 12% do so from the perspective of higher paid workers and seem to give less consideration to the position of the lower paid or those who do not, or cannot, work for 40 years or more. Around 30% of workers – generally the lower paid – have their conditions set by award or an "award-influenced" individual contract, and by law they will receive both award and SG increases. In addition, close to 40% of workers are covered by enterprise agreements that similarly prescribe their wages outcomes. Within these regulated frameworks, there can be, and are, legal protections for both wage and superannuation outcomes. Further analysis of this issue is presented in Appendix A.

AIST strongly recommends that no change is made to the legislated increase to the SG rate to 12%, following on from the increase from 9.5% to 10% that commenced on 1 July 2021.

AIST Recommendation
9. Ensure the legislated timetable for increases to the Superannuation Guarantee (SG) rate is not delayed.

TRANSPARENCY

A legislated objective for the retirement income system, including superannuation and aged care

It is important that the issues and recommendations raised throughout this submission are considered against a legislated retirement income system objective. Lack of a co-ordinated approach in meeting a retirement system objective can result in ad hoc and inefficient policy.

The Government has no current announced plans to legislate the objective of the retirement income system per se.

The Government's intention to legislate amendments to the SIS Act (currently being considered by the Senate Economics Legislation Committee) to insert a new covenant that requires super fund trustees of RSEs to develop a retirement income strategy for beneficiaries who are retired or are approaching retirement is an important de facto element of such an objective.

The preamble to the Regulation Impact Statement – Retirement Income Covenant[11] introduces the case for a legislated retirement income system objective –as well as for a retirement income covenant. Following the heading *What is the problem you are trying to solve*? the statement continues:

> The Retirement Income Review (the Review) suggested an objective of the retirement income system be designed around the goal '*to deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way*.' It noted that '*providing income in retirement is the fundamental role of compulsory superannuation*.' However, 29 years after the introduction of compulsory superannuation, the retirement phase of superannuation remains under-developed. There is substantial room for improvement in how the superannuation system delivers adequate standards of living in retirement for all Australians, both now and into the future.

AIST supports there being a legislated objective of the retirement income system, and also specifically calls for a legislated objective of the superannuation system, as follows:

'*To provide an adequate income to ensure all Australians achieve a comfortable standard of living in retirement, supplementing or substituting the Age Pension*.'

As we have called for in other submissions, a legislated objective should be accompanied by measures to report against the objective along with secondary objectives and principles. We recommend the following guiding principles:

- **Adequacy:** Adequacy should consider superannuation, public pensions, as well as other sources of income through, for example, means-testing.
- **Fairness:** Delivery of fairer outcomes within the retirement incomes system through proper targeting of public pensions and superannuation concessions.

[11] Parliament of the Commonwealth of Australia, House of Representatives, Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021, Explanatory Memorandum. Attachment 2: Regulation Impact Statement – Retirement Income Covenant, p.400.

- **Intergenerational fairness:** ensuring the retirement incomes system takes generations (between and within) into account.
- **Superannuation is a savings and not a wealth creation vehicle:** Ensuring the retirement incomes system does not unreasonably create intergenerational wealth transfer.
- **Sustainability:** Ensuring adequacy and sustainability are suitably balanced considering current and future generations.
- **Gender lens:** Application of a gender lens to the retirement incomes system with a view to closing the gender gap.
- **Employment lens:** Application of a retirement incomes lens to employment policy development.
- **Structural change:** Demographic ageing and structural changes are considered.
- **Sole purpose of superannuation:** Implementation of the primary objective of the retirement incomes system should be designed so as not to interfere with the operation of the sole purpose test, including the provision of insurance as part of superannuation benefits.
- **Transparency and accountability:** Policy development should not be ad hoc but should be developed within a transparent and accountable retirement incomes framework. The community needs to know how proposed policies will affect the adequacy, sustainability and fairness of the retirement incomes system prior to policies being tabled within Parliament. Statements of Compatibility should be used and include an assessment of how any proposed policies may impact quantifiable goals which have been set.
- **Role of superannuation in national savings:** Recognition of role of the superannuation system in national saving and funding economic activity, especially infrastructure.

AIST Recommendation
10. Legislate the objective of the retirement income system, including the roles of superannuation and aged care, to ensure superannuation is not viewed as a resource able to be used for anything other than retirement savings (except in the most exceptional of circumstances).

Improve transparency and controls around the early release of superannuation, including assessing the impact on those experiencing family violence

Assess the level of financial coercion experienced through the early release of superannuation scheme

AIST member funds are reporting an increase in cases of financial abuse. The fund member, usually female, has contacted the fund to inform them that their superannuation was accessed during the early release scheme as a result of coercion or a domestic partner fraudulently accessing their superannuation using the member's details.

When the scheme was announced in 2020 AIST raised concerns that such behaviour would occur and sought assurances that the Government was undertaking measures to protect vulnerable women from being exploited and coerced. No specific measures were introduced to address this risk. Prior to the introduction of the COVID-19 early release of superannuation scheme, there were limited opportunities for abusive partners to access the superannuation of their partner/spouse. Due to there being no requirement that evidence be provided to prove the individual was eligible for the scheme, for the first-time women's superannuation monies became a widespread target of coercive control.

A survey of 15,000 women by the Australian Institute of Criminology[12] revealed more than half of women who had experienced violence before the COVID-19 crisis said the violence had become more frequent, and more severe, since the start of the pandemic. Nearly 5% of respondents indicated they had experienced financial abuse. While superannuation was not specifically called out in the survey, it is not unreasonable to hypothesise that a similar proportion of women who accessed their super during the early release scheme did so because of financial coercion. Women made up 43% of the 3.5 million individuals who applied for early release of super.[13]

Of these 1.5 million women it can be estimated that over 70,000 women may have done so as the result of coercion.

AIST request's that the Government undertake a comprehensive assessment of the number of women who were coerced into accessing their superannuation during the early release of superannuation scheme and the detrimental financial impact this will have on their retirement. This information is critical to informing future policy decisions and avoiding unintentionally facilitating abusive behaviour. The initiative also aligns with the Government's intent to end family violence as espoused in its draft *National Plan to End Violence against Women and Children 2022-2032*.

[12] The prevalence of domestic violence among women during the COVID-19 pandemic | Australian Institute of Criminology (aic.gov.au)

[13] APRA, *The superannuation Early Release Scheme: Insights from APRA's Pandemic Data Collection,* apra.gov.au/superannuation-early-release-scheme-insights-from-apra's-pandemic-data-collection,

Address ineligible repeat applications on grounds of severe financial hardship

Provisions in the *Superannuation Industry (Supervision) Act 1993* allowing for early release of superannuation on the grounds of severe financial hardship (separate from the recently closed temporary COVID-19 expanded scheme which occurred under compassionate grounds legislation) are well-intentioned and necessary. A withdrawal under hardship is only permitted once every 12 months.

AIST is concerned about recent reports highlighting possible manipulation of the measure – part of a broader trend, highlighted with concern by the International Organization of Securities Commissions, of fraudulent activity.[14] Member funds have noted to us they have become aware of members withdrawing money on financial hardship grounds from one fund, and then switching into another fund and making another application within 12 months.

In summary, where a member makes a financial hardship claim with Fund A, the trustee assesses the information provided and checks eligibility and if it is met Fund A pays the financial hardship claim. The member then rolls their balance from Fund A to Fund B and then makes another financial hardship claim despite having made one in the last 12 months.

Fund B has no visibility of the claim made with Fund A, so the trustee assesses the claim (likely the same evidence that was provided to Fund A is provided to Fund B). Fund B pays the claim.

The member then rolls the balance to Fund C and the process is repeated and so on. Funds can only see that the money has been rolled from another fund and that the member exits their fund shortly after making the claim.

There are also reports of groups on social media encouraging this illegal early access of super. Table 1 below represents data from eight AIST member funds for successful financial hardship claims, showing by calendar year this pattern of behaviour.

Financial Hardship Claims				
Collated data from Eight AIST member funds	**2021 (to 30 April)**	**2020**	**2019**	**2018**
Total Fin hardship claims	5,755	10,867	11,861	9,487
Within 2 months of joining	399	1,457	2,017	1,069
% of total FH claims	7%	13%	17%	11%

[14] International Organization of Securities Commissions, 'Retail Market Conduct Task Force Report: Initial Findings and Observations About the Impact of COVID-19 on Retail Market Conduct', 13 December 2020, FR13/2020 Initial Findings and Observations About the Impact of COVID-19 on Retail Market Conduct (iosco.org)

Who then exited within 2 months of claiming financial hardship	33	250	474	126
% of those making claim within 2 months of joining	8%	17%	24%	12%

Table 1

In a typical year between 10% to 17% of all financial hardship claims are made within 2 months of rolling into the fund, and of these between 12 % to 24% then quickly roll out of the fund and likely make a claim at another fund.

A number of members would also have withdrawn their remaining balance via the early release of super which is likely to account for the dip in numbers in 2020 of financial hardship claims.

Given each repeat application may result in up to $10,000 of savings being withdrawn, the potential impact on a member's final balance at the point of retirement is significant. In turn, such depleted balances impose a fiscal impact on government, by way of increased Age Pension expenditure. Within the current system architecture, superannuation funds are unable to know whether a member has applied for, or been granted, an early withdrawal on severe financial hardship grounds at another fund in the last 12 months.

To facilitate greater transparency in the processing of severe financial hardship early release applications, AIST recommends that either:

- The ATO manage the application and approval of financial hardship claims, in the same way it does for compassionate grounds claims. Only where a person is eligible would the ATO send a release request to the fund; or
- Government develops a tool providing super funds look-through visibility to their members' past engagement with the superannuation system, focusing on applications made (and processed) for the early release of benefits.

AIST Recommendations
11. Government must comprehensively assess the number of women who were coerced into accessing their superannuation during the early release of superannuation scheme and the detrimental financial impact this will have on their retirement. This information should be published for the purposes of transparency, aligned with the Government's initiative to end violence against women. 12. Reduce incidence of ineligible repeat financial hardship applications by tightening transparency around access to early release of superannuation.

Measure and publish the impact that any future changes to super would have on women

Several factors act against women reaching the best possible retirement outcomes, and the impact of tax, economic and social policy can have different consequences for women as opposed to men.

AIST recommends that the Government measure and publish the super gap each year and assess the impact that any future legislative changes to super would have on women. The Workplace Gender Equality Agency already provides much needed analysis and insight about pay gaps so would be well placed to undertake an expanded role that includes super.

AIST also considers that there is a need to strengthen the reinstated Women's Budget Statement to allow further in-depth analysis of the impact of the Budget on women and could help in rectifying the gender super and gender pay gap. Consideration should be given to reinstating the prior whole-of Government practice of requiring the Government to provide an impact statement in any future legislation, noting its potential impact on women.

AIST Recommendation
13. Measure and publish the impact that any future changes to super would have on women.

Other measures to address equity & fairness, adequacy & transparency

Increase the LISTO ceiling to $45,000 a year

The low-income super tax offset (LISTO) is a government superannuation payment of up to $500 that helps people earning $37,000 or less a year save for retirement.

Until 2019-20, the $37,000 ceiling for LISTO corresponded with the top of the second tax bracket. However, the top of the second tax bracket was increased to $45,000 for 2020-21 and 2021-22.

Given that the first tax bracket ($0-$18,200) incurs a 0% rate of tax and the second ($18,201-$45,000) incurs a 19% rate of tax, it is equitable that a compulsory and preserved component of salary is not taxed at a higher rate than take-home pay.

AIST therefore recommends that the ceiling for LISTO payments be increased to correspond with the top of the second tax bracket and that the maximum value of the LISTO payment be increased correspondingly to $675 a year.

It is noted that the 3% fee cap introduced by the Protecting Your Super reforms for low account balances help protect low account balance holders from paying excessive fees on their balances, which will also prevent unnecessary erosion of these additional payments.

AIST Recommendation
14. Take further steps to improve the equity of tax concessions Government by: a. not permitting individuals to hold a total superannuation balance of more than $5 million across both the accumulation and pension stages, and by requiring existing members with a total superannuation balance of more than $5 million across both the accumulation and pension stages to withdraw the excess amount by 1 July 2023. b. increasing the maximum income eligible for the low-income superannuation tax offset (LISTO) to $45,000 a year from 1 July 2022 to align with marginal tax brackets, and for the maximum value of the LISTO payment to be increased correspondingly to $675 a year.

Single asset-based means test for the Age Pension and Aged Care & Reduce the taper rate to $2 per $1,000 in assets

Single asset-based means test

Another contributing factor to existing inequity in the system is the current means testing thresholds for the Age Pension. Australia is the only country with the complexity of both an assets test and an income test. In another added layer of complexity, the means tests for the Age Pension and aged care are both structured differently. Although both have an income and assets test, the thresholds and tapers differ. This complexity makes it exceptionally difficult for individuals to plan for and understand what their level of income in retirement will be.

Given that some assets are assessed under both tests, while other assets are assessed only under the assets test, the current two-part means test results in people receiving different levels of government payments even though they have the same level of wealth.

It is noted that the Henry Review also found that inconsistencies in scope between the income and assets tests reduce system coherence and results in an unequal treatment of pensioners with similar levels of private means.[15]

A single asset test would also address issues that have been raised regarding the way in which the deeming rates have not tracked changes in official interest rates.

Reducing the taper rate to $2.00 per $1,000 of assets

The changes made by the Government as part of the 2015-16 Budget to increase the taper rate from $1.50 to $3.00 (which became effective as of 1 January 2017) substantially reduced net Age Pension payments to many recipients. These changes reduced the partial Age Pension significantly for middle-income households.

Research by AIST and Mercer at the time found that the fairness in the level of Government support was significantly impacted by this change. The modelling showed that the new taper rate would cut the level of government support for average income earners by up to 40%, removing incentives for voluntary saving both in and outside of super, and threatening the integrity and sustainability of Australia's super system.

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[15] Henry et al (2009), Australia's Future Tax System: The retirement income system. Available from: https://tinyurl.com/w9k6mbz

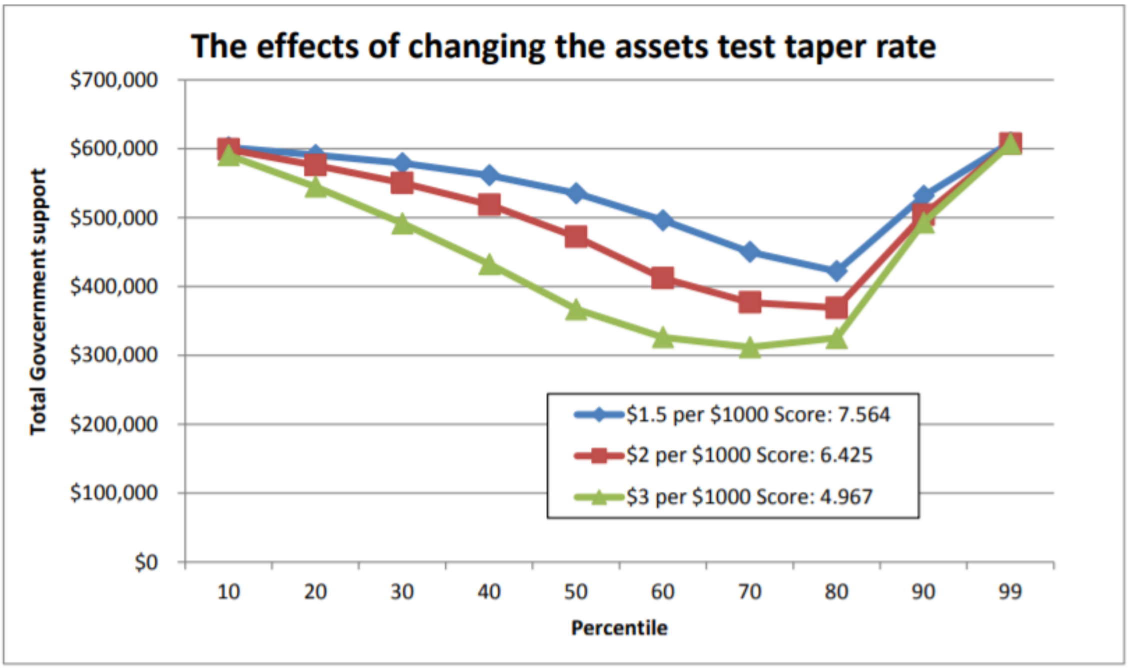

Chart 3

The perverse disincentive that resulted from the changes in the taper rate for individuals to save for their own retirement was explored by Asher and Ravin in 2018[16] who found that the assets test creates a trough in income between about $300,000 and $700,000 in assessable assets. The authors noted that within this range, annual income **declines** with increasing assets because the income from the marginal assets (whether returning 3% p.a. or 5% p.a.) is less than the Age Pension foregone.

These findings are also supported by National Seniors Australia and are highlighted by the chart below.

[16] Asher and Ravin (2018), The Age Pension means tests: contorting Australian retirement. Available from: https://tinyurl.com/unaaanc

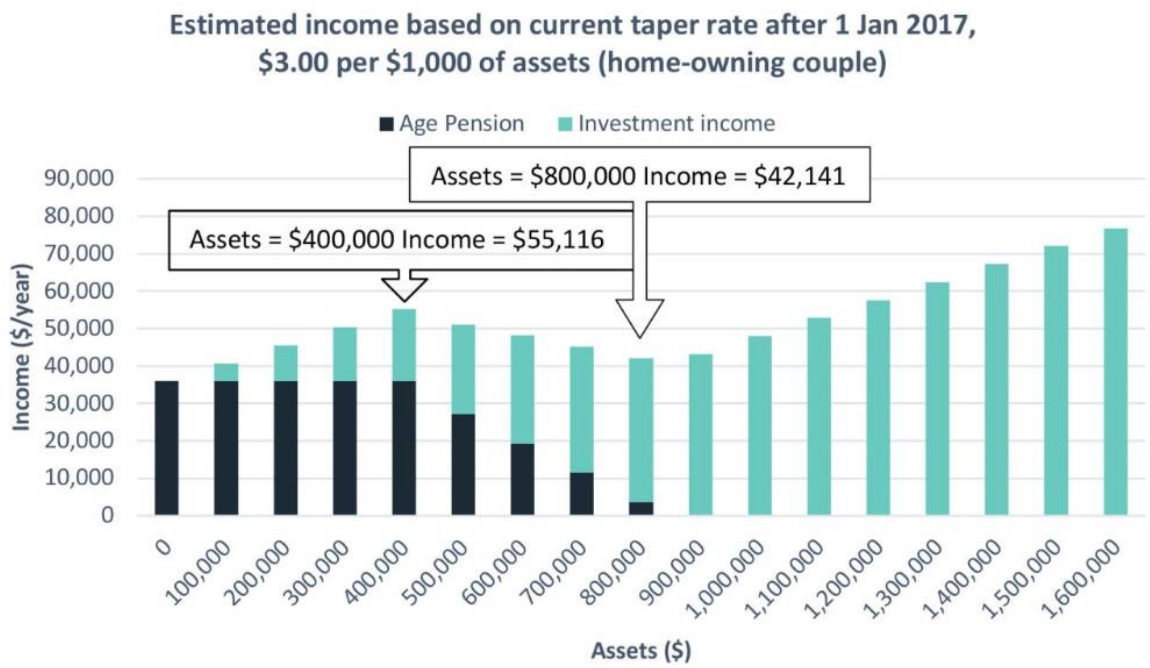

Chart 4

Source: National Seniors Australia[17] & based on investment income on assets of 20% bank deposit @2%, 80% LICs @5.5%.

Chart 4 shows that under the changed taper rate, a home owning couple with $400,000 in assets would receive an income of approximately $55,000, whereas a couple with $800,000 in assets would only receive an income of approximately $42,000. This situation not only penalises individuals for saving for their retirement but encourages and rewards individuals to adapt their spending in order to increase Age Pension entitlements.

The Retirement Income Review – although modelling a reduction in the taper rate to $2.25, rather than the $2 AIST recommends – found that long-term projected benefits in total Age Pension entitlements would extend down to those in almost all income cohorts (excepting only those in the lowest income decile).[18]

AIST Recommendations
15. Introduce a single asset-based means test for the Age Pension and Aged Care.   16. Reduce the taper rate to $2 per $1,000 in assets.

[17] National Seniors Australia (2019): *Reduce the asset test taper rate*. Available from: https://tinyurl.com/t5uyhkg
[18] Retirement Income Review final report, p.466.

Increase Age Pension rental assistance for non-homeowners

Our current retirement income system does not sufficiently meet the needs of non-homeowners as it is has implicitly taken for granted that retirees will own their own homes by retirement. Analysis by the Centre of Excellence in Population Ageing Research (CEPAR) of the 2016 Census, indicates that about 12% of people of aged 65+ were renting.[19] The likelihood of renting in retirement is higher among the less educated, single, poor, disabled and those living in rural areas.[20] Declining rates of home ownership are only likely to exacerbate this issue into the future.

It is generally understood that a household is experiencing 'housing stress' if it is paying more than 30% of its income in housing costs. In 2016, about 44% of renters aged 65-74 spent more than 30% of their income on rent, the highest rate of all age groups and the highest level over time[21].

Commonwealth Rent Assistance (CRA) is meant to help those who are renting but current levels are significantly lower than the amount being paid in rent because the payment has not kept pace with rental prices. This has resulted in increasing levels of poverty among older renters. The current maximum amounts are inadequately low and are shown below (for people without dependent children):

If you're	The maximum fortnightly payment is
Single	$142.80
Couple, combined	$134.60

The actual amounts received as at September 2021 for those on the Age Pension are shown below:

September 2021

Recipient household – Age Pension		Fortnightly rent paid	Fortnightly CRA
Number*	**Per cent***	**Median**	**Median**
307,955	21.2	$400.00	$134.60

Data sourced from DSS[22]

The number and percentage listed are a proportion of the* ***total number* *of households in Australia in receipt of CRA, not just those on the Age Pension.*

A key reason for the difference in rent being paid and the rental assistance being received is because CRA is linked to increases in the CPI whereas rents have generally been rising at a faster

[19] CEPAR, Housing in an ageing Australia: Nest and nest egg? (2019). Available from: https://tinyurl.com/rvkpqba

[20] Ibid.

[21] Ibid.

[22] DSS, Payment Demographic Date (2019). Available from: https://tinyurl.com/v9bdpch

rate – as illustrated in Chart 5. Lack of access to affordable rental properties is supported by Anglicare research which estimates that less than one percent of properties across the country were suitable and affordable for a single person on the Age Pension.[23]

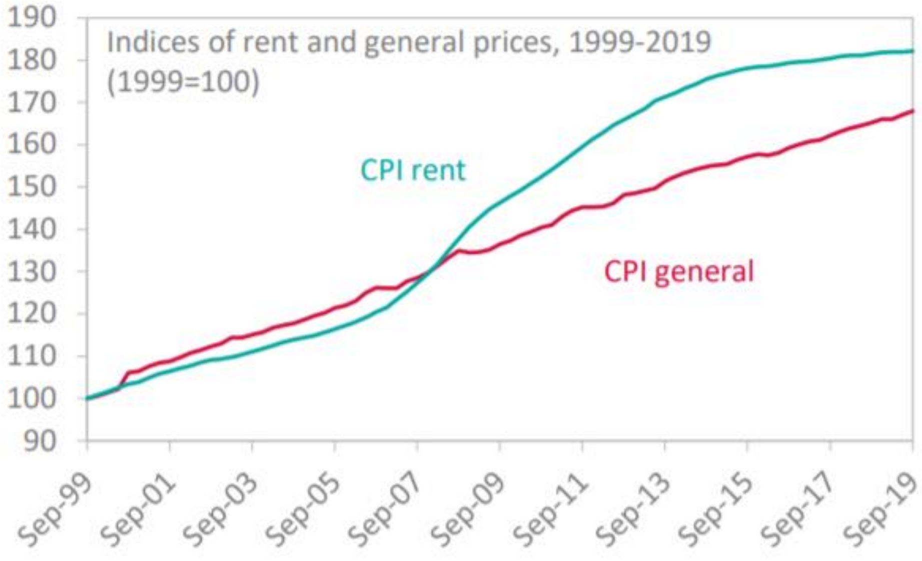

Chart 5

Source: CEPAR

The Retirement Income Review highlighted the urgent need for reform in this space. Noting the Panel's observation that raising rental assistance for those on the Age Pension by 40% would only reduce the housing expenditure gap between renters and homeowners by around 8%,[24] AIST suggests consideration should be had to at least doubling the amount of such support.

AIST Recommendation
17. At least double the rate of Age Pension rental assistance for those who do not own their home.

[23] Anglicare Australia, Rental Affordability Snapshot (2019). Available from: https://tinyurl.com/y4gufhal
[24] Retirement Income Review, p.

Reducing the incidence of unpaid and underpaid super

AIST has long called for greater action on SG non-compliance, noting both:

- the financial impact on affected members (who are effectively robbed of their rightful retirement savings entitlements, and fail to take advantage of compounding earnings through no fault of their own); and
- the fiscal impact on government (through higher Age Pension expenditure and lower receipts of tax on superannuation contributions and earnings).

Although the expansion of the Single Touch Payroll (STP) infrastructure to employers of all sizes may organically reduce the incidence of non-intentional SG underpayment, the risk remains that rogue employers may seek to circumvent their obligations. STP requires employers to send the ATO a range of payroll information, including their employees' SG entitlements reported via super fund reporting.

On paper, existing penalties for such egregious non-compliance are strong, with Part 7 of the *Superannuation Guarantee (Administration) Act 1992* ('SGAA') allowing for fines of up to 200% of the relevant Superannuation Guarantee Charge (an amount comprised of the underpaid SG contributions, 10% tax, and an administration fee charged per quarter of non-compliance). By October 2019, the ATO had applied the maximum penalty on only one occasion.[25]

As the economy rebuilds – alongside employment rates – it is important that enforcement efforts accordingly sharpen. AIST recommends that:

- The ATO strengthen its monitoring of the relationship between data generated by the Member Account Transaction Services (through which super funds report to the regulator the contributions made to them from employers on members' behalf) and STP infrastructures.
- Consideration could also be given to increasing the frequency with which MATS reporting be required to be undertaken.

Additional possible policy responses to address SG non-compliance include:

- Amending the SGAA to require employers to make their SG contribution payments at the same time as employees' regular salary payments (which would reduce the ability for unscrupulous employers to avoid their obligations). This approach has been endorsed by ATO Commissioner Chris Jordan;[26]
- Amending legislation to ensure that when wages are paid late (sometimes by many years) interest is paid on associated SG contributions, aligning it with the late SG penalties.

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[25] Senate Economics Legislation Committee, *Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019* public hearings, 30 October 2019, p.31.

[26] Senate Economics Legislation Committee, 30 May 2017, p.29.

Currently when an employer pays back late wages, there is no recognition of lost earnings on associated missed SG payments; and

- Adding the entitlement to superannuation to the National Employment Standards framework. Doing so would make the payment of SG contributions enforceable as an industrial right, broadening the scope of actors able to pursue non-compliance by giving the Fair Work Commission standing to sue liable employers.

AIST Recommendation
18. Strengthen action against Superannuation Guarantee non-compliance, to address unpaid and underpaid super.

Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements (LRBA) by superannuation funds

A limited recourse borrowing arrangement (LRBA) involves a SMSF trustee taking out a loan from a third-party lender. The trustee then uses those funds to purchase a single asset (or collection of identical assets that have the same market value) to be held in a separate trust.

Direct borrowing for limited recourse borrowing arrangements for superannuation funds creates the potential for systemic risk and should be addressed in the Budget before the risk is realised.

The purpose of superannuation is to provide income in retirement. AIST's recommendation in this submission is for the Government to act on the 2015 recommendation of the Financial System Inquiry (FSI) to remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds before it becomes a major problem.

Since the final report of the FSI was released, AIST has agreed with this recommendation and the conclusion that the essence of a savings vehicle for retirement income, together with the "strengths and benefits the superannuation system has delivered to individuals, the financial system and the economy" could be lost if the original prohibition on borrowing is not restored.

The FSI pointed out that risks are magnified across the financial system by leverage. Types of financial risk impacted by leverage include:

- market risk;
- credit risk;
- manager risk; and
- liquidity risk.

These increased at both an investor level, as well as a macroeconomic level. The interconnectedness of our financial system means that should failure in the form of defaults by borrowers become widespread, the spill-over effect may be unable to be contained by ordinary provisioning. This type of risk was noted by the FSI, and we submit falls within the definition of systemic risk.

In 2015, the Government did not agree with the FSI's recommendation for a ban, choosing instead to tighten some of the underlying rules. and commissioning the Council of Financial Regulators (CFR) and the Australian Tax Office (ATO) to monitor leverage and risk in the superannuation system and report back to Government after three years.

The 2019 CFR/ATO report and the 2018 Productivity Commission's '*Superannuation: Assessing Efficiency and Competitiveness'* report both noted that the relatively small number of super funds using LRBAs means that such borrowing did not pose a material systemic risk at that time.

A closer reading of both reports reveals serious potential concerns about the use of LRBAs. The Productivity Commission concluded that continued growth, coupled with any gross underperformance of the LRBA being underwritten by the age pension could generate systemic risk in the future.

The conclusions of the CFR/ATO report revealed that it and the regulators had serious concerns. These concerns remain and should be addressed.

Of concern is the prevalence of property as the main asset purchased under a LRBA, most commonly by low balance SMSFs (those under $500,000) who have little investment diversification and high Loan to Value Ratios making these funds particularly susceptible to shifts in the property market.

APRA regulatory changes since the FSI have also influenced the environment. The subsequent withdrawal of most major banks from SMSF lending is likely to change market conditions further, including through increased lending by non-ADI lenders and related parties.

This sector does not have the same prudential scrutiny as larger ADIs. This further adds to concern around highly leveraged low diversified funds.

Evidence presented to the Royal Commission, along with ASIC findings (Report 575: SMSF: Improving the quality of advice and member experiences) into the rise of 'SMSF one stop shops' have raised concerns with the number of funds that have entered into a LRBA because of poor and/or conflicted advice.

The regulators agree that the presence of leverage in SMSFs through LRBAs has significant implications for the security of individuals' retirement savings. Other than the regulators' preferred option of removing the exception to allow SMSFs access to LRBAs, some potential policy interventions could address these concerns. These range from truly limiting the recourse of the lender over the asset by prohibiting the use of personal guarantees, to reducing high leverage and concentration risk within the fund by creating prudential responsibilities for the regulator.

Where the regulators' preferred option to remove the exception to allow LRBAs is not accepted, further monitoring to track the future growth of leverage and identified risks within the SMSF environment is recommended, which the Productivity Commission also recommended. A further report to Government in three years would provide further analysis of the ATO's enhanced SAR data collection and the impact of major banks' withdrawing from lending to SMSFs.[27]

The superannuation industry – currently $3.3 trillion in assets under management, with only $63 billion in borrowings in September 2021 – is now so large that exogenous shocks, such as the global financial crisis, or shocks created within Australia, may be cushioned to a large extent by investment in unleveraged assets. This stabilising influence is reduced as leverage increases. Superannuation's unleveraged nature meant that the GFC was not as pronounced in superannuation and may have had a role in protecting the economy during the pandemic. This acts as a stabilising influence on Australia's financial system and the effect of interconnectedness was not magnified.

We submit that an unleveraged superannuation sector assists management of systemic risk and that there should be a return of a prohibition on leverage in superannuation. At the very least, the Government should commission another report from the CFR and ATO to again report on these issues.

AIST Recommendation
19. Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds

A Federal Government data-sharing framework to support the introduction of the Retirement Income Covenant

We acknowledge the Bill introducing the Retirement Income Covenant is currently with the Senate Economics Legislation Committee. The introduction of a Retirement Income Covenant presents an opportunity to integrate data-sharing capabilities that would enhance superannuation funds' ability to tailor retirement strategies for its members.

AIST believes that establishing a robust data-sharing framework for bodies like the ATO to release de-identified data would assist trustees with their obligations.

[27] Council of Financial regulators and ATO report to Government: Leverage and risk in the superannuation system, February 2019, p.21

Having access to other de-identified data sets, including those from Services Australia (e.g., Centrelink payment statistics, Child Support statistics, etc.) would provide a clearer stream of information that will assist trustees determine the key characteristics of cohorts of their membership and any sub-classes within it.

This would be in addition to the proposed expansion to superannuation of the Consumer Data Right (CDR). AIST supports this expansion but notes the benefit would likely be limited to members who are actively engaged with their finances over more disengaged members, or members who are vulnerable and may not be able to engage with CDR.

Reform of Non-Arm's Length Income and Expense Rules (NALI/E)

AIST highlights the release of the ATOs Law Companion Ruling LCR 2021/2 (LCR) in relation to non-arm's length income (NALI) and non-arm's length expenditure (NALE) rules in section 295-550 of the *Income Tax Assessment Act 1997* (ITAA 1997). The ruling has implications that only became evident following the release of the ATO's interpretative guidance containing various examples.

It is understood that the original policy intent of the expansion of the scope of the NALI rule was to prevent superannuation funds sidestepping the contribution caps by using NALE to inflate their overall income. However, while this is not an issue that pervades APRA-regulated funds, the expansion of the ruling does impact large APRA-regulated funds.

For example, given the common structure for these types of funds, where the trustee company is separate to the fund, it is the trustee company that incurs a range of costs, including occupancy, staff, and other operational costs. In the case of profit-to-member funds, any trustee fee paid by the superannuation funds is for the purpose of cost recovery.

Based on the ATO's interpretation of the section 295-550 of the ITAA 1997, as these expenses are general in nature, the NALI rule applies to treat all income of the APRA-regulated fund to be subject to 45% tax.

This income includes SG contributions that the fund accepts on behalf of its members, thus the ruling "taints" all income with dire impacts to fund members.

AIST does not believe that this is the policy intent of the amendment to the rule, and in fact is an unintended consequence that became evident only after the ATO's interpretative guidance was made available.

AIST is across and supportive of submissions made by several peak bodies from the accounting, SMSF, and superannuation industries proposing alternative approaches to reform section 295-550. The options were outlined in a letter to Treasury on 22 December 2021 with several signatories from the accounting, tax, superannuation, and financial services sectors. A summary of the proposed alternatives is included here, and a copy of the letter with detailed proposals can be found in **Appendix B** of this document.

AIST Recommendations
20. Re-write of the provision with new principles (preferred approach); or 21. Re-draft utilising existing principles within the provision

AIST appreciates the opportunity to present our Pre-Budget Submission for 2022-23 and would be happy to further discuss the issues raised in this document.

APPENDIX A

Wage/ superannuation setting method	% of all workers	Income status	Industries/ occupations (predominant)	SG arrangement	Trade-off process between SG and wages	Impact of SG increase
Award (and award influenced individual contract)	Award (21%) Award reliant individual contract (9%) Total 30%	Low to middle income earners (Av hourly earnings: $29)	Health and community services, hospitality, labourers – around 50% are casual, higher proportion of women than men	Minimum legislated SG only, strictly limited ability to bargain for additional SG (requires Award variation)	No bargaining process. Legislated minimum wages and conditions only. Wage setting Fair Work Commission may decide to take SG changes into consideration, but repeals of legislated SG increases have not improved wage outcomes in the past.	Whole SG increase will apply
Enterprise Agreement	38%	Higher paid non managerial staff (Av hourly earnings: $42)	Government employees, employees of large private sector employers	Many paid above SG but most SG reliant - varies by industry/workplace	Trade off process. Workers choose to take additional bargained entitlements as pay, additional super above SG or non-monetary improvements.	Depends on clause - SG increase will not apply where super is already paid at a higher rate*

Individual contract	28%	Varied (Av hourly earnings: $41)	Managers, clerical/admin, smaller employers	Quite varied - some likely to be SG reliant while managers have a negotiated package that may pay super above SG	Varied: Limited trade-off where contract is determined by employer, but managers may be able to negotiate a trade-off for above SG super entitlements	Depends on clause - SG increase will not apply where super is already paid at a higher rate*
Business owner-managers	4%	Varied	N/A	No requirement to pay super to themselves	N/A	N/A

APPENDIX B

THE TAX INSTITUTE

22 December 2021

Ms Lynn Kelly
First Assistant Secretary, Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: lynn.kelly@treasury.gov.au

Dear Ms Kelly

Reform of Non-Arm's Length Income and Expense Rules

Further to recent correspondence, meetings and discussions with Senator Hume's office, Treasury and the Australian Taxation Office (**ATO**), we write to request Treasury urgently support the need to amend the existing non-arm's length income (**NALI**) and non-arm's length expenditure (**NALE**) rules in section 295-550 (**the provision**) of the *Income Tax Assessment Act 1997* (**ITAA 1997**).

Following the release of the ATO's recent Law Companion Ruling LCR 2021/2 (**LCR**) and Practical Compliance Guideline PCG 2020/5 (**PCG**), it has become evident that the administration of the provision is broader than the original policy intent.

On this basis, the Professional Bodies (**Bodies**), as noted in **Appendix A**, either separately or together, have engaged with Senator Hume's office, Treasury and the ATO on numerous occasions to raise concerns with the ATO's interpretation and broad implications of the provision.

We refer to various previous meetings and correspondence with the Treasury and the ATO for background. The Bodies' technical concerns with the operation and administration of the provision and the detailed background are most clearly set out in a joint letter dated 3 September 2021 from the Bodies to Senator Hume.

The Bodies are supportive of the original policy intent of the provision as outlined in **Appendix B**. We do not disagree with its purpose.

We also acknowledge the original consultation on the implementation of the provision. However, the consultation at the time did not include all peak industry bodies and did not draw out the issues we are now seeing in practice given the manner in which the consultation focused on the specific mischief that was being addressed. It was only once the ATO's recent interpretative guidance containing various examples was released that the full implications of the provision became apparent. These implications had not been fully considered in the original consultation.

The ATO's recent interpretative guidance highlights the Bodies' concerns with the broad implications of the provision that clearly have implications beyond those originally intended. Accordingly, we consider that the law needs to be amended so that superannuation fund members do not face adverse and unintended tax implications and their retirement benefits are not depleted in inappropriate circumstances, both for APRA-regulated funds and self-managed superannuation funds (**SMSFs**).

It is our opinion that the provision could, and should, be amended to rectify its scope and application while preserving the original policy intent. We have set out our rationale in this regard in **Appendix B** and included proposed solutions in **Appendix C** for the sole purpose of furthering this discussion. Please note that the proposed solution we proffer is a suggested approach only, and this would need to be shaped into the form and style of Treasury drafting so it is fit for purpose. We consider it imperative that further consultation with all the professional bodies is needed to ensure that any new draft legislation operates as intended.

If you would like to discuss any of the above, please contact Andrew Mills, Executive Director of The Tax Institute, on (02) 8223 0005.

Yours faithfully,

Peter Godber

President

Cc:

Senator The Hon Jane Hume, Minister for Superannuation, Financial Services and the Digital Economy
senator.hume@aph.gov.au

The Hon Josh Frydenberg MP, Treasurer
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The Hon Michael Sukkar MP, Minister for Housing and Assistant Treasurer
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James Thomson, Director, Retirement, Advice and Investments Division, Treasury
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Euan Campbell, Australian Taxation Office
euan.campbell@ato.gov.au

APPENDIX A

List of Professional Bodies involved

Professional Body	Name and Position
Actuaries Institute	**Tim Jenkins**, Convenor – Superannuation & Investments Practice Committee **Vanessa Beenders**, Head of Public Policy & Practice Excellence
The Association of Superannuation Funds of Australia	**Julian Cabarrus**, Director – Policy Operations, Member Engagement & External Relation **Ian Roberts**, Head of Tax, Sunsuper **Damien Ryan**, Tax Partner, Superannuation & Funds, KPMG **Ross Stephens**, Director, Corporate Tax, KPMG
Australian Institute of Superannuation Trustees	**Carlos Lopez**, Policy & Regulatory Analyst
Chartered Accountants Australia and New Zealand	**Simon Grant**, Group Executive – Advocacy & International **Tony Negline**, Superannuation Leader
CPA Australia	**Dr Gary Pflugrath**, Executive General Manager, Policy & Advocacy **Richard Webb**, Policy Advisor Financial Planning and Superannuation, Policy and Advocacy **Michael Davison**, Senior Manager, Advocacy and Retirement
Financial Planning Association of Australia	**Benjamin Marshan**, Head of Policy, Strategy and Innovation
Financial Services Council	**Michael Potter**, Policy Director, Economics & Tax
Institute of Public Accountants	**Tony Greco**, General Manager Technical Policy
National Tax and Accountants Association	**Geoff Boxer**, CEO **Andrew Gardiner**, Senior Tax Manager **Siobhan Simpson**, Taxation Manager
Self-managed Independent Superannuation Funds Association	**Michael Lorimer**, Managing Director

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Professional Body	Name and Position
SMSF Association	**Peter Burgess**, Deputy CEO
Tax & Super Australia	**Pippa McKee**, Chief Executive Officer **Natasha Panagis**, Head of Superannuation
The Tax Institute	**Peter Godber**, President **Andrew Mills**, Executive Director **Scott Treatt**, General Manager, Tax Policy and Advocacy **Phil Broderick**, Principal, Sladen Legal and Member of TTI's National Superannuation Technical Committee **Daniel Butler**, Director, DBA Lawyers and Member of TTI's National Superannuation Technical Committee

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APPENDIX B

Policy intent

The original policy intent of the expansion of the scope of the NALI rule in section 295-550 of the ITAA 1997 was clearly expressed twice in the second reading speech to the *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2019* by the Assistant Treasurer:

> The bill also extends the existing non-arm's-length income rules to capture non-arm's-length expenses. This will ensure that superannuation funds can't circumvent the contribution caps by using non-arm's-length expenditure to inflate their overall income — for example, by borrowing money from a member at a reduced interest rate.

We have no disagreement with that policy intent.

Basis of concerns

As noted above, we have previously made representations to Senator Hume setting out our concerns with the operation and interpretation of section 295-550.

The introduction of the NALI rules and the ATO's interpretation of the provision, as published in the recently finalised LCR, will have far-reaching, harmful, consequences for members in commonplace scenarios. It is difficult to imagine that such needless outcomes were intended for hard-working Australians saving for their retirement. These rules apply with effect from 1 July 2018, including with respect to income derived as a result of an arrangement entered into prior to that date.[1]

While the Bodies have a number of issues with the reach of these provisions, our overarching concern is that the ATO's interpretation of the law means that, rather than merely addressing the mischief at which the government policy was directed, the rules could result in unwarranted substantial and long-term detriment to fund members. It could also operate in conflict with a range of trustee obligations, including the newly enacted best financial interests duty (**BFID**) rule in the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SISA**).

Rationale for amendment

As mentioned above, consultation was undertaken, although it appears that not all the peak industry bodies were involved in that original consultation. In fact, reports from those who were involved suggest that the focus of the consultation was around addressing the narrower examples rather than the wider implications that arise, given the way the law was amended in October 2019.

That is, it seems that those involved in the consultation were not (and arguably could not be) fully aware of the potential scope of the amended provision. The scope of the law and the kind of practical issues and examples have come to light only following the release of the ATO's recent interpretative guidance. The current concerns of the Bodies were not anticipated or highlighted during the original consultation.

Our suggested proposal to amend section 295-550 does not alter in any way the original policy intent of the provision. In fact, it is intended that the provision still has the potential for broad application. However, we are aware that the kinds of issues that arise from the interaction of the

[1] Given the potentially severe consequences of the new law, the ATO has allowed a grace period in Practical Compliance Guide PCG 2020/5. The ATO will not allocate compliance resources to determining whether the NALI general expenditure rule applies to the 2021–22 and earlier income years.

NALI/NALE provisions with the recently enacted BFID is an unintended consequence and could be addressed through better-targeted drafting of amendments.

We have worked through a number of case studies which we would be pleased to meet and discuss with you. Two of these are set out below at a high level, that illustrate that if the trustee of the fund does things at a discount for the fund, or does not charge the fund, the fund falls foul of the NALI rule that results in inappropriate and severe financial consequences for members.

Case study 1 — SMSF member who is a plumber

A member of an SMSF is a qualified plumber who carries on a business. The SMSF holds a residential rental property. The member undertakes a renovation of the bathroom in the property and on-charges only the cost of materials. As a result of the renovation, the managing estate agent suggests the rent should be increased by $50 per week.

Under the current law, the ATO's view is that not only is **all** rent forever subject to NALI tax at the top rate of 45%, but the whole of the capital gain on disposal of the property in the future is also subject to the NALI tax rate of 45%.

Proposal: Our alternative proposal is that either the opportunity is given to correct the underpayment (in appropriate circumstances) or *only the additional rent (*for as long as is appropriate) *and/or only an appropriate part of the capital gain* is subject to the consequences of the provision.

Case study 2 — APRA-regulated fund

A common structure for large APRA-regulated funds is where the trustee company incurs, in addition to the mere appointment of directors and payment of trustee/directors' liability insurance, the various trustee office costs (occupancy costs, staff costs, etc). In some cases, in addition to the trustee office costs, the trustee company (in its personal/corporate capacity) may also be the party contracting with third parties such as the external administrator or custodian.

This structure is observed both in the profit for member sector (i.e. corporate superannuation funds, public sector superannuation funds and industry superannuation funds), and in the usual model in the retail sector.

However, while the trustee fee paid by the superannuation funds in the retail sector will frequently include a profit margin, the usual structure for those superannuation funds in the profit for member sector is that the only fee paid by superannuation funds to their corporate trustees is comprised of cost recovery of the underlying costs.

Based on the current interpretation of the law, as these expenses are general in nature, the NALI rule applies to treat all income of the APRA-regulated Fund (which may have millions of members) to be subject to 45% (including 45% tax on compulsory minimum superannuation guarantee (SG) contributions).

Proposal: Our alternative proposal is that unless (a) this can be determined to be a non-arm's length arrangement, and (b) a member was involved, it would be unnecessary to apply the provision.

APPENDIX C

We have set out below suggested approaches to potentially reform section 295-550. The suggested wording should be considered in conjunction with the guiding principles and notes described below.

Guiding Principles

When drafting the revised provisions below, we have proceeded on the assumptions of the guiding principles listed below:

- The provisions would be redrafted to operate consistently with other anti-avoidance provisions. In particular, we consider that the provision should not apply automatically. Instead, the provision should apply upon the exercise of the Commissioner's determination. This approach is consistent with the Commissioner's power to make determinations present throughout the tax legislation. Further, we consider that the provision should be targeted at the relevant mischief rather than, for example, all the income or expenditure of a fund.
- Under both options, the Commissioner would be empowered to make a determination that, where a transaction to which a member was a party was not undertaken at arm's length, the Commissioner would make such adjustments and consequential adjustments that were necessary to reflect the tax consequences of the transaction as if it had been conducted at arm's length.
- The Commissioner would have the discretion to allow the rectification of the breach of the NALE amount by the trustee and any other party. We consider that a discretion to allow rectification is an important aspect of the provision. It will encourage greater self-compliance and correction by trustees and their tax advisers, proactively engaging with the system to resolve NALE amounts.
- We consider that the provisions should not apply a punitive tax to a fund's income or expenditure. Rather, penalties for intentional non-compliance or repeated breaches could instead be imposed on the trustees themselves or any other party to the arrangement in accordance with the regime under Subdivision 284-C of Schedule 1 to the *Taxation Administration Act 1953* (Cth).

Option 1: re-write of the provision

The first proposed option aims to re-write the existing legislation with new principles that, in our view, ensure a reasonable outcome while achieving the same policy intent described above in **Appendix B**. This is our preferred approach as it ensures the provisions are drafted in a simple and effective manner to give effect to both the policy intent and our guiding principles above.

The proposed amended wording for section 295-550 under the first option is set out below:

(1) The Commissioner may make a determination[2] that this section applies where a member, an associate of a member, or another person under an arrangement between the member and that other person, enters into a scheme or arrangement with the trustee of the member's fund, and as a consequence of that scheme or arrangement, one or more of the following applies:

[2] We understand that, in the process of making this determination, the Commissioner is bound by the usual rules of administrative decision making and therefore such determination must always be reasonable.

(a) an amount of income of the fund is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme;

(b) in gaining or producing an amount of income of the fund, the entity incurs a loss, outgoing or expenditure of an amount that is less than the amount of a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme;

(c) in gaining or producing an amount of income of the fund, the entity does not incur a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme.

(2) If the Commissioner has made a determination that this section applies, he must give a notice to the trustee of that determination and of the difference between the relevant amount (or part thereof) of a transaction and the arm's length amount of that transaction (the **Arm's Length Shortfall Amount**).

(3) Within 60 days of receiving the notice, or such further time approved by the Commissioner, the trustee must:

(a) if the Commissioner is satisfied that the Arm's Length Shortfall Amount arose from an honest or inadvertent error, enter into an agreement with the Commissioner to rectify the transaction such that it reflects the correct arm's length amount; or

(b) advise the Commissioner that it will treat the Arm's Length Shortfall Amount as an excess concessional contribution of the relevant member or members, and unless the Commissioner is satisfied that the Arm's Length Shortfall Amount arose from an honest or inadvertent error:

(i) not claim a deduction for the arm's length shortfall amount; or

(ii) where the arm's length shortfall amount would otherwise be included, or deemed to be included, either directly or indirectly, in the cost base or reduced cost base of an asset, reduce the cost base or reduced cost base of the asset by that amount.

(4) If the trustee fails to so advise the Commissioner, the Commissioner may make whichever of the adjustments in (3) that he or she deems appropriate.

(5) Where the trustee makes a choice under (3) to treat the Arm's Length Shortfall Amount as an excess concessional contribution, the trustee must release, the Arm's Length Shortfall Amount as an excess concessional contribution less the applicable tax payable by the complying superannuation entity.[3]

(6) This section does not apply to a transfer of an asset to a complying superannuation entity by a member where the arm's length shortfall amount is treated as a non-concessional contribution of that member.

[3] We note that this subsection may need to be inserted into another area of the law to ensure it operates as intended.

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(7) This section does not apply to an amount that is a concessional contribution.

Option 2: re-draft utilising existing principles within the provision

The second proposed option below utilises the existing principles in the provisions and makes modifications to achieve the guiding principles described above. This is not our preferred approach given the inherent complexity in the drafting.

The proposed amended wording for section 295-550 under the second option is below:

(1) An amount of ordinary income or statutory income is non-arm's length income of a complying superannuation entity if, as a result of a scheme the parties to which were not dealing with each other at arm's length in relation to the scheme, the Commissioner determines[4] one or more of the following applies:

(a) the amount of the income is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme;

(b) in gaining or producing the income, the entity incurs a loss, outgoing or expenditure of an amount that is less than the amount of a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme;

(c) in gaining or producing the income, the entity does not incur a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme.

(2) The Commissioner may determine that an amount of *ordinary income or *statutory income is also non-arm's length income of the entity if it is:

(a) a *dividend paid to the entity by a *private company; or

(b) ordinary income or statutory income that is reasonably attributable to such a dividend;

to the extent that the amount is not consistent with an *arm's length dealing.

Subsections (3) and (4) remain unchanged

(5) The Commissioner may determine that other income *derived by the entity as a beneficiary of a trust through holding a fixed entitlement to the income of the trust is non-arm's length income of the entity to the extent that if, as a result of a *scheme the parties to which were not dealing with each other at *arm's length in relation to the scheme, one or more of the following applies:

(a) the amount of the income is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme;

[4] We understand that, in the process of making this determination, the Commissioner is bound by the usual rules of administrative decision making and therefore such determination must always be reasonable.

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(b) in acquiring the entitlement or in gaining or producing the income, the entity incurs a loss, outgoing or expenditure of an amount that is less than the amount of a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme; or

(c) in acquiring the entitlement or in gaining or producing the income, the entity does not incur a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme.

The determination is limited to the **Arm's Length Shortfall Amount**.

Subsections (6) and (7) remain unchanged

(8) Subsections (1) and (5) do not apply in relation to an amount that is a loss, outgoing or expenditure incurred, or might otherwise be expected to be incurred, by a complying superannuation entity for the provision of services by a Trustee, a Director of a company which is a Trustee, or a member of the complying superannuation entity to the complying superannuation entity or a fixed trust in which the complying superannuation entity holds an interest, where:

(a) the services were provided by a Trustee, or a Director of a company which is a trustee, of the complying superannuation entity, unless those services were provided, directly or indirectly, under an arrangement with a member; or

(b) if the services were provided by a member or, directly or indirectly, under an arrangement with a member of the complying superannuation fund, then within 60 days of being notified of the determination, or such further time approved by the Commissioner, the trustee:

(i) if the Commissioner is satisfied that the Arm's Length Shortfall Amount arose from an honest or inadvertent error, enter into an agreement with the Commissioner to rectifies the transaction such that it reflects the correct arm's length amount; or

(ii) advises the Commissioner that it will treat the Arm's Length Shortfall Amount as an excess concessional contribution of the relevant member or members, and unless the Commissioner is satisfied that the Arm's Length Shortfall Amount arose from an honest or inadvertent error, that it will:

a. not to claim a deduction for arm's length shortfall amount; and

b. where the arm's length shortfall amount would otherwise be included, or deemed to be included, either directly or indirectly, in the cost base or reduced cost base of an asset, reduce the cost base or reduced cost base of the asset by that amount.

(9) Where a member makes an election under subsection (8)(b)(ii), the complying superannuation entity must release, and the Commissioner must permit the release of, the amount treated as an excess concessional contribution less the applicable tax payable by the complying superannuation entity.[5]

[5] We note that this subsection may need to be inserted into another area of the law to ensure it operates as intended.

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(10) Subsection (1) does not apply to a transfer of an asset to a complying superannuation entity by a member where the arm's length shortfall amount is treated as a non-concessional contribution of that member.

(11) Subsection (1) does not apply to ordinary shares acquired by a fund in respect of the employment of a member where any discount on acquisition of those shares is included in the assessable income of the employee under Subdivision 83A-B or Subdivision 83A-C of this Act, where:

(a) the complying superannuation entity pays for the acquisition of the shares;

(b) the member chooses for any discount assessed under Subdivision 83A-B or Subdivision 83A-C of this Act to be treated as a non-concessional contribution to the fund; and

(c) the member's non-concessional contribution limit is not exceeded.

(12) This section does not apply to an amount that is a concessional contribution.

Definitions:

Arm's length shortfall amount is the difference between the relevant amount (or part thereof) of a transaction and the arm's length amount of that transaction.

Notes

When considering the draft provisions above, please note that:

- The above drafts are for illustrative purposes only. We note that the design of these alternative provisions would benefit from further consultation with industry, including the testing of case studies we may not have considered. The Tax Institute is of the strong view that further consultation with all the professional bodies should be undertaken to ensure any amended provisions operate as intended.
- We consider that determinations are more desirable in this instance than a discretion. The use of a discretion leads to uncertainty, especially given the ATO's current views on the application of the provision are over-reaching their intended operation. Requiring the Commissioner to make a determination ensures that the provision continues to operate as intended, but empowers the Commissioner to not make a determination if doing so would result in inappropriate outcomes.
- Our proposed options set out above ensure that there is a controlled mechanism to facilitate the rectification of non-arm's length dealings where the application of the provisions would otherwise give rise to inappropriate and unintended outcomes. Accordingly, the Commissioner would have the ability to not make a determination in minor cases. Examples of minor instances include the provision of bookkeeping or accounting services by a member or trustee of a fund that may otherwise result in all of the fund's income including SG contributions being tainted.[6]

[6] Paragraph 91 of LCR 2021/2 notes 'that general fund expenses are non-arm's length is likely to have a very significant tax impact on the complying superannuation fund, even where the relevant expenses are immaterial.'

- The proposed rectification continues to operate as a disincentive for the targeted non-arm's length arrangements. The alternative provisions instead encourage trustees, members and advisers to undertake the proper compliance activities and engage with the Commissioner to resolve non-arm's length transactions. As currently drafted, the consequences of the provisions have such severe consequences that these parties are not incentivised to engage and resolve these issues.