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SUBMISSION

Submission to Treasury — Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023

18 October 2023

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Director

Superannuation Tax Unit

Retirement, Advice and Investment Division

Treasury

Via email: superannuation@treasury.gov.au

18 October 2023

Dear Sir/Madam

Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023* and *Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the draft *Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023* (the draft Bill) and *Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023* (the draft imposition Bill).

About ASFA

ASFA is a non-profit, non-partisan national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $3.5 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 17 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact Julia Stannard on (03) 9225 4027 or by email JStannard@superannuation.asn.au.

Yours sincerely

Julian Cabarrus
Director – Policy Operations, Member Engagement & External Relations

General comments in relation to the proposed Division 296 tax

ASFA supports measures to improve the equity and long-term sustainability of the superannuation system.

While our superannuation system works to provide better retirement outcomes for the majority of Australians, ASFA has longstanding views regarding the need to ensure the tax concessions underpinning the system are distributed equitably. We have for many years called for reforms limiting the tax concessions that flow to those on high incomes and/or with very high superannuation balances and on that basis we support the intent of the Government's current proposal regarding total superannuation balances over $3 million.

As widely reported, the methodology adopted for the proposed Division 296 tax uses a proxy calculation of an individual's 'earnings' in relation to their superannuation interest, which includes unrealised capital gains. This is an unorthodox approach, in the context of Australian taxation arrangements, and one that should not set a precedent for the taxation of superannuation or personal income tax more broadly.

However, ASFA accepts the rationale for use of this simplified, proxy calculation is to minimise the potential compliance burden and cost that might be incurred – and passed through to individual superannuants – if all funds are required to determine, attribute and report, at the individual level, a more precise calculation of 'earnings' for Division 296 purposes. While the effort and cost of performing such calculations would vary depending on the nature and structure of funds and their product offerings, ASFA considers – as outlined below – the cost-effective and efficient administration of Division 296 tax across the industry to be of paramount importance. We acknowledge that any model that prioritises simplicity involves some difficult compromises.

ASFA's submission focuses on the impacts of the proposed Division 296 tax on APRA-regulated superannuation funds.

ASFA wishes to highlight five key matters in relation to the proposal.

1. Efficient and cost-effective administration of the proposed tax is critical

It is important to ensure the proposed Division 296 tax can be administered as efficiently as possible, to avoid imposing a cost burden on superannuation funds that would indirectly be borne by fund members whose total superannuation balances (TSBs) are below the threshold at which the proposed tax will apply.

The present consultation package is largely silent on the process for administration and collection of the Division 296 tax, other than confirming that the ATO will issue an assessment for any tax liability directly to the individual and may, if the individual chooses, issue a release authority to one or more nominated superannuation providers for the release of monies in relation to that assessment. We understand Treasury and the ATO are continuing to develop the necessary administration regime, and that it will seek to minimise any additional administrative and reporting obligations on funds.

As outlined in ASFA's April 2023 submission in response to Treasury's consultation paper on this measure, in the short term the most appropriate and cost-effective method for collecting the information required to assess an individual's liability under Division 296 is for the ATO to make a preliminary assessment, on the basis of information it already holds, to identify whether an individual has a potentially tax liability. The ATO should then issue requests to the individual's superannuation fund(s), using an approved form (electronic or otherwise) and format, to obtain a comprehensive report of all data needed to finally determine the individual's tax liability.

The form of this interim reporting should be settled using the existing 'codesign' process between the ATO and funds, in advance of the first determinations of liability being made. Given it is anticipated that – at least in the early years – some funds may have very few members who are subject to the tax, it is important that appropriate options are provided in relation to reporting channels.

The need for any reforms to the scope of data proactively reported by all funds to the ATO should be considered as part of a post-implementation review of the Division 296 tax and – only if clearly warranted by the volume of data requests under the interim arrangements and the extent of the data not already covered by existing reporting channels – proceeded with as opportunities arise as part of the evolution of the fund reporting arrangements. Even at that time it may be prudent to adopt a multi-channel approach given some funds may have no, or very few, members potentially impacted by the proposed tax.

2. Consultation on the valuation methodology for the 'TSB value' and other regulations supporting the Division 296 tax should occur as soon as possible

The draft Bill leaves several key details of the Division 296 tax to be specified in regulations, including modifications to withdrawals and contributions totals and valuation methods for superannuation interests.

In particular, the draft Bill requires the determination of an individual's TSB with reference to the 'TSB value', rather than by reference to the individual's transfer balance account (as applies under the current law). The TSB value is to be determined by a method or value prescribed in regulations or, if there is no prescribed method or value, by using what is colloquially known as the 'withdrawal benefit' for the interest. The 'withdrawal benefit' concept is relevant to account-based interests (for example, defined contribution accounts in the accumulation phase or account-based pensions) but will not be applicable for defined benefit (DB) interests.

Given the adoption of this 'TSB value' concept, and the scope of detail that is to be prescribed by regulation, the full impacts of the Division 296 tax for many superannuation funds and individuals cannot be ascertained from the draft legislation currently under consultation.

Further, it should be noted that the adoption of the TSB value concept will extend beyond the application of the new Division 296 tax, to impact taxation calculations and reporting of DB interests and lifetime pension products more widely. Matters impacted will include calculations of 'notional taxed contributions'/defined benefit 'contributions' and annual values for interests where balances of zero are currently reported annually to the ATO via the Member Account Transaction Service (MATS). These will require changes to funds' administration systems, their disclosure to product holders and their MATS reporting to the ATO and may require significant actuarial input.

ASFA urges Treasury to release the draft regulations for consultation as soon as possible. Without this detail it is not possible for stakeholders to assess the totality of the legislative regime for the Division 296 tax. It is important that the draft regulations are made available before the enabling legislation is considered by Parliament.

3. Exceptions to the tax should be revisited, to prevent inconsistency and inequity

It is important that any exceptions from liability for Division 296 tax are carefully considered to avoid inconsistency or inequity and ensure they will operate appropriately in practice. ASFA considers that the proposed exceptions would benefit from re-examination to ensure they operate as intended.

For example, an individual might receive into their superannuation interest amounts in relation to a significant injury, permanent disability or terminal medical condition they have suffered. The manner in which these amounts are treated for Division 296 tax purposes will differ: in some cases the individual will be fully exempt from Division 296 tax liability, in other cases some adjustments are made but the amounts still have the potential to cause an individual to trigger, or contribute to, a tax liability under Division 296.

Given all of these amounts involve individuals whose past and/or future ability to earn income and accrue superannuation has been substantially impacted by serious disability, injury or illness, ASFA sees little policy justification for treating some less concessionally than others. See section B.1 below for further comments.

4. There should be a post-implementation review of the tax and periodic review of the threshold

The draft Bills seek to introduce into the tax system an entirely new tax, with some adjustments to existing areas of the tax law - for example, removal of the link between the total superannuation balance and the transfer balance account. This adds complexity and the risk that unintended consequences may arise, particularly given the short timeframe allowed for consultation on the draft Bills. There are many aspects to be considered – including application of the tax to different fund and product types and the necessary data reporting flows.

ASFA considers the enabling legislation should require a **post-implementation review** of the Division 296 tax, to be undertaken no more than two years after its commencement. This should specifically consider:

- whether the methods adopted have been effective at taking into account superannuation interests of all types, including DB interests and interests in untaxed and constitutionally protected funds
- the efficiency and sustainability of the administration arrangements for the tax – including whether the volume and nature of data requests from the ATO under interim reporting arrangements is sufficient to warrant enhancing funds' general reporting obligations
- whether the threshold for imposition of the tax remains appropriate or should be indexed.

We are further of the view that the threshold for imposition of Division 296 tax should be subject to **periodic review** – we recommend review intervals of no more than five years. Without adjustment of the threshold over the time, an increasing number of individuals will become subject to Division 296 tax. It is, in ASFA's view, important to ensure the tax remains appropriately targeted only at higher superannuation balances.

5. Further reforms are necessary to improve equity in the superannuation system

The Government has proposed introducing the Division 296 tax to address one aspect of equity in the superannuation system – the tax concessions enjoyed by those with higher incomes and/or balances.

ASFA believes equity should be further improved through measures that might more directly target those with lower incomes and/or balances. As outlined in ASFA submissions over many years, this should include extending Superannuation Guarantee obligations to paid parental leave and improving eligibility for the Low Income Superannuation Tax Offset.

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The remaining sections of this submission address a number of technical issues identified by ASFA members in relation to the draft Bills and the administration of the Division 296 tax.

B. Comments on technical aspects of the draft Bills

B.1 Exceptions from liability for Division 296 tax

B.1.1 Inconsistent treatment of individuals suffering from personal injury, permanent disability or terminal medical condition

Proposed new section 296-25 provides concessional treatment under Division 296 for 'structured settlement contributions' –amounts paid into an individual's superannuation interest, arising from a settlement or order for compensation for personal injury they have suffered, that meet conditions prescribed in the income tax law.

A structured settlement contribution is excluded from the calculation of an individual's TSB currently, and the draft Bill further proposes that an individual is not liable to Division 296 tax for an income year if a structured settlement contribution is made in respect of them "in that year or in any earlier income year".

As a matter of policy, ASFA agrees that it is appropriate to exclude the recipient of a structured settlement from Division 296 tax. As stated in the draft explanatory memorandum, these are typically large payments intended to fund ongoing medical and care expenses resulting from serious injury and income loss.

The draft Bill also provides, in proposed new section 296-20, a full and permanent exception from Division 296 tax liability for an individual who is receiving a superannuation income stream that arose due to the death of another person, where the individual qualified as a 'child recipient' when the income stream commenced to be paid and they continue to receive payment after reaching age 25 (when such income streams must ordinarily be cashed out) because they have a permanent disability. The draft explanatory memorandum acknowledges that a disabled 'child recipient' may have had limited opportunity to earn income and accumulate their own superannuation. ASFA agrees that Division 296 tax should not apply to individuals in these circumstances.

The draft Bills provide no comparable exception in relation to an individual who has received into their superannuation interest payment of an insured (or self-insured) Total and Permanent Disability (TPD) or Terminal Medical Condition (TMC) benefit. A limited adjustment is made for these amounts – they are not treated as Division 296 'earnings' in the year of receipt but they remain part of the individual's TSB and may cause them to exceed the Division 296 threshold either in that year or in any future year while the amounts remain in the individual's superannuation interest at year end.

Further, in the absence of a specific exclusion, any benefits paid in relation to a member's TPD or TMC during an income year are added back as 'withdrawals' when calculating the individual's 'adjusted' TSB for Division 296 tax purposes at year end, so their receipt as cash benefits could potentially also trigger, or contribute to, a Division 296 liability for that year.

We acknowledge that TPD and particularly TMC benefits are immediately withdrawn by the individual in the overwhelming majority of cases, but this is not a requirement – some individuals may choose to partially draw down the amount in an income year or, in the case of a TPD benefit, to commence withdrawal in the form of an income stream. We further acknowledge that Division 296 liability would likely arise for these individuals only where they already had a substantial TSB or their TPD/TMC benefit is significant – however, large payments will not be uncommon, particularly if the individual is comparatively young.

Given TPD and TMC benefits arise in circumstances where the individual's ability to earn income or accrue superannuation in future is impacted by their health – as is the case for structured settlement contributions and pensions paid to disabled child recipients – it is unclear why they are treated less concessionally for Division 296 purposes.

ASFA recommends that proposed new subdivision 296-B is expanded to include an exception from Division 296 tax liability where an insured (or self-insured) TPD benefit or TMC benefit has been paid into a fund in respect of an individual.

B.1.2 Issues arising on the death of an individual

The draft Bill provides that there is no liability for Division 296 tax for an income year if an individual dies "before the last day of the year" (proposed new section 296-30). ASFA agrees it is appropriate that liability for Division 296 tax should not be raised in respect of an individual after their death.

ASFA requests clarification, however, of any Division 296 tax implications if an individual's superannuation interest has not been cashed out by the end of the following income year. While this is not common, it might occur where the distribution of the individual's death benefit is contested and a complaint made to the Australian Financial Complaints Authority has not yet been resolved, or where there are legal proceedings underway that impact distribution of the benefit (for example an appeal from an AFCA determination to the Federal Court). To avoid a Division 296 tax liability arising in these circumstances, ASFA suggests that proposed section 296-30 is redrafted to provide that an individual is not liable to pay Division 296 tax for an income year if the individual has died "before the last day of the year or in an earlier year".

We note that where a benefit is payable to a spouse on the death of a fund member, the spouse may in many cases choose to take that benefit as a lump sum without tax consequences. However, if the benefit is payable only as an income stream, this will have potential tax implications under Division 296. The amount underpinning the income stream will be part of the spouse's 'contributions total' and will therefore be excluded when calculating their 'adjusted TSB' in the year they commence to receive the income stream. However, that value will remain part of the spouse's TSB in future years, and payments from the income stream will be added back as 'withdrawals' when calculating their adjusted TSB. Accordingly, the death benefit income stream may cause or contribute to the spouse exceeding the Division 296 threshold in later years.

This appears to be a harsh outcome in circumstances where the spouse had no choice but to continue to receive payments as an income stream. In contrast, where there is a rollover to a child recipient (in the limited circumstances permitted by the *Superannuation Industry (Supervision) Regulations 1994*), the child recipient will be specifically exempt from Division 296 tax under the draft Bill.

ASFA members have also noted some practical, timing-related issues that arise with respect to release authorities when an individual has died, for example, where a release authority is issued by the ATO before it is aware of the individual's death. We anticipate similar issues will arise in relation to Division 296 tax and encourage the ATO to work with stakeholders to ensure there are clear processes in place to address them.

B.2 Calculation of 'contributions total' for Division 296 purposes

Proposed new section 296-55 specifies the amounts that are to make up an individual's 'contributions total', which is an element of their 'adjusted superannuation balance'. ASFA members have raised some potential technical issues with the 'contributions' total definition, particularly sub-paragraph 296-55(1)(e) in relation to amounts paid to a superannuation plan under an insurance policy:

- The language used in draft subparagraph 296-55(1)(e) will not be appropriate for all DB interests.

  The payment from an insurance policy for DB members may not always be equal to the difference between the DB death/TPD benefit and the member's withdrawal benefit. The level of insurance taken out in respect of DB members is often dependent on the amount of any surplus within the fund. For example, DB funds with significant amounts of surplus may elect to only insure, say, the difference between the death/TPD benefit formula and the full accrued benefit. Based on the current drafting, members with identical death/TPD benefits in different funds could have different amounts of insurance included in their 'contributions total' if the funds have different insured benefit formulae due to their respective surplus positions.

- Proposed section 296-55(1)(e) does not appear to provide for self-insurance proceeds paid into member accounts to be treated the same way as proceeds of insurance policies.

  We acknowledge that the ability to self-insure is now limited to DB funds (or sub-plans) that were self-insuring at 1 July 2013 and meets the requirements of regulation 4.07E of the *Superannuation Industry (Supervision) Regulation 1994*. However, we understand that this involves a not insignificant number of funds (or sub-plans), some of considerable size. It is, in ASFA's view, important to appropriately reflect such funds/sub-plans within the Division 296 tax mechanism, to avoid creating potential equity issues.

- Draft subparagraph 296-55(1)(e)(ii) provides that the amount of a benefit that is payable because of the happening of a ***contingency dependent on the termination of the life of the person*** is included in an individual's 'contributions total'. As this term has not been defined it is not clear what types of payments the subparagraph is intended to capture. While it is possible it is intended to encompass insurance proceeds received in relation to TMC, this appears to be unnecessary as we consider it would be covered by subparagraph 296-55(1)(e)(i) (subject to recognition of the potential for self-insurance proceeds as noted above).

We anticipate that the intention may be to address at least some of these matters via the supporting regulations and note our call, earlier in this submission, for consultation on those regulations to commence as soon as possible.

B.3 Issues in relation to release authorities

B.3.1 Increasing use of release authorities emphasises need for streamlining/consolidation

The Commissioner of Taxation currently has the ability, under a range of provisions of the income tax law, to issue a release authority authorising the release of monies from an individual's superannuation interest for payment of a tax liability – for example, in relation to Division 293 tax or excess contributions tax – or in relation to the First Home Super Saver Scheme. The draft Bills extend that, by allowing an individual to choose to have the Commissioner issue a release authority for the release of monies from their superannuation interest(s) in relation to their liability for Division 296 tax.

The increasing utilisation of release authorities for different purposes has the potential to cause confusion. It also raises the potential that multiple release authorities may be simultaneously (or almost simultaneously) received by a fund for an individual, that might, collectively, exhaust the individual's balance.

ASFA recommends that, to the extent possible, the ATO seeks to streamline its assessment processes and consolidate assessments and release authorities it issues in respect of an individual. For example, if an individual has a liability to any combination of excess contributions tax, Division 293 and 296 tax, a single release authority should be issued to the taxpayer's nominated fund (or each of their nominated funds), with the itemised liability amounts clearly stated on both the release authority and the assessment issued to the individual.

To the extent it remains possible for multiple release authorities to be issued in respect of an individual, ASFA recommends that, whether within the relevant legislative provisions or as part of a documented ATO administrative practice, clarity is provided regarding the order in which those release authorities are to be actioned by funds. For example, does any particular type of release authority take precedence over others, or are they simply to be actioned by a fund in the order in which they are received?

B.3.2 Release authorities for deferred debt accounts

Currently, issues can arise in relation to release authorities under Division 293 tax liability for deferred debt accounts for DB interests. A fund holding a DB interest in relation to which there is a debt account is required to notify the ATO when the 'end benefit' in relation to the interest becomes payable. This acts as the trigger for the ATO to issue a release authority in relation to payment of the deferred debt.

In practice, as a result of pressing financial circumstances, individuals often direct their fund to cash out their superannuation balance before the fund has received the release authority. Alternatively, the individual may have rolled their interest from the DB fund into another fund. The individual is then unable to direct that the release authority be sent to any other fund holding a superannuation interest for them and has no alternative but to pay the tax liability from monies held outside superannuation.

This issue will also arise under the proposed deferred debt account mechanism for Division 296 tax, as proposed new subsection 135-40(4) permits a release authority for Division 296 debt account discharge liability to be given *only* to the superannuation provider that holds the interest to which the debt account relates.

ASFA recommends that, in such cases, the legislation be amended to allow the release authority to be given to any superannuation provider that still holds an interest for the individual – as would be the case for other types of release authorities that do not relate to a DB interest. We also recommend that correspondence provided by the ATO to the individual, when notifying them of their Division 296 (or Division 293) liability, is revised to make clearer the consequences where the DB interest is withdrawn prior to the issue of the release authority to the fund.