FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

14 October 2016

Superannuation Tax Reform

Retirement Income Policy Division

Email: superannuation@treasury.gov.au

Re. Superannuation reform package - tranche two

Dear Sir/Madam,

The Financial Planning Association of Australia (FPA) welcomes the opportunity to provide feedback on the second tranche of superannuation reforms announced in the 2016 federal budget. We acknowledge the rigorous approach to drafting the legislation, however we are concerned about its complexity and unintended consequences. With these issues in mind, we have made some alternative proposals, which we ask you to consider.

If you have any queries or comments, please do not hesitate to contact me at policy@fpa.com.au or on 02 9220 4500.

Yours sincerely

Dimitri Diamantes
Policy Manager
Financial Planning Association of Australia[1]

[1] The Financial Planning Association (FPA) has more than 11,000 members and affiliates of whom 9,000 are practising financial planners and 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Mark Vincent, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board

SUPERANNUATION REFORM PACKAGE – SECOND TRANCHE

FPA submission to:
Treasury

14 October 2016

INTRODUCTION

There is often a tension between rigour and simplicity, especially in the drafting of legislation. While we acknowledge the rigour shown in drafting detailed rules to provide for superannuation reforms announced in the 2016 federal budget, we are concerned that the new rules introduces unintended consequences and excessive complexity.

For these reasons, we have proposed alternative solutions, which we ask you to consider.

Transfer balance cap

Transfer balance cap

General Terminology

We are concerned with the number of the new terms used in the drafts including the introduction of such terms as transfer balance cap, general transfer balance cap, debit, credit, excess transfer balance, retirement phase recipient, child transfer balance cap and total superannuation balance. Many of these terms are otherwise defined under other terminology within Australian superannuation and tax law, and adding new terms and the use of accounting concepts (debit and credit) only increase the complexity of the superannuation system for Australian consumers.

Alternative proposal

We would therefore recommend that consideration be given to using existing terminology within the superannuation and tax systems to define these new concepts or where new terminology is required, use clearer language. As an example, transfer balance cap could more simply be termed a pension balance cap which more clearly describes the concept, and the pension balance cap may be increased (credit) or decreased (debit) as required. This would provide significantly more clarity to consumers and super administrators, particularly given so many superannuation funds are self-managed superannuation funds.

Credits to transfer balance account - ITAA 1997 s 294-25

We are also concerned that pensions created by the proceeds of a death benefit can create excess transfer balances. Given the general rules around how super death benefits can be transferred to a beneficiary, there are instances where there may be insufficient flexibility to manage the benefits due to these proposals as follows:

- Where the deceased super balance is in excess of the transfer balance cap, the beneficiary is unable to make a commutation back to super within the later of 6 months of death and 3 months of grant of probate if they need to keep the funds within the super system due to the rules around cashing death benefits;
- As above, however each individual's balance may be below the transfer balance cap, but as a combined super balance for the beneficiary, they may be above the transfer balance cap. This can lead to a situation where, if they want to keep funds in the super system, they would be unable to reduce their balances below the cap until outside the death benefit window;
- Finally, there are many instances where life insurance policies will be held within super by relatively young Australians to support their spouse and young families for amounts significantly above the transfer balance cap. As with the above example, where the benefit must be rolled into a retirement pension to maintain the balance within super, the beneficiary has no alternative but to be above the transfer balance cap. Further, in this instance, the beneficiary may never be able to use a retirement pension for their own super benefits when they reach retirement age as they will have used up their cap.

Alternative proposal

We recommend that where a retirement pension is created due to the death of a super member, that the retirement pension is exempted from the transfer balance cap (similar to structured settlements).

An alternative option (although less favourable) would be for the cashing rules around death benefits to be amended to allow death benefits to be transferred into the accumulation phase as unrestricted non-preserved benefits. In either case, the death benefit amount should be exempt from the beneficiaries transfer cap balance.

Child recipient of death benefit income stream - ITAA 1997 s 294-185

We are concerned that, where a child beneficiary's benefit is attributable to both a superannuation interest of the deceased in retirement phase and a superannuation interest of the deceased that is not in retirement phase, the child's cap increment is limited to their transfer balance credit (less their share of the deceased's excess transfer balance) arising from the superannuation interest in retirement phase. These is inconsistent with the treatment in s 294-180, which deals with the situation where the deceased has no existing transfer balance account.

Alternative proposal
As stated above, we recommend that where a retirement pension is created due to the death of a super member, that the retirement pension is exempted from the transfer balance cap.

Alternatively, we would recommend that, in these circumstances, the child beneficiary's cap increment be the greater of the general transfer balance cap; and that child's transfer balance credits (less their share of excess transfer balances from deceased members) arising from the superannuation interests in retirement phase.

Replenishment debits - ITAA 1997 s 294-75

We are concerned that in order for a debit to arise in respect of fraud or dishonesty, an individual needs to have been *convicted* of an offence involving fraud or dishonesty. This places an extremely high hurdle on generating debits in these situations. Further, it would result in uncertainty and long delays.

We appreciate the need to limit opportunities to artificially exploit the provision. However, members should also be given an opportunity to adjust their plans as soon as possible after they've suffered a loss due to dishonest or fraudulent conduct.

We are also concerned that no other circumstances, apart from fraud and dishonesty, bankruptcy and payment splits, are covered by the replenishment debits provisions. While we accept that mere poor investment performance should not give rise to replenishment debits, there is an argument for providing for replenishment debits where there has been a catastrophic fall that is expected to be long-lasting, in the investment market (for example, as was the case when the global financial crisis hit).

Alternative proposal
We recommend that draft subsections (c) and (d) be replaced with the following:

(c) the relevant regulator has certified that it reasonably satisfied that:

  (i) the loss is a result of fraud or dishonesty

  (ii) if the matter went to court, an individual would be likely to be convicted of an offence involving that fraud or dishonesty

We also recommend that provision is made for replenishment debits if a market benchmark specified in the legislation falls by more than a certain percentage. Replenishment debits could be set at a maximum percentage of the following: the member's transfer balances account balance less their excess transfer balance.

In addition, the Minister should have a discretion to declare additional circumstances when replenishment debits will arise.

We would also recommend that consideration be given to allowing super funds to accept contributions from a member to provide for the member's replenishment debits and that the contributions are not taxed.

Indexing of transfer balance cap - ITAA 1997 s 960-290

We are concerned that the index number merely reflects the consumer price index. Indexation should reflect not only price inflation but also improvements in living standards.

Alternative proposal
We would recommend that the index number should instead be Average Weekly Ordinary Times Earnings, which is consistent with other indexation numbers used for existing superannuation measures.

Proportional indexing - ITAA 1997 s 294-40

We are concerned that the proportionally indexed transfer balance cap concept adds significant complexity and uncertainty for super fund members around the new concept of transfer balance caps. Not only do super members need to keep track of a new $1.6 million figure, but also the percentage of unused cap, which is then indexed.

Alternative proposal
At present, when a superannuation cap is indexed, the threshold is measured against how much of the threshold has been used by the member on a dollar basis, such as the low rate cap and non-concessional contribution cap. This is a much simpler concept for consumers to understand, and creates certainty for them in the operation of the super thresholds. Using a percentage-based approach increases complexity and uncertainty and in many circumstances will not lead to significant difference in the additional amounts which could be transferred into a retirement pension.

Excess transfer balance determination and default commutation notices – Div 136 in Sch 1 to TAA 1953

In our view, the timeframe (60 days from the ATO's issue of an excess transfer balance determination) for members to make an commutation election is too short. So too is the 30-day window for super funds to comply with commutation notices.

Alternative proposal
We would recommend a 90-day window for members to make an election and a 60-day window for super funds to comply with a commutation notice.

Transitional relief for excess transfer balances - ITTP 1997 s 294-30

While we support the concept of a leeway period in the transitional stages of these amendments, and we understand the need to impose penalties for breaches of the transfer balance cap, we believe that, in many instances, 60 days is insufficient time to remedy such a breach.

Transitional rules apply to transfer balance cap breaches of less than $100,000 that occur on 30 June 2017. Such breaches do not give rise to notional earnings or an excess transfer balance tax liability if they are rectified within 60 days. We are concerned that members will have such a short time to remedy the breach.

Many retirees maintain multiple retirement income streams for the purposes of diversification and in some instances, product availability, and it is therefore unclear who will be informing members of the excess transfer balance. This is compounded by the fact that different retirement income stream products may have different methods to calculate the transfer balance credit and debit, and therefore many consumers may be unaware they are in excess until a notification is received. For example defined benefit pension members would never have considered their pension benefits to have a capital value to have an idea they may be above the transfer balance limit. We would also highlight that most super funds don't send annual reports and statements to members until October, and therefore some members may not know that they are in excess for a considerable period of time.

It would be extremely difficult to ensure that as at 30 June 2017, the member's transfer balance cap is debited by just enough to ensure that that they don't have an excess transfer balance on 1 July 2017. This is because, especially where a financial planner is involved, there would be an excessive administrative burden if all redemption requests for all affected clients had to be lodged with just enough time to ensure the redemption occurs on 30 June (assuming redemption timeframes were known with certainty, which may not be the case).

Alternative proposal
We would recommend that the proposed grace period be extended to 12 months. This acknowledges that members should have the benefit of advice in relation to the rectification, for example, advice as to which investments should be moved from retirement phase to accumulation phase (or cashed out of super). Further, given that a financial planner may have multiple clients that need to take rectification action (and at any rate, 2016/17 financial year will be particularly onerous for planners given the major reforms), a 12 month period would be more appropriate.

Transition to retirement income stream

Removal of tax exemption - ITAA 1997 s 295-385 and s 307-80

We are concerned that the removal of the tax exemption for transition to retirement income streams (TRISs) will have the unintended consequence that many funds will stop providing these types of products. This is because a new product category where earnings are treated the same as an accumulation account, but benefits are paid as income. The system changes required may make this new category uneconomical for providers.

This would be an unfortunate outcome as, despite the removal of the tax exemption, members close to retirement may benefit from the budgeting and other benefits that TRISs can offers. For this reason, we have proposed an alternative that would make it easier for funds to include assets supporting TRISs, in their accumulation funds.

Alternative proposal
We would recommend providing for a transition period ending 30 June 2024. During the transition period, members under age 60 could draw their TRIS benefits as lump sums within the annual limits. From 1 July 2024, TRIS account holders would be aged 60 or over.

This arrangement would ensure that providers that use the segregation method could hold assets supporting TRISs in the same pool as assets supporting accumulation benefits, without needing to provide for differential tax treatment. This may mean that the product survives the superannuation reforms.

Small funds

Excluding small funds from segregating assets - ITAA 1997 s 295-387

We are concerned that self-managed superannuation funds and small APRA funds are prohibited from using the segregation method where, broadly, a member with a total superannuation balance over $1.6 million is receiving a retirement phase income stream from the fund. We appreciate that the introduction of the transfer balance cap increases the incentive to wash assets through the retirement phase. However, we believe that this issue should be dealt with through anti-avoidance measures, rather than a general prohibition.

Alternative proposal
We would recommend that the proposed section is not proceeded with. If there is concern that Part IVA of ITAA 1936 will not be complied with in relation to the circumstances contemplated by the provision, the ATO should step up its compliance efforts.

CGT relief – Part 3 Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 No. , 2016

We are concerned about the complexity of these provisions, especially the modifications where the proportionate method for calculating tax exempt income is used by the fund. We acknowledge the draft legislation's rigorous approach to attaching a tax benefit to specific assets. However, this approach comes at the expense of simplicity and also, in our view, pays too little attention to the significant detriment that could be suffered by those counting on being able to realise their superannuation assets in retirement phase. It is this detriment that the transitional relief is trying to deal with, and our recommendation seeks to provide a more generous (but still reasonably limited) solution that is much simpler that the measures in the draft legislation.

Alternative proposal

We would recommend that unrealised capital gains attributable to asset value held in retirement phase as at 30 June 2017 gives rise to a notional capital loss if the asset value is moved out of retirement phase by 30 June 2018 (to align with our proposed 12-month grace period). The loss equals the capital gain that would arise if the asset value were disposed of on 30 June 2017. The loss is crystallised at the time the asset value is moved out of retirement phase.

However, the loss is limited to the capital gains attributable to the asset value of the following taken together:

(a) total excess transfer balances that would arise on 1 July 2017 if it were assumed that the general definition of 'excess transfer balance' isn't modified; and

(b) superannuation income streams that would cease to be in retirement phase on 1 July 2017 (e.g. TRISs)

This would apply regardless of whether the segregated method or unsegregated method is used. For segregated assets, the asset value means all the particular assets held as at 30 June 2017 that are moved out of retirement; whereas for unsegregated assets, the asset value means the share of the fund's total assets that represents (a) and (b) (see above) that are moved out of retirement phase. For the unsegregated method, the maximum potential loss would crystallise proportionally until (a) and (b) are exhausted. This crystallised notional loss would then be used in the normal way to work out net capital gains.

For example, a fund using the unsegregated method has $2 million in retirement phase (of which $400,000 would be an excess transfer balance on 1 July 2017) and $1 million in accumulation phase on 30 June 2017. If all the fund's assets were sold on 30 June 2017, the capital gain would be $1 million. This would give rise to a notional capital loss of $133,333 ($1 million x $400,000/$3 million).

Yes, the notional loss is not attached to any of the usual economic events that give rise to tax consequences; and there is no requirement to make elections or nominate particular assets. However, this alternative proposal goes some way to offsetting the detriment to the fund (and ultimately members) of adjusting to the superannuation reform.