



THE TAX INSTITUTE

THE MARK OF EXPERTISE

16 September 2016

Ms Jenny Wilkinson
Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: jenny.wilkinson@treasury.gov.au

Dear Ms Wilkinson,

Superannuation reform package

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the *Superannuation reform package* of exposure drafts.

Summary

The Tax Institute broadly supports the measures contained in this package of reforms as they contribute positively to the overall reduction of 'red tape', and in the case of the deduction for personal contributions, remove an anomaly that has meant some Australians have been unable to make a deductible contribution to superannuation.

Our submission below addresses our main concerns in relation to the package of exposure draft legislation and associated explanatory material. In particular, the primary objective of superannuation is too narrow. It should encompass:

- i) the three long-held pillars of income in retirement - the Age Pension, compulsory superannuation savings, and voluntary superannuation savings;
- ii) emphasise the principle of self-provision in retirement; and
- iii) acknowledge the role superannuation plays in a member's death.

Discussion

1. The Objective of Superannuation

The *Superannuation (Objective) Bill 2016* Exposure Draft (**Objective Exposure Draft**) contains the proposed 'primary objective of superannuation' to be enacted by Parliament by way of a separate Act.

The Tax Institute has previously made submissions to Treasury in relation to the 'objective of superannuation' by our letters dated 6 April¹ and 22 July 2016².

The Tax Institute broadly agrees with the primary objective that superannuation should be to provide income in retirement, however:

- a) we reiterate the concern raised by our 6 April and 22 July 2016 submissions that linking the primary objective solely to the Age Pension is undesirable because it allows for policy development that could significantly diminish the Australian superannuation system;
- b) a primary objective of superannuation should endorse all three long-held pillars of income in retirement - the Age Pension, compulsory superannuation savings, and voluntary superannuation savings. In particular, the legislature should be encouraging the principle of self-provision in retirement to provide a comfortable lifestyle, especially now there are proposed to be strict contribution limits and also restrictions on the tax-free level of assets that can be maintained in the superannuation system from mid-2017; and
- c) all announcements of superannuation tax change should provide ample time for systems changes to be made and be accompanied by a detailed explanation of how the change advances the objectives of superannuation, including economic analysis.

Further, The Tax Institute is concerned that, without all major industry stakeholders being in general agreement on the scope of the enshrined objective, the objective will fail to deliver on one of its key purposes, being to ensure that superannuation policy does not undermine long-term confidence in the system.³

We strongly recommend the definition of 'primary objective of the superannuation system' encapsulate the points made in a) to c) noted above.

Subsidiary objectives – mechanical issues

The Exposure Draft Explanatory Materials (**EM**) to the Objective Exposure Draft contains a number of 'subsidiary objectives' that purport to provide a framework to assessing compatibility of a Bill or regulation⁴ with the primary objective of the superannuation system. It is noted that the EM indicates that these subsidiary objectives are to be considered alongside the primary objective and in the Statement of Compatibility. In our view, the subsidiary objectives are significant elements of the overall objective of the superannuation system and therefore it is inappropriate to allocate them to the EM, where they have doubtful force.

¹ <http://www.taxinstitute.com.au/tisubmission/objectives-of-superannuation>

² <http://www.taxinstitute.com.au/tisubmission/budget-2016-17-superannuation-announcements>

³ See Chapter 2 of the Final Report of the *Financial System Inquiry*, 7 December 2014.

⁴ Paragraph 1.17 of the EM

There is uncertainty created by the statement in the EM that it is 'best practice' to make reference to the subsidiary objectives in the 'Statement of Compatibility' when this is not required by the principal legislation. The EM does not of itself have any legal force.

In The Tax Institute's view, the subsidiary objectives should be set out in the principal legislation and should, where relevant, form part of the Statement of Compatibility.

Subsidiary objectives – substantive issues

The Tax Institute recommends that the subsidiary objectives be subject to further consultation as they should be consistent with the 'sole purpose test' contained in section 62 of the *Superannuation (Industry) Supervision Act 1993* (Cth). The very short consultation period allocated does not allow sufficient time for stakeholders to give proper consideration to these matters.

One example of an important element that should be addressed within the subsidiary objectives relates to ensuring that there are no adverse retrospective changes made to superannuation. Arguably this element may be encompassed under the 'simple, efficient and provide safeguards' objective, but there is no reference made to this important issue in the EM.

Another important element to expressly recognise is that superannuation is also relied upon by the dependants of a superannuant upon their death. One of the key planks of the sole purpose test has been the provision of a tax-free or lesser taxed benefit to a dependant upon a superannuant's death.

From the inception of superannuation in Australia, a death benefit has been recognised in favour of the deceased superannuant's dependants and legal personal representatives. The Tax Institute is concerned that references made in the EM to superannuation not being for 'estate planning purposes' might be misconstrued to not allow for death benefits to be properly paid from funds. It would be an enormous shift in policy to no longer recognise superannuation as a mechanism for the provision of tax-free or lesser taxed death benefits, particularly to a spouse and dependent children (or other genuine dependants).

It is only genuine dependants of a deceased member who receive death benefits on a tax-free basis. Adult children are typically taxed at 15% (plus Medicare levy) in respect of the taxable component of any death benefit from a deceased parent. This operates to return superannuation monies to consolidated revenue upon the death of a member. This is similarly the case where death benefits are paid to a deceased estate (and where no tax dependant will benefit).

Further, it is an important consideration for the objective to expressly take into account 'estate planning' that might naturally and properly occur as part of the superannuation system. Life expectancy for Australians is increasing and the medical needs and living expenses for elderly Australians, which may not be government funded will also

continue to increase. As such, many superannuants have (and will aim to have) considerable superannuation savings to address longevity risk and to ensure that they can fund or supplement their income from their superannuation to ensure a reasonable standard of living until their death.

If a superannuant dies prior to exhausting their superannuation savings, there will be an amount available for payment to their dependants and/or legal personal representative. The Tax Institute submits that it would be incorrect to assume that in such cases the superannuant has engaged in any inappropriate behaviour or practice such as 'estate planning' designed to achieve 'unlimited wealth accumulation or bequests' for the benefit of the next generation.

The Tax Institute would welcome clarification in the EM to ensure that references to superannuation not being available for estate planning purposes are not aimed at prohibiting genuine arrangements surrounding a superannuant's death in favour of their dependants and/or the legal personal representative.

On a related point, The Tax Institute notes that there is only one minor reference in the EM to 'insurance' being provided through superannuation.⁵ Insured death, permanent incapacity and temporary incapacity benefits are currently a fundamental part of the superannuation system. The Tax Institute is concerned that neither the primary objective nor the subsidiary objectives consider insurance for members (whereas, in contrast, the sole purpose tests does).

Failure to reference these kinds of insured benefits in either the primary objective or the subsidiary objectives creates uncertainty in the superannuation system and policy development going forward. For example, it is unclear how a Statement of Compatibility would assess a regulation altering a definition of 'permanent incapacity' or 'temporary incapacity' under the *Superannuation Industry (Supervision) Regulations 1994* (Cth), or, perhaps more problematic, altering the taxation rates to apply to those benefits. The Tax Institute considers that life and TPD insurance is an important element of the superannuation system and should be included in the subsidiary objectives.

2. Deducting personal contributions

Schedule 1 of the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* Exposure Draft (**Treasury Exposure Draft**) contains amendments to the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**) to give effect to the Government's 2016-17 Federal Budget measure 'Superannuation Reform Package – tax deductions for personal superannuation contributions'.

In our view, broadly the proposed amendments are positive changes to the taxation of superannuation in terms of providing a deduction for contributions to superannuation made by individuals. This removes the '10% rule' which caused considerable 'red tape'

⁵ At paragraph 1.28

for individual taxpayers, was complex in nature, was difficult to administer and was no longer applicable given our current system. This change results in a significant cut to 'red tape' in line with the Government's policy of deregulation.

However, we consider there are other issues relating to personal deductible contributions that require further consideration:

- Further consideration should be given to the 'Notice of Deduction' processes where an individual has made personal deductible contributions to their superannuation and whether they can be abolished or streamlined⁶;
- Under the law as currently administered, partial withdrawals are an administrative issue and ideally this would be addressed when these changes are made given the likely increase in the number of personal contributions to be made to superannuation funds by individuals⁷; and
- Consideration should also be given to making a consequential amendment to section 26-55(1)(d) of the 1997 Act pertaining to limitations on deductions for personal superannuation contributions to either delete that provision or to ensure that contributions are still treated as concessional contributions even if the deduction is lost.

3. Improving superannuation balances of low income spouses

Schedule 2 of the Treasury Exposure Draft contains amendments to the 1997 Act to give effect to the Government's 2016-17 Federal Budget measure 'Superannuation Reform Package – improve superannuation balances of low income spouses'.

The Tax Institute commends the Government on making this amendment.

4. Low income superannuation tax offset

Schedule 3 of the Treasury Exposure Draft contains amendments to the *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* to give effect to the Government's 2016-17 Federal Budget measure 'Superannuation Reform Package – introducing a Low Income Superannuation Tax Offset (LISTO)'.

We note this measure is consistent with the submission The Tax Institute made to Treasury dated 22 July 2016 in relation to this proposed measure.

⁶ See previous comments we have made in relation to the Notice of Deduction on our submission of 22 July 2016

⁷ Refer to Examples 10 and 10A in TR 2010/1

5. Harmonising contribution rules for those aged 65-74

This measure is a sensible policy change that is consistent with previous submissions we have made about removing the 'work test' and other matters that add complexity. We are disappointed this measure is not proceeding due to current budgetary constraints⁸. We recommend this measure be reconsidered at a point in time when budgetary conditions allow.

Other matter

We note that Treasury holds the following view:

Prior to the amendments, there was a condition of release that permitted individuals to withdraw without restriction, any benefits they held at the age of 65. This condition would not have permitted benefits to be released where the benefit accrued or the contribution was made after the individual reached 65.⁹

While we do not share this view, if Treasury maintains this view, then we consider the amendments contained in Items 4, 12 and 13 of the defunct¹⁰ *Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulation 2016* Exposure Draft to amend 'attaining age 65' to 'attaining or have attained, age 65' are still required.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely



Arthur Athanasiou
President

⁸ <http://sjm.ministers.treasury.gov.au/media-release/096-2016/> (Treasurer's announcement)

⁹ Page 4 of the *Exposure Draft Explanatory Statement*

¹⁰ Due to the Treasurer's announcement